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CONSUMER CHOICE IN THE AUTO INSURANCE MARKET

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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

I. 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 accidents² 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 payments⁷ 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

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 policy-makers 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 non-economic 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

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 I 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 ($100 - 36 = .64 \times .76 = .486$). CARROLL ET AL., *supra* note 3, at 75 tbl. G. 3.1, 1.2 ($\$4239 \times .37 = \1568 ; $\$1568 \div \$2052 = .76$).

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

32. *Id.* at 32.

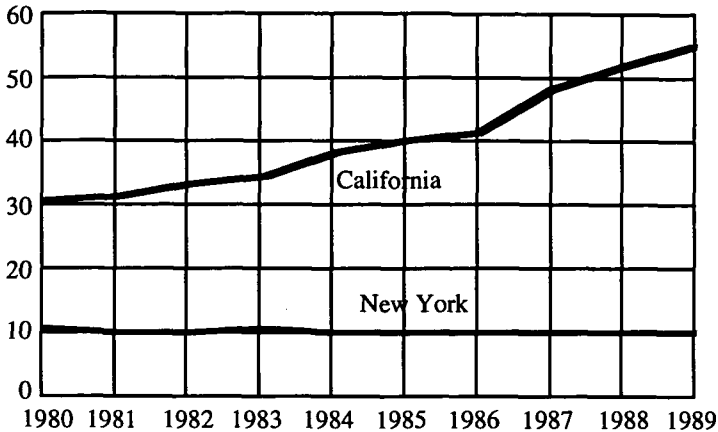
conomic losses in excess of the \$50,000 PIP benefit level in column five could seek compensation for their unreimbursed *economic* losses exceeding \$50,000—that is, through a traditional tort claim.³³ By definition, there would be no unreimbursed economic losses in column six due to its assumption 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.*

33. *Id.*

BI Claims per 100 PD Claims



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-

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-

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 Popes, *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.

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).

II. THE PROPOSED CHOICE SYSTEM

One possible answer examined here is a reform that replaces no-fault proposals, burdened as they are with expensive—and arguably even subsidized⁴⁴—claims for non-economic loss, while also providing for automatic payment for economic loss. Such a new type of reform could give motorists the *option* of forgoing claims for non-economic loss, without forcing them to do so. That theory led, in turn, to a proposal by the Bush administration for a federal statute providing in substance as follows: Motorists would be given the option of purchasing PIP coverages at financial responsibility levels required by state law for liability for personal injury—for example, \$20,000 in Illinois.⁴⁵ Persons electing such PIP coverage could neither sue nor be sued for pain-and-suffering damages in an auto accident, regardless of whether the other motorist had elected PIP coverage. But such PIP motorists could claim in tort against other motorists, whether covered by PIP or not, for economic loss in excess of their PIP coverage.⁴⁶ An exception would exist when the injury was caused by a tortfeasor's alcohol or drug abuse, in which event no restriction on the right to sue in tort would apply.⁴⁷ As to accidents between PIP insureds and those electing to stay under the tort system, tort insureds would make a claim against their own insurer for both economic and non-economic loss—under coverage termed “tort maintenance coverage”—just as they do today under uninsured motorists' coverage.⁴⁸ Claims for economic loss in ex-

44. See O'Connell & Joost, *supra* note 41, at 70-72 (arguing that no-fault payments subsidize liability claims by enabling the plaintiff to reject unsatisfactory settlement offers, as well as by serving as a multiplier of pain and suffering claims). See also Jeffrey O'Connell & Michael Horowitz, *The Lawyer Will See You Now*, WASH. POST, June 13, 1993, at C3.

45. Peter Passell, *Bush's Bold Plan for Car Insurance*, N.Y. TIMES, Oct. 17, 1992, at 41. See also O'Connell & Joost, *supra* note 41, at 63, 77-82 (proposing a new scheme allowing motorists a choice between no-fault and traditional insurance). The Bush administration proposal was crafted at the urging, and with the participation, of Michael Horowitz and Jeffrey O'Connell. See Passell, *supra*, at 41.

46. Passell, *supra* note 45, at 41. Just as one could opt to buy more liability insurance than financial responsibility limits mandate, so too could one opt to buy more PIP coverage than financial responsibility limits mandate.

47. *Id.*

48. See *infra* note 55. The defendant in a tort maintenance claim would be the insured's own insurer, not the tortfeasor. On the philosophical question of whether it is necessary for tort payments to be made by, or even on behalf of, tortfeasors (by their liability insurers, for example), see *Symposium: Corrective Justice and Formalism: The Care One Gives One's Neighbors*, 77 IOWA L. REV. 443-44, 445, 672-74, 677, 698-99, 703-04 (1992). See also JULES COLEMAN, RISKS AND WRONGS chs. 16, 18, 19 (1992). For an answer to possible adverse selection under a choice plan, see O'Connell & Joost, *supra* note 41, at 88 n.4.

cess of one's own tort maintenance coverage would be allowed against PIP insureds. In accidents between two tort liability insureds, the current common-law system would apply without change.

Furthermore, PIP coverage would be in excess of all collateral sources⁴⁹ and payable periodically. When claims for economic loss in excess of either PIP or tort maintenance coverages are pursued, a reasonable attorney's fee, in addition to economic loss, would be recoverable.⁵⁰ No change would be made in the law applicable to property damage.⁵¹

III. ESTIMATING THE EFFECTS OF THE CHOICE PLAN

A. General Approach

The objective here is to estimate how the adoption of the choice plan would affect the costs of auto insurance in states now having the traditional tort system. The focus is on the effects of the choice plan on the amount each insured motorist must be charged, on average, to defray the costs of compensating auto accident victims. As used here, compensation costs include all the costs auto insurers incur in compensating auto accident victims, including both the compensation paid to accident victims from all forms of auto insur-

49. *But see infra* text accompanying note 64.

50. This is necessary because attorneys' fees today are normally paid out of damage awards for pain and suffering; thus, a regime not paying for pain and suffering calls for an alternate source for such payment.

51. The rationale for excluding property damage from no-fault coverage is explained in Robert E. Keeton & Jeffrey O'Connell, *Basic Protection Automobile Insurance*, 1967 U. ILL. L.F. 400, 411-12.

Appendix II sets forth the terms of some key provisions of a tentative draft bill implementing the federal proposal—a bill worked out by Jeffrey O'Connell and Michael Horowitz with lawyers at the Civil Division of the U.S. Department of Justice, with additional input from the White House Domestic Policy Council, the Office of Management and Budget, the Council of Economic Advisers, and the Office of Legal Counsel in the Department of Justice. The bill was drafted in order to convey, in some detail, what the principal provisions that would eventually emerge in a final draft would look like. Even a final federal bill, however, would, in the interest of federalism, be less detailed than earlier "choice" bills drafted by Professor O'Connell for state enactment. *See* O'Connell & Joost, *supra* note 41, at 80-82 (describing more extensively the components of a statute creating a choice-based automobile insurance system); Jeffrey O'Connell, *A Draft Bill to Allow Choice Between No-Fault and Fault-Based Auto Insurance*, 27 HARV. J. LEGIS. 144 (1990); Jeffrey O'Connell & Robert H. Joost, *A Model Bill Allowing Choice Between Auto Insurance Payable With and Without Regard to Fault*, 51 OHIO ST. L.J. 947 (1990). For a provision in this model bill requiring insurers to make available "pain and suffering coverage . . . with a [minimum] limit of \$50,000, payable if the insured person sustains . . . a [defined] serious injury," see *id.* at 965. Such a provision could be readily added to the proposal made herein.

ance and all transaction costs involved in making such payments.⁵² This, of course, neglects the many other factors, such as insurers' overhead and profit margins and investment income, that also enter into the determination of insurance premiums. Compensation costs, however, are a major component of insurance premiums and, in the long run, the effects of the choice plan on insurance premiums should be broadly similar in direction and order of magnitude to its effects on compensation costs.⁵³

In focusing on the effects of the choice plan on the costs of auto insurance to insured motorists, we first estimated what auto insurers would have to charge the average insured motorist to recover the costs they incur in compensating accident victims under all coverages under the traditional tort system. We then developed corresponding estimates for motorists who elect to remain in the tort system and for motorists who elect PIP coverage under the choice plan. These estimates were then compared to determine how the adoption of the choice plan would affect the costs of auto insurance to motorists, depending on their insurance status under the choice plan.

Specifically, under the traditional tort system, motorists may purchase several different personal injury coverages—Bodily Injury (BI),⁵⁴ Uninsured Motorist (UM), Underinsured Motorist (UIM),⁵⁵ and Medical Payments (MedPay).⁵⁶ Accordingly, under that system, insured motorists must bear the sum of the compensation costs of each of those coverages. The compensation cost of the traditional tort system to the average insured motorist is estimated as the sum of what insurers pay out and the associated transactions costs under all the above coverages, divided by the total number of insured mo-

52. Tort claimants pay their legal fees and costs out of any compensation they receive.

53. See *supra* note 43 and accompanying text.

54. "Bodily Injury" refers to tort liability coverage for personal injury, thereby excluding property damage.

55. Uninsured coverage (UM) pays up to the limit specified in the policy when the insured or others in the insured vehicle are injured by uninsured or hit-and-run drivers. Thus the insured's own insurer pays what the insured person is eligible to recover in tort from the other uninsured-at-fault driver. Underinsured motorist coverage (UIM) similarly pays the injured and other occupants of the insured vehicle under UIM coverage when the at-fault driver has liability coverage but with lower limits than those carried by the insured.

56. Medical payments coverage is a supplemental coverage payable by one's own insurance company for medical expenses without regard to fault, often at low limits, *e.g.*, \$500-\$1000.

torists. Motorists who are uninsured, of course, bear none of the costs of auto insurance.

Under the choice plan, recall that motorists may remain in the tort system, elect PIP coverage, or go uninsured (illegally). Those who remain in the tort system will purchase tort maintenance coverage in addition to BI, and possibly UM and MedPay. We estimated the average tort insured motorist's compensation costs under the choice plan as the sum of what auto insurers pay injured people and the associated transactions costs under all coverages on behalf of tort insured motorists, divided by the total number of tort insured motorists. Note that the average tort insured motorist's compensation costs include the costs insurers incur on her behalf in providing compensation under tort liability-type coverages—BI, UM, and tort maintenance—and any MedPay coverage.

Motorists who elect PIP coverage under the choice plan purchase not only PIP but may also purchase BI to cover liability claims brought against them by others for losses in excess of policy limits. The average PIP insured's compensation costs are estimated as the sum of the costs auto insurers incur on behalf of motorists who elect PIP for both their PIP and their BI coverages, divided by the number of PIP insureds. Note that this average equals the costs insurers incur on behalf of PIP insureds in providing compensation under both their PIP coverage and their BI coverage. As was the case under the traditional tort system, people who go uninsured under the choice plan bear none of the costs of compensating auto accident victims.

B. The Results

The effects of the choice plan on premiums charged particular drivers will vary with such factors as the coverages they buy, their policy limits, the insurer they buy from, the type of car and mileage driven, as well as the home state and their location within that state. So our estimates are only meant to indicate the general nature of cost effects averaged over all drivers, keeping such variables in mind.

The following discussion involves both Figures 1 and 2 below. Figure 1 combines the results for all states having the traditional tort system but assumed to have adopted a choice system. By and large the savings of thus adopting a choice plan are similar across all states, although the savings are especially high in Louisiana. Indeed the savings in Figure 2 for California are identical to the results across all states, with two exceptions for those who choose to re-

FIGURE 1
RELATIVE SAVINGS

All tort states

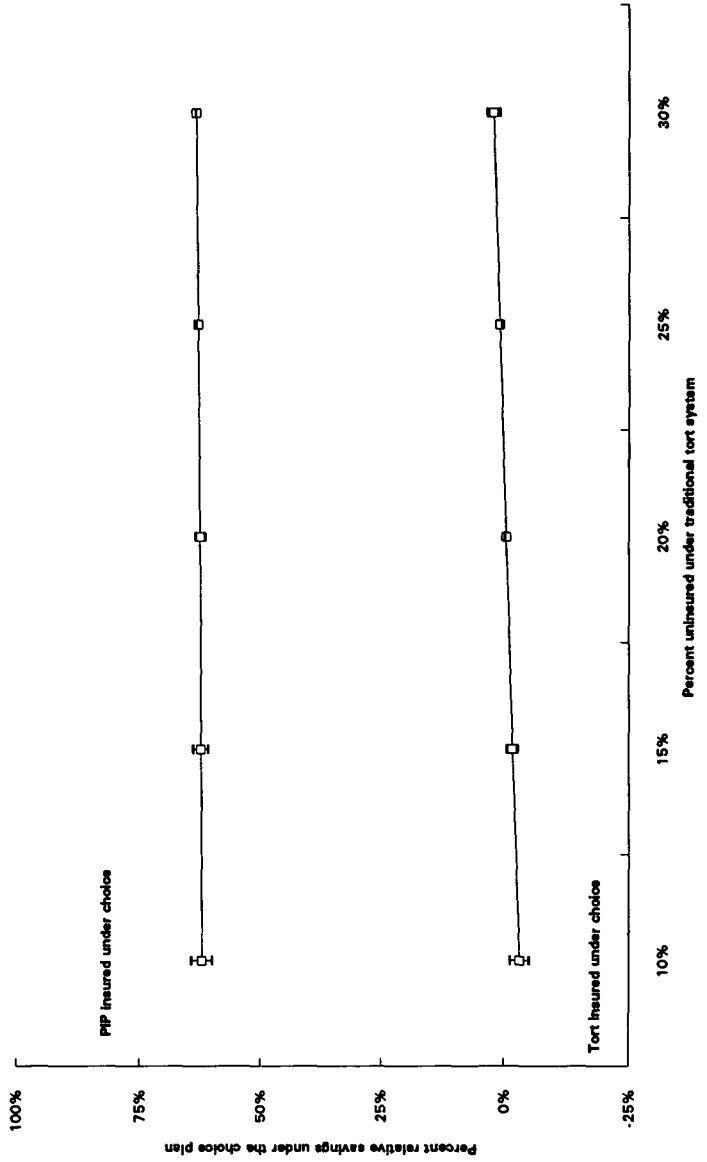
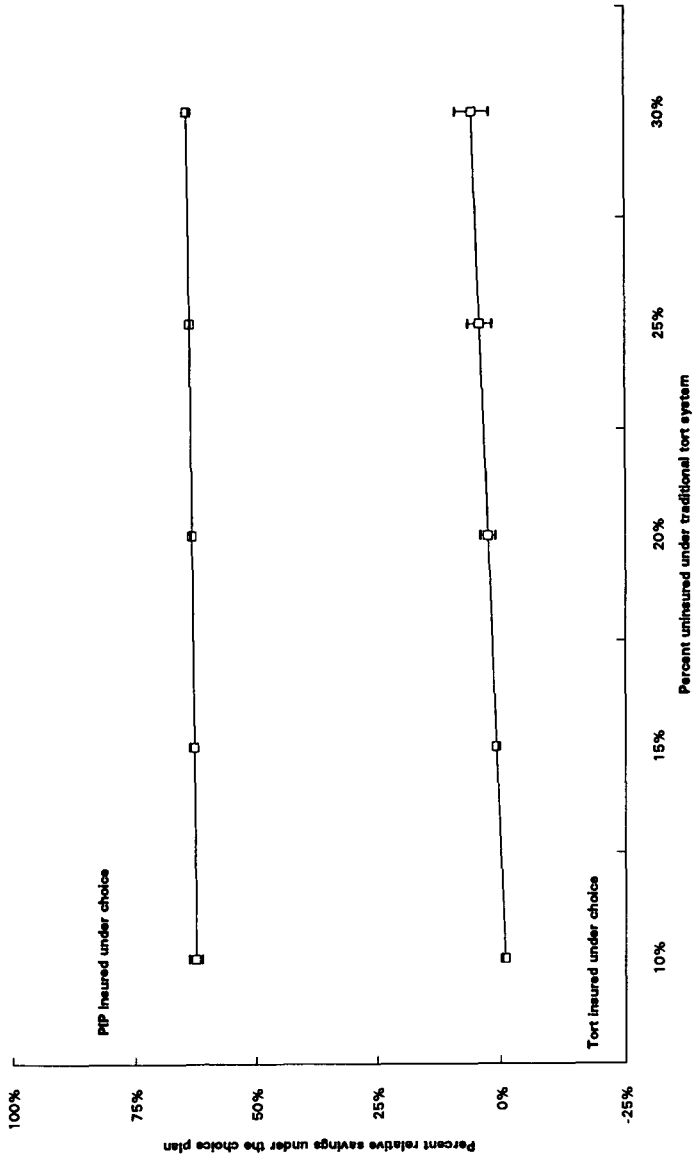


FIGURE 2
RELATIVE SAVINGS

California



main insured under tort criteria appearing at the end of the discussion of Figures 1 and 2. The savings for those who choose PIP turn out to be very substantial—in the sixty to sixty-five percent range for personal injury coverage. (This relatively small five percent differential turns on three variables discussed in the immediately following paragraph.) The discussion of Figures 1 and 2 is followed by individual results for some representative states, including Illinois (Figure 3), Louisiana (Figure 4), North Carolina (Figure 5), and Ohio (Figure 6).

The three variables shown in Figures 1-6 below are as follows: (1) the uninsured motorist rate under the traditional tort system, (2) the rate at which motorists insured under the traditional tort system would opt for PIP coverage if given the choice, and (3) the rate at which uninsureds under the traditional tort system would opt for PIP coverage if given the choice.⁵⁷ The results are presented first in Figures 1 and 2.

The vertical axis is the percentage reduction in compensation costs under the choice plan relative to compensation costs under the traditional tort system. The horizontal axis is the proportion of motorists who had been uninsured under the traditional tort system. The solid line denoted "PIP insured under choice" plots the results for motorists who had been insured under the traditional tort system who then opted for PIP coverage under choice, correlated with various uninsured motorist rates that had existed under the traditional tort system, assuming that fifty percent of motorists both insured and uninsured under the traditional tort system opted for PIP under choice. For example, this PIP line shows a relative savings of about sixty-three percent when the uninsured motorist rate is twenty percent. This means that if the choice plan were adopted in a state in which the uninsured motorist rate had been twenty percent, and if both insured and uninsured motorists in that state opted for PIP coverage at a fifty percent rate, the average PIP insured who had been insured under the traditional tort system would save sixty-three percent on what he would have to pay to defray an insurer's compensation costs for bodily injury compared to what he would have to pay under the traditional tort system.

The vertical bars attached to the solid PIP line show how the estimate would change if the rates at which motorists selected PIP coverage were either higher or lower than fifty percent. The upward

57. See *supra* Section III.A. For more on the basis of our cost estimates, see *infra* Appendix III.

bars show the estimate if we assume that twenty percent of insured and previously uninsured motorists opted for PIP coverage. The downward bars show what would happen if eighty percent of insured and uninsured motorists opted for PIP under choice.⁵⁸ For example, the upward vertical bar attached to the PIP line at a former uninsured motorist rate of twenty percent has a value of about sixty-four percent. If the choice plan were adopted in a state where the uninsured motorist rate had been twenty percent and if both insured and uninsured motorists in that state opted for PIP coverage at a twenty percent rate, insurers would have to charge the average PIP insured who had been insured under the traditional tort system only about thirty-six percent (one hundred minus sixty-four) of what they would have had to charge that motorist under the traditional tort system. The downward bar attached to the PIP line at an uninsured motorist rate of twenty percent shows that if eighty percent of insured and uninsured motorists under the traditional tort system opted for PIP coverage under choice, those who had been insured under the traditional tort system would realize savings of about sixty-two percent.

Thus the estimated savings for motorists who had been insured under the traditional tort system but opt for PIP coverage under a choice plan do not much depend on the situation in a given state regarding the uninsured motorist rate under the traditional tort system nor on the rate at which motorists then opt for PIP coverage. Because PIP insureds under choice are not liable for others' non-economic losses, the compensation costs incurred on their behalf are substantially lower compared to the traditional tort system, regardless of such other conditions. This is confirmed by the fact that, generally speaking, in Figures 1-6 the line labeled "PIP insured under choice" is relatively flat. For all practical purposes, then, costs for PIP insureds vary very little with the rate motorists had

58. Motorists who opt for PIP are exposed to claims for economic loss in excess of the limits of a claimant's own PIP coverage or, in the case of a tort insured, a claimant's own tort maintenance coverage. See *supra* text accompanying notes 45-49. If the tort insurance limits that tort insureds purchase for their tort maintenance coverage approximate the relatively high limits they purchased for BI coverage under the traditional tort system, see RAND, *supra* note 4, at 105 (indicating that nationwide, almost two-thirds of motorists buy more than \$25,000 of BI limits), then the likelihood that a PIP insured will have to compensate a tort insured for economic loss will be small, and the larger the proportion of people who remain in tort the smaller will be the expected cost of supplemental BI coverage for those who choose PIP. Hence the higher the limits purchased by tort insureds, the larger the savings for PIP insureds. And *vice versa*. See also *infra* note 60 and accompanying text.

FIGURE 3
RELATIVE SAVINGS

Illinois

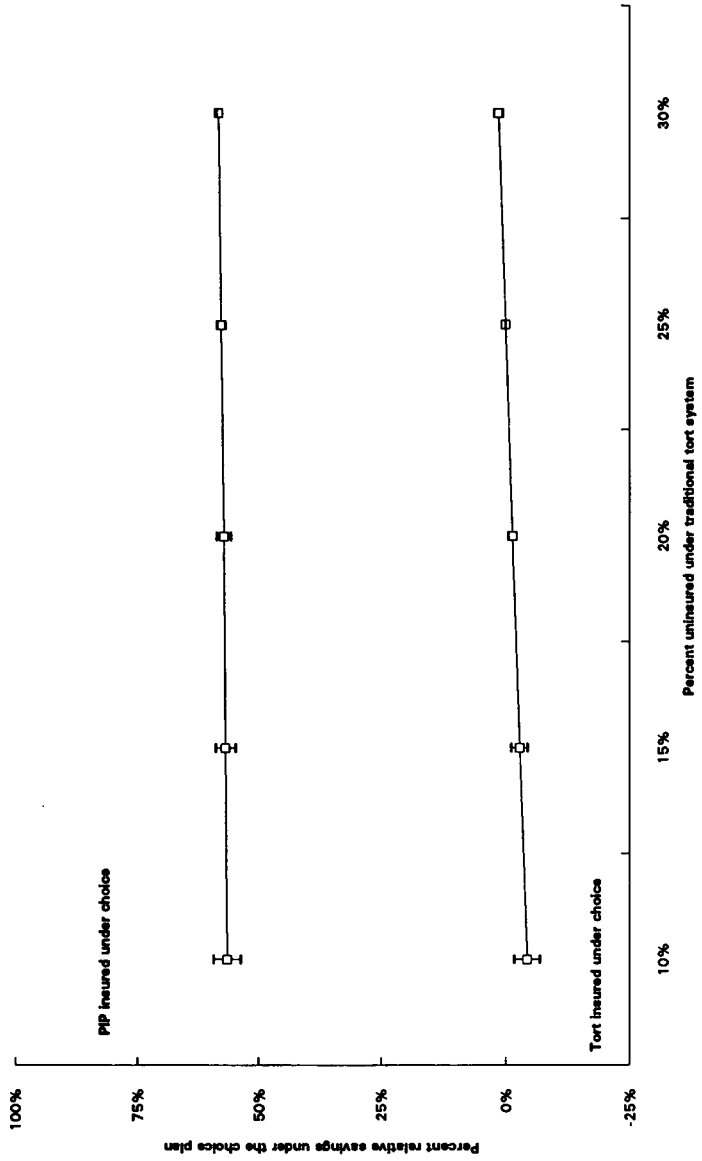


FIGURE 4
RELATIVE SAVINGS

Louisiana

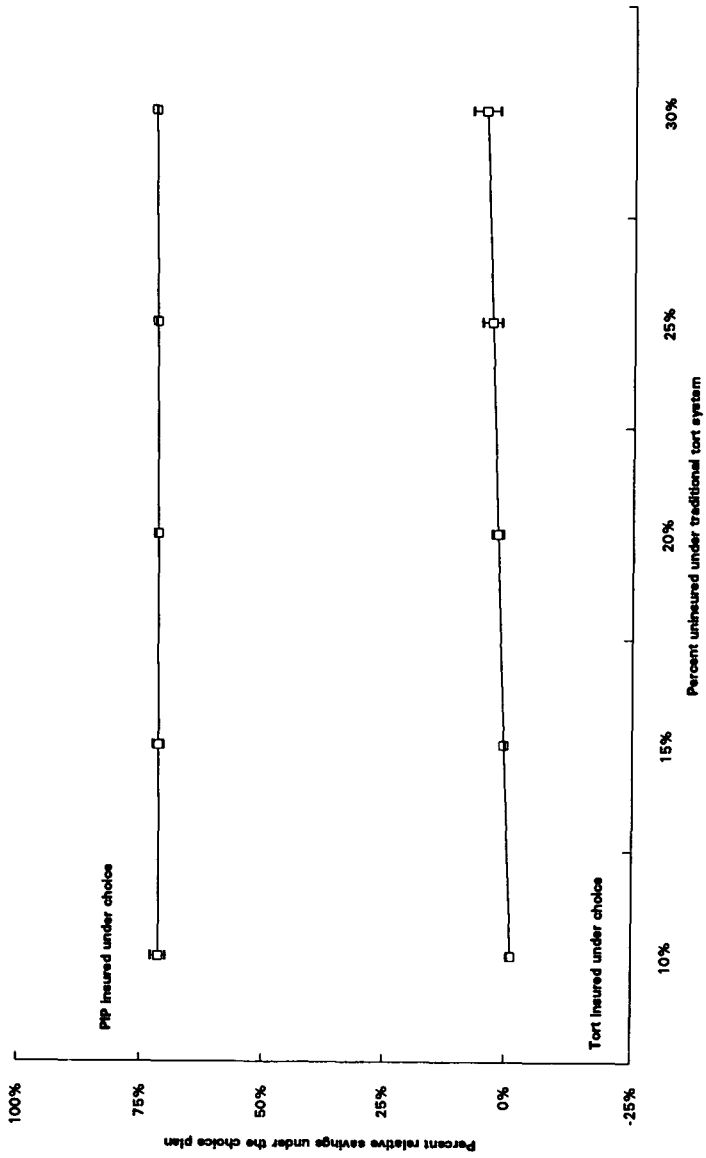


FIGURE 5
RELATIVE SAVINGS
North Carolina

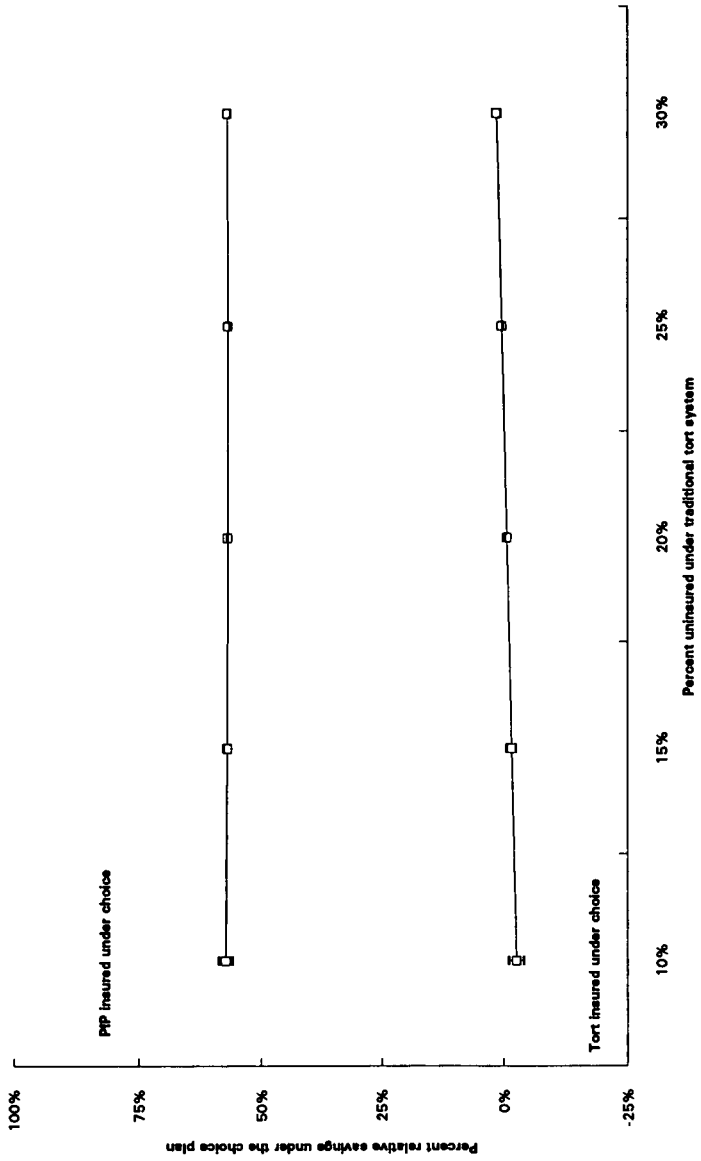
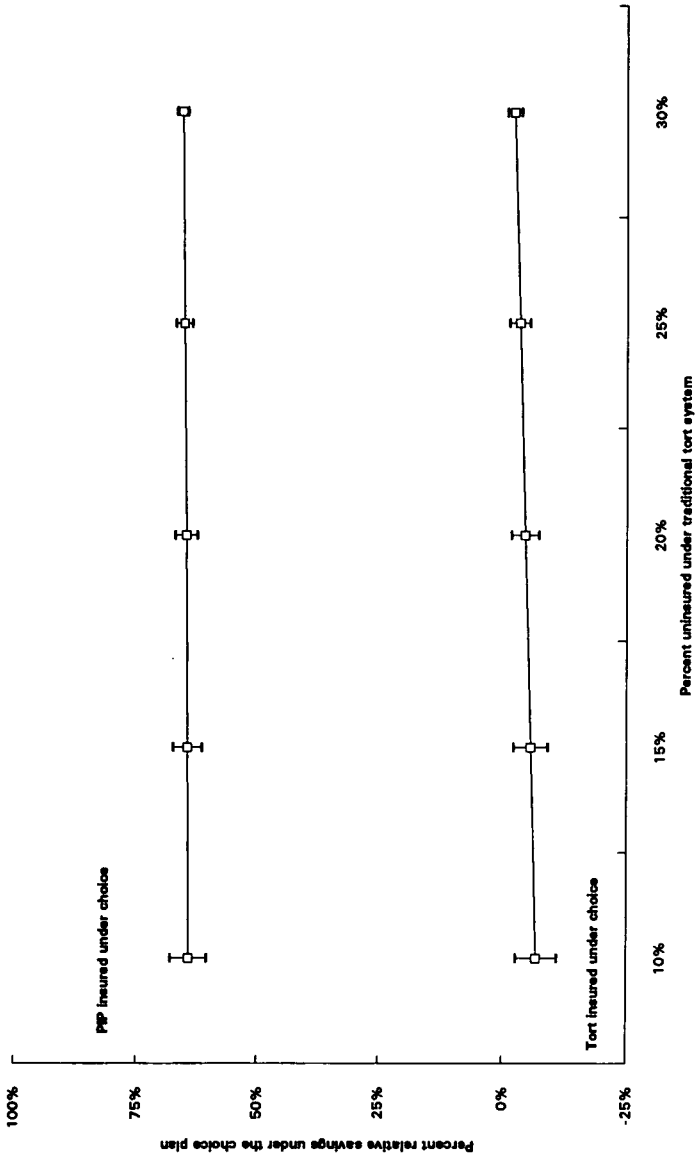


FIGURE 6
RELATIVE SAVINGS
Ohio



been uninsured under the traditional tort system.⁵⁹ Furthermore, because PIP insureds are insulated from damages for non-economic losses suffered by other motorists, whether uninsured or otherwise, the savings to a PIP insured are largely independent of whether or how others insure under the choice system. These savings, as indicated, will be between sixty and sixty-five percent in compensation costs across all tort states adopting choice and for California in particular, presumably therefore translating into such savings on total auto insurance premiums for bodily injury.

On the other hand, as shown on the line in Figures 1 and 2 labeled "Tort Insured under traditional tort system," costs for motorists who elect to remain in tort under the choice plan will be only slightly affected by the adoption of a choice plan.⁶⁰ The solid line denoted "Tort insured under choice" presents the corresponding results for the motorists who were insured under the traditional tort system and opted to remain in tort under the choice plan. Here, too, the variables mentioned above do not change things very much. For example, if the uninsured rate was low under the former tort system—less than ten percent or so—the costs for tort insureds under choice may indeed increase slightly—possibly as much as three percent (one percent in California).⁶¹ If the uninsured motorist rate had been larger, they will realize some savings, possibly as much as two percent (six percent in California). These varying results reflect the effects of the choice plan on the costs of compensating uninsured motorists. In computing costs incurred on behalf of insured motorists, the full common-law costs incurred by insurers of tort insureds in compensating uninsured motorists are included in

59. What small variations there are reflect varying costs of supplemental BI coverage under varying conditions. See *supra* note 57; see also *infra* notes 60-61 and accompanying text concerning the variations in cost for those choosing tort under a choice system.

60. For tort insureds, the upper bar reflects an assumption under choice that 80% of insured and previously uninsured motorists opted for PIP coverage, with the downward bar showing what would happen if only 20% of insured and previously uninsured motorists opted for PIP. This is just the opposite for the bars for PIP insureds. See *supra* note 58 and accompanying text. Why the difference?

Tort insureds are at risk for full common-law tort damages—covering both non-economic as well as economic losses—only to other tort insureds and uninsured motorists. By way of contrast, they are exposed to PIP insureds only for excess economic loss. Thus, as the percentage of motorists choosing PIP grows bigger, the exposure of tort insureds grows smaller. Hence the larger the savings for tort insureds. And *vice versa*.

61. It will be noted that in Figures 1, 2, 3, 4, and 6, at a rate of 15% of uninsured motorists under the traditional tort system, the line labeled "Tort insured under choice" dips below "0," indicating an *increase* in cost, *i.e.*, "negative savings." (In Figure 5, the line is close to "0.") This results from two interrelating factors explained *infra*, text accompanying and following note 62.

the calculations—just as they are under the traditional tort system. This reflects the fact that under the traditional tort system, uninsured motorists pay nothing into the insurance system—but even so are eligible for full common-law damages from it.⁶² If, then, there were few uninsured motorists in the first place, the costs of compensating them would not be large under a choice of tort and the savings realized by inducing uninsured motorists into the insurance system by a choice plan would be correspondingly small. On the other hand, if there were many uninsured motorists under the traditional tort system and the choice plan succeeds in bringing even a small fraction of them into insured status, the savings for those who choose tort could be somewhat higher—but still much less than for those who choose PIP.

As indicated above, there follow Figures 3-6 for some other representative individual states. As also indicated above, the most important thing to glean from Figures 2-6 is how the general pattern of savings from Figure 1 applies to all states, despite relatively marginal individual differences.

Savings in the sixty to sixty-five percent range for personal injury are, of course, very high. Furthermore, such estimates are conservative. Based on the available data,⁶³ estimates by RAND only subtracted as collateral sources private health insurance benefits, excluding any publicly mandated sources such as Medicare, Medicaid, and workers' compensation, and all private sick leave or disability coverages for wage loss.⁶⁴ In addition, with no or at least greatly lessened incentives to incur medical bills and wage loss as a means of inflating claims for pain and suffering,⁶⁵ those who opt for PIP should oftentimes be inclined to incur lower economic losses and/or forego making claims at all compared to their inclinations under the traditional tort system. But RAND's estimates, without any means in its data of precisely weighing those likely reductions, do not include them.⁶⁶ One should also note that the savings mirror

62. Under the proposal as presented herein, tort insureds under the choice plan continue to be fully liable to uninsured motorists. See *infra* Appendix II. The choice plan could, however, be drafted such as to allow uninsured motorists to collect only economic losses against both tort and PIP insureds, resulting in slightly larger savings to tort insureds.

63. See *infra* Appendix III.

64. See *supra* text accompanying note 49.

65. On the effects of such inflation see *supra* text accompanying notes 34-38; see also *supra* note 44.

66. But see CARROLL ET AL., *supra* note 3, at 224-31, where in an alternate hypothesis RAND assumes that elimination of payment for pain and suffering will reduce both the size and number of claims, leading to a further reduction in cost of about 4%, added to a

progressive taxation in that they will be higher still for the less affluent. This results from freeing PIP insureds from any obligation to buy supplementary BI liability insurance—a freedom that will be embraced by those having few or no assets to protect, that is, the poor. RAND's estimates are based on the premise that anyone choosing PIP coverage would also buy supplementary BI coverage at the same BI 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 poorer motorists with few or no assets had previously bought BI only to comply with state financial responsibility laws and would not buy supplementary BI coverage under a choice system.⁶⁷ With an obligation under choice, then, to buy only PD liability plus PIP (excluding also collision and comprehensive coverage), savings of sixty to sixty-five percent on the BI side would translate into savings, not of about thirty to thirty-three percent in total premium but rather about forty-five to fifty percent (assuming PD liability costs—as distinguished from collision coverage costs—are typically only about one-third of total liability costs, including both BI and PD).⁶⁸

IV. A FURTHER RESULT?

Another potential advantage might be mentioned under a first-party system whereby both those who choose traditional tort coverage as well as those who choose PIP coverage are paid by their own insurers. In their book, *The Struggle for Auto Safety*, authors Jerry Mashaw, a Yale law professor, and David Harfst, a Washington, D.C., lawyer, tell what they deem the sad but edifying tale of the ineffectiveness of the command and control regime instituted by the National Highway Traffic Safety Administration (NHTSA), the agency charged by Congress with regulating the safety of automobiles.⁶⁹ They contend that NHTSA has been increasingly enmeshed in prolonged administrative proceedings, experiencing massive reversals by the federal courts and a Congress that has ap-

finding of a 22% cost reduction for a system, set forth in the first column of Table 1 and the third column of Table 2 *supra*, with a benefit level of \$15,000 and a strong verbal threshold.

67. See *infra* note 90. For a further source of possible savings, see *supra* text accompanying notes 69-74.

68. See *supra* text accompanying notes 25, 43 & 53. See also INSURANCE INSTITUTE, *supra* note 24, at 2.

69. JERRY L. MASHAW & DAVID L. HARFST, *THE STRUGGLE FOR AUTO SAFETY* 41-45 (1990). For a review of the book, see Michael J. Trebilcock, *Requiem for Regulators: The Passing of a Counter-Culture*, 8 YALE J. ON REG. 497 (1991).

parently abandoned its commitment to the initial ideals of the Act.⁷⁰ According to their exhaustively documented view, in the wake of judicial and legislative assaults on the agency's original statutory mandate for air bags and other injury-preventing devices, NHTSA has shifted its focus from regulation by rule-making, which is difficult to justify before skeptical judges and legislators, to regulation by recall of defective vehicles, which is relatively easy to get everyone to understand—a shift that continues to the present day, with highly deleterious results. Since the early 1970s, Mashaw and Harfst argue, NHTSA has adopted few if any new safety standards, while the number of mandatory recalls of cars with unsafe features has escalated dramatically.⁷¹ But despite the number of recalls, they cite empirical evidence that indicates that the effect of recalls on enhanced safety is trivial, perhaps on the order of less than 1.5 percent in reduction of deaths and injuries.⁷²

While not ignoring the difficulties involved, Mashaw and Harfst in their final chapter suggest that a better prospect for achieving vehicle safety may lie in a movement towards first-party insurance of the type suggested herein.⁷³ Such a movement could provide an effective extra incentive—reduced auto insurance rates—for motorists to purchase cars that reduce their own accident costs. The prospect for such an incentive is clearly attenuated under traditional tort third-party liability insurance, in which the lessening of insurance payouts from the greater auto safety accrues not to an insurer's own insureds but to negligent third parties whose liabilities are correspondingly reduced when colliding with an insurer's own insureds. Because the benefits of increased safety do not accrue to them, there is no way for insurers to reward their own insureds for installing injury-reducing devices. With first-party insurance, however, whether PIP or tort maintenance coverage, the situation changes dramatically. Under such a system, an insurer *can* reduce premiums for safer cars, secure in the knowledge that the savings from injury-reducing devices will accrue to its own insureds and *not* to third-parties unknowable in advance.⁷⁴

70. MASHAW & HARFST, *supra* note 69, at 13.

71. *Id.* at 11-12.

72. *Id.* at 168.

73. *Id.* at 242.

74. *Id.* at 501. *But see* Warren Brown, *Air Bag Aftermath: The Device Saves Lives, But Socks Insurance Firms as Medical Costs Rise*, WASH. POST, Mar. 21, 1993, at H1 (indicating that while air bags save lives, they may end up causing insurers higher costs in payments for surviving victims' medical and rehabilitation expenses that can be far larger than

V. CONCLUSION

With the defeat of President Bush in the 1992 election, prospects for a federal bill incorporating choice of coverage and waiver of recovery for pain and suffering may well be greatly diminished.⁷⁵ But even so, the issue of high—and rising—auto insurance costs assures that interest in “choice” auto insurance can be expected, at least at the state level. This is so, argue proponents of change, because such proposals could radically drive down the high cost of insurance while also having the political virtue of arguably freeing the debate from the claims that reform involves involuntary surrender of rights by consumers. In this connection, can consumers be trusted to have additional rights and understand complex auto insurance liability options? Proponents of choice answer that consumers must exercise many options in buying life, health, disability, or homeowners’ insurance, and even in buying first-party auto insurance under uninsured motorist coverage and collision and comprehensive coverages applicable to damage to their cars as well as in selecting appropriate limits under tort liability coverage.

Further, proponents of choice argue that the political equation may now be altered in that important segments of the consumer movement have recently broken with Ralph Nader and the trial bar in calling for drastic systemic reform of the auto tort system.⁷⁶ Even more to the point, argue proponents of choice, this new critique, along with recommending first-party no-fault coverage, is significantly based on the proposition that the pain-and-suffering component of auto tort law is an important aspect of what they contend is tort law’s *anti*-consumer character. Proponents point to a recent report by the National Insurance Consumer Organization, an organization closely associated with Ralph Nader, that generally defends the tort system but breaks with Nader in describing the pain-and-

would have been payable in death benefits). Note that higher costs per case would not explain higher claim frequency. See *supra* note 36 and accompanying text.

75. It might be noted, though, that a version of the Bush administration bill in Appendix II has been introduced as H.R. —, 103d Cong., 1st Sess. (1993) by Congressman Christopher Cox (R. Cal.).

76. Andrew Tobias, . . . *Fairness and Efficiency Are Vital*, N.Y. TIMES, Mar. 21, 1993, § 3, at 11 (viewpoint) (promoting a private, no-fault auto-insurance reform that eliminates pain and suffering claims and is funded at the pump by a gasoline surcharge); Michael Horowitz, *Let Drivers Tailor Auto Insurance . . .*, N.Y. TIMES, Mar. 21, 1993, § 3, at 11 (viewpoint) (promoting the consumer-choice plan over Tobias’s “pay-at-the-pump” plan, criticizing Tobias’s as too politicized and bureaucratized); Peter Passell, *The Nation, This California Dream is All About Auto Insurance*, N.Y. TIMES, Feb. 28, 1993, at E4 (describing the “pay-at-the-pump” proposal for auto insurance reform and noting the criticism and obstacles the proposal faces).

suffering component of automobile tort law as a “dream for huge rewards . . . [that] is, for almost all, only a dream. And whatever large sums are awarded are heavily taxed by the lawyers. . . . On economic grounds it’s a bad buy. . . .”⁷⁷

In short, regardless of one’s views of the merits of all this, the issue of auto insurance reform will remain, whether at the federal or, more likely, state level. And the merits of allowing motorists to opt out of payment for pain and suffering and other non-economic loss, while receiving automatic payment for economic loss,⁷⁸ will remain a part—and perhaps even at the heart—of the debate.

77. Pay-At-The Pump: Private No-Fault Auto Insurance—A Proposal by the National Insurance Consumer Organization ii (Nat’l Ins. Consumer Org., Alexandria, Va., undated); see also ANDREW TOBIAS, AUTO INSURANCE ALERT! 57-58 (1993).

78. For a study echoing points made herein and emphasizing the necessity of PIP payments while concomitantly eliminating claims for pain and suffering as a means of controlling auto insurance costs, see J. David Cummins and Sharon Tennyson, *Controlling Automobile Insurance Costs*, 6 J. ECON. PERSP. 95 (1992).

APPENDIX I
A COMPARISON OF ESTIMATED 1987 TORT LIABILITY PURE PREMIUMS^a WITHOUT A NO-FAULT (N-F)
LAW TO ACTUAL PURE PREMIUMS IN N-F STATES

(1) 1987 Threshold	(2) 1987 N-F Benefit Limits	(3) Estimated 1987 Tort Pure Premium	(4) 1987 BI, ^b UM ^c & N-F ^d Pure Premium	(5) 1987 N-F Pure Premium	(6) 1987 N-F as % of BI, UM, N-F	(7) Change in Injury Coverage Costs in N-F States 1987	(8) 1982
Verbal Threshold							
(1) Florida	\$10,000	\$187.32	\$157.45	\$41.11	26.1%	-16% ^e	-21%
(2) Michigan	Unlimited	171.67	116.57	74.93	64.3	-32	-17
(3) New York	50,000	198.48	138.12	49.78	36.0	-30	-6
Threshold \$1,000 or more							
(4) Hawaii	\$5,600 ^f	141.49	147.82	62.74	42.4	4	37
(5) Minnesota	4,000	138.97	112.59	43.88	39.0	-19	-2
(6) Utah	3,000 ^g	82.22	85.00	22.87	26.9	3	-13
(7) Colorado	2,500 ^h	90.70	131.86	64.22	48.7	45	-15
(8) North Dakota	2,500 ⁱ	66.11	49.81	17.17	34.5	-25	-19
(9) Kentucky	1,000	93.96	75.06	28.79	38.4	-20	-29
Threshold Less than \$1,000							
(10) Georgia	5,000	91.32	107.24	39.97	36.3	17	15
(11) Kansas	28,925	74.90	58.87	14.64	24.9	-21	-9
(12) Massachusetts	2,000	231.70	173.99	21.82	12.3	-25	-33
(13) Connecticut	5,000	162.54	162.54	24.02	14.1	5	14
(14) New Jersey	200 ^j	183.59	226.77	91.17	40.2	24	65
Add-On States							
(15) Oregon	None	113.62	110.01	25.26	23.0	-3	-8
(16) Delaware	None	108.56	173.13	53.53	30.9	59	17
(17) Maryland	2,500	134.63	170.10	38.73	22.8	26	26
(18) Pennsylvania	None ^k	118.61	162.78	61.78	38.0	37	53

^a Pure Premium is that portion of premium used to pay losses, thereby excluding an insurer's expenses in marketing and administrative costs as well as legal defense costs.

^b BI means tort liability coverage for bodily injury, thereby excluding property damage.

^c UM means uninsured motorist coverage.

^d N-F means no-fault coverage.

^e Threshold was raised between 1982 and 1987. Colorado raised its threshold from \$500 to \$2,500, effective 1/1/85. North Dakota raised its threshold from \$1,000 to \$2,500, effective 7/1/85. Hawaii's threshold was \$1,500 in 1982. Since 1982, the state's tort threshold has been raised several times. Utah increased its threshold from \$500 to \$3,000, effective 7/1/86. Pennsylvania eliminated its \$750 tort threshold, effective 10/1/84. New Jersey adopted an optimal \$1,700 tort threshold, effective 7/1/84. For further changes in some of the states in this chart, see Summary of Selected State Laws & Regulations Relating to Automobile Insurance (Am. Insur. Ass'n 1991).

^f A negative result indicates an insurance cost savings in a no-fault state. A positive figure indicates an increase in costs in same.

This table is based on work done by Brian A. Smith, Research Manager, Alliance of American Insurers. A version of this table appeared in an article entitled *Reexamining the Cost Benefit of No-Fault, CHARTERED PROF. & CASUALTY UNDERWRITERS J.*, Mar. 1989, at 28; see also Letter to author from Brian A. Smith (Mar. 22, 1989). It is slightly altered from O'Connell, *supra* note 9a, at 998-99.

APPENDIX II

[SOME DRAFT PROVISIONS OF A BILL]

To provide a means for motor vehicle insurance customers and motor vehicle insurance providers to agree upon optional insurance provisions to reduce liability costs, expedite resolution of claims, ensure fair and prompt payment of claims, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE

This act may be cited as the "Motor Vehicle Personal Protection Insurance Act of 1992."

TITLE I. FINDINGS AND PURPOSE**SECTION 101. Findings.**

The Congress finds that:

- (a) Motor vehicle insurance costs are excessive due to the costs of litigation and payment of claims and administrative costs due to the necessity to determine liability;
- (b) Consumer choice in selection of motor vehicle insurance would be greatly enhanced if each consumer could decide upon the form of insurance that best suits the individual needs of the consumer;
- (c) Insurance to indemnify individuals for personal injury arising from motor vehicle collisions is frequently unavailable at reasonable cost because of the potential for third-party claims; and
- (d) A system enabling individuals to select the form of motor vehicle insurance coverage that best suits individual needs would enhance individual freedom and reduce the costs of the motor vehicle insurance provided through our free enterprise system due to market-based competition.

SECTION 102. Purpose

It is the purpose of this Act to authorize consumers of motor vehicle insurance to choose between their present tort remedies under State law and a system which combines first-party insurance and the right to sue negligent drivers for all further uncompensated economic losses.

TITLE II. MOTOR VEHICLE PERSONAL PROTECTION CONTRACTS

SECTION 201. *Motor Vehicle Personal Protection Insurance Act.*

Title ____ of the United States Code is hereby amended by adding a new section, as follows:

SECTION __. *Motor Vehicle Personal Protection Act.*

(a) *Insurance Policy Provisions.*

- (1) *In General.* An insurance policy that includes provisions that entitle the insured to receive, without regard to fault or lack of fault, the insured's net economic losses caused by an injury along with an express, specific waiver of tort rights as provided in the insurance policy shall be valid notwithstanding any contrary provisions of State law.
- (2) *State Law.* In order for a personal protection insurance policy to be covered by this Act, a motor vehicle insurance policy issued by an insurer shall, at a minimum, provide personal protection coverage; (i) up to the minimum limits of liability insurance for personal injury under the State's financial responsibility law; or, (ii) in a State already covered by a no-fault motor vehicle insurance law, up to the minimum level of insurance required for no-fault benefits or liability insurance for personal injury, whichever is greater, and shall contain provisions under the State's financial responsibility law, including those related to liability for property damage, except to the extent State law would bar contractual provisions giving effect to personal protection authorizations set forth in this Act, or to the extent that State law would be contrary to other provisions of this Act.
- (3) *Periodic Payment and Penalty Upon Insurers.* A personal protection insurer is authorized to contract to pay personal protection benefits periodically as losses accrue. Unless the treatment or expenses related thereto are in reasonable dispute, an insurer who does not pay a claim for net economic loss covered by a personal protection insurance under this Act within thirty days after payment is due, shall pay the loss compounded at a rate of 50% per annum, as liquidated damages and in lieu of any penalty or exemplary damages.

- (b) *Definitions.* For the purposes of this Act, the term:

- (1) "accident" means unforeseen or unplanned event causing loss or injury;
- (2) "economic loss" means reasonable amounts incurred for necessary health care treatment and medical expenses, lost wages, burial expenses, replacement service losses, and other pecuniary expenditures due to personal injuries suffered by an individual as a result of a motor vehicle accident, and for personal protection a death benefit equal to the amount of the minimum level of liability insurance required pursuant to State law for personal injury resulting from motor vehicle accidents; subject to a deduction for amounts payable for lost wages or replacement services losses;
- (3) "financial responsibility law" means a statute (including, but not limited to, one requiring compulsory coverage) penalizing motorists for failing to carry defined limits of tort liability insurance covering motor vehicle accidents;
- (4) "insurer" includes a person who is self-insured within the meaning of applicable State law;
- (5) "intentional misconduct" means conduct whereby harm is intentionally caused or attempted to be caused by one who acts or fails to act for the purpose of causing harm or with knowledge that harm is substantially certain to follow when such conduct caused or substantially contributed to the harm claimed for. A person does not intentionally cause or attempt to cause harm; (i) merely because his or her act or failure to act is intentional or done with the realization that it creates a grave risk of causing harm; or (ii) if the act or omission causing bodily harm is for the purpose of averting bodily harm to oneself or another person;
- (6) "motor vehicle" means a vehicle of any kind required to be registered under the provisions of the applicable State law relating to motor vehicles;
- (7) "net economic loss" means economic loss, including when payable based on fault, a reasonable attorney's fee calculated on the basis of the value of the attorney's efforts as reflected in payment to the attorney's client. The term excludes amounts paid or payable under:
 - (i) Federal, State, or private disability or sickness programs;

- (ii) Federal, State, or private health insurance programs;
 - (iii) employer wage continuation programs;
 - (iv) workers' compensation or similar occupational compensation acts; and
 - (v) any other source of payment intended to compensate such individual for injuries resulting from a motor vehicle accident;
- (8) "no-fault motor vehicle law" means a statute under which those injured in motor vehicle accidents are paid without regard to fault for their pecuniary losses as a result of personal injury, in return for which claims based on fault including for nonpecuniary losses, are to a defined extent limited;
- (9) "non-economic loss" means physical and emotional pain, suffering, physical impairment, emotional distress, mental anguish, disfigurement, loss of enjoyment, and loss of companionship, services, consortium and other nonpecuniary losses incurred by an individual as a result of a motor vehicle accident;
- (10) "person" means any individual, corporation, company, association, firm, partnership, society, joint stock company, or any other entity (including any governmental entity);
- (11) "personal protection" means an insurance contract payable without regard to fault for net economic loss due to personal injury resulting from a motor vehicle accident, along with waiver of tort claims pursuant to the Act;
- (12) "replacement service loss" means expenses reasonably incurred in obtaining ordinary and necessary services from others, not members of the injured person's household, in lieu of the services the injured person would have performed for the benefit of the household;
- (13) "resident relative or dependent" means a person related to the owner of a motor vehicle by blood, marriage, adoption, or otherwise (including a dependent receiving financial services or support from such owner), and residing in the same household at the time of accidental personal injury. A person resides in the same household if he or she usually makes his

- or her home in the same family unit, even though temporarily living elsewhere;
- (14) "State" means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, Guam, the Virgin Islands, American Samoa, the Northern Mariana Islands, the Trust Territories of the Pacific Islands, and any other territory or possession of the United States;
 - (15) "tort liability" means the legal obligation for payment of damages caused by one adjudged to have committed a tort;
 - (16) "tort liability insurance" means insurance by the terms of which an insurer agrees to pay, on behalf of an insured, damages the latter is obligated to pay a third person because of his or her liability to that third person;
 - (17) "tort maintenance coverage" means coverage under which a tort liability insured, when involved in an accident with a personal protection insured, retains his or her right to claim for personal injury under state law without modification by any provision of this Act except that responsibility for payment for any such claim is assumed by his or her own insurer to the extent of such coverage under subsection (c)(1);
 - (18) "uninsured motorist" means the owner of a motor vehicle, including his or her resident relatives, uninsured for either personal protection or tort liability insurance at the limits prescribed by the applicable state's financial responsibility law or higher under subsection (2)(ii) of this section.
- (c) *Operation of the Right to Choose.* Under this Act, in lieu of buying traditional tort liability insurance for personal injury to protect third parties, motorists have the right to choose personal protection which will be available to themselves and their family members in the event of a motor vehicle accident, including the amount of financial protection they deem appropriate and affordable for themselves and such others. As an alternative, motorists have the right to elect traditional tort liability coverage for personal injury at the minimum limits (or higher) under the State's financial responsibility law.
- (1) A motorist who chooses traditional tort liability has automatically included in such coverage tort maintenance

coverage at least at the equivalent of the minimum levels of insurance under (i) the State's financial responsibility law for personal injury or (ii) the State's no-fault motor vehicle law (if it has one), whichever is higher. Such a motorist who is involved in an accident with another motorist remains subject to tort law for personal injury except that, based on fault, (a) he or she can be claimed against by those covered by personal protection policies only for net economic loss in excess of the limits of the claimant's own personal protection policy, and (b) he or she cannot claim against those covered by personal protection insurance except for net economic loss. As to the latter claim, a deduction is made against the recovery equal to the limits of tort maintenance coverage applicable to the claimant.

- (2) A motorist who chooses personal protection coverage and who is involved in an accident with another such motorist is compensated under his or her own policy for net economic loss only without regard to fault. But if he or she sustains net economic loss in excess of his or her policy's benefit levels, that person retains the right to claim and sue for net economic loss based on fault.
- (3) If a motorist who has chosen personal protection coverage is involved in an accident with an uninsured motorist, the personal protection insured is compensated for net economic loss without regard to fault according to the terms of his or her personal protection policy, and has the right to claim against the uninsured motorist for net economic loss based on fault. The uninsured motorist forfeits the right to claim for non-economic loss against the motorist who has chosen the personal protection policy.
- (4) A motorist who chooses either personal protection insurance or tort liability insurance also thereby binds by such choice his or her resident relatives, provided that:
 - (i) an adult resident relative shall not be bound without his or her consent, which, in the absence of express consent, shall be implied when the relative is present in a motor vehicle operated by the motorist; and
 - (ii) insurers are authorized to specify reasonable terms and conditions governing the commencement, du-

ration, and application of the chosen coverage depending on the number of motor vehicles and owners thereof in a household.

In order to minimize conflict between the two options, insurers are authorized to maintain underwriting rules that encourage uniformity within a household.

- (5) A personal protection insured retains the right to claim, and remains subject to a claim, for driving under the influence of alcohol or illegal drugs, both as defined by State law, or for intentional misconduct.
 - (6) A personal protection insured claims personal protection benefits, up to the limits of the coverage chosen by or for him or her, in the following priority:
 - (a) the personal protection covering a motor vehicle involved in the accident, if the person injured was an occupant or was struck by such motor vehicle at the time of the accident; followed by
 - (b) the personal protection under which the injured person is or was an insured.
 - (7) A personal protection insurer is authorized to write personal protection coverage (i) without any deductible or subject to a reasonable deductible not to exceed \$1,000 and (ii) with an exclusion of coverage for persons driving under the influence of alcohol or illegal drugs.
 - (8) A personal protection insurer is subrogated, to the extent of its obligations, to all of the rights of its personal protection insured with respect to an accident caused in whole or in part, as determined by applicable State law, by the negligence of an uninsured motorist or driving under the influence of alcohol or illegal drugs, or caused in whole or in part by intentional misconduct or any person who is not affected by the limitations on tort rights and liabilities under this Act.
 - (9) Any person lawfully uninsured under the terms of State law for either personal protection or tort liability insurance retains his or her tort rights in a form unaffected by this Act.
- (d) *Renewal or Cancellation.*

An insurer shall not cancel, fail to renew, or increase the premium of its insured solely on account of the insured or any other injured person making a claim for personal protection benefits or, where there is no basis for ascribing

fault to the insured or one for whom the insured is vicariously liable, for tort maintenance coverage.

(e) *Immunity.*

No insurer or any agent or employee of such insurer, no insurance producer representing a motor vehicle insurer or any automobile residual market plan, and no attorney licensed to practice law within this State shall be liable in an action for damages on account of an election of the tort liability option, an election of the personal protection option, or a failure to make a required election, unless such person has willfully misrepresented the available choices or has fraudulently induced the election of one system over the other.

(f) *In General.*

Nothing in this Act shall be construed—

- (1) to waive or affect any defense of sovereign immunity asserted by any State under any law or by the United States;
- (2) to preempt State choice-of-law rules with respect to claims brought by a foreign nation or a citizen of a foreign nation;
- (3) to affect the right of any court to transfer venue, to apply the law of a foreign nation, or to dismiss a claim of a foreign nation or of a citizen of a foreign nation on the ground of inconvenient forum;
- (4) subject to subsection (1) of this Section, to create or vest jurisdiction in the district courts of the United States over any motor vehicle accident liability and/or damages action subject to this Act which is not otherwise properly in the United States District Court;
- (5) to prevent insurers and insureds from contracting to limit recovery for lost wages and income under personal protection coverage such that only 60% or more of lost wages or income is covered, or to offset death benefits under personal protection coverage by amounts paid for lost wages and replacement service losses;
- (6) to prevent an insurer from contracting with personal protection insureds, as permitted by State law, to have submitted to arbitration any dispute with respect to payment of personal protection benefits;
- (7) to relieve a motorist of the obligations imposed by State law to purchase tort liability insurance for per-

sonal injury to protect third parties who are not affected by the immunities of Section (c).

- (g) *Jurisdiction.* The United States District Courts shall have original jurisdiction over any civil action to enforce any provisions of this Act except for any civil action or claim for monetary damages not otherwise within the jurisdiction of the District Courts.

SECTION 202. *Effective Date.*

This Act shall become effective on its date of enactment.

APPENDIX III

Factors that strongly influence the effects on costs of both the tort system and a choice plan vary from one state to another. The proportion of drivers who are uninsured under the traditional tort system varies from state to state. Further, the available data on the fraction of drivers who are uninsured are notoriously unreliable. Similarly, the rates at which either uninsured drivers or insured drivers under the traditional tort system would opt for PIP coverage if it were available would likely vary among states and are, in any event, unknown.⁷⁹

We adopted the following approach in our analysis. We assumed values for the proportion of drivers who are uninsured under the traditional tort system and for the rates at which insured and uninsured motorists, respectively, would opt for the PIP coverage if it were made available to them. Given these assumptions, we estimated the effects of the choice plan on people who were insured under the traditional tort system and opt to remain in tort under the choice plan and on people who were insured under the traditional tort system and opt for the PIP coverage under the choice plan.⁸⁰ We then varied one or another of the assumptions and repeated the entire analysis. We repeated the process until we had systematically considered all reasonable combinations of assumed values for these key factors.

The results mapped out the effects of adopting the choice plan for all possible combinations of values for these key factors. Accordingly, policymakers interested in the results for a specific state can focus on that portion of the map that reflects what the values for these factors are in that state. And, because the mapping shows how the results vary as each of the factors varies, it indicates the sensitivity of the results to the values of the underlying factors.

A. Data

The study was based primarily on data from two sources:

79. Kentucky has long had, and New Jersey and Pennsylvania have recently adopted, variations on a choice plan. All three preserve tort claims above a threshold. For Kentucky's modest choice law, see Appendix I, l. 9. For a critique of the New Jersey and Pennsylvania laws, see O'Connell & Joost, *supra* note 51, at 949-51 & nn. 8-10. The effects of a choice plan, like those of any legal standard, are likely to evolve over time as the courts interpret and reinterpret the meaning of key words and phrases in the law and participants in the system—claims' managers and plaintiffs' and defense attorneys—learn how to use various aspects of the system to their advantage.

80. Note that people who are uninsured in either the traditional tort system or under the choice plan pay nothing either before or after the choice plan is adopted.

closed claim surveys⁸¹ and a household survey,⁸² both conducted by the Insurance Research Council (IRC), formerly named the All Industry Research Advisory Council (AIRAC). AIRAC obtained detailed information on a national sample of auto-accident injury claims closed during 1987 under the principal auto-injury coverages—BI, MedPay, UM, UIM, and PIP. The data were collected by thirty-four insurance companies that together accounted for about sixty percent of private-passenger automobile insurance by premium volume at the time the data were collected. Claims closed without payment were not included.

We weighted the observations in each closed-claim file by the inverse of the participating insurers' share of the private-passenger auto insurance market state by state. Assuming that the distribution of claims is proportional to the distribution of policies written and that the participating insurers are representative of auto insurers generally, the weighted sample for each state is representative of the aggregate distribution of paid auto-insurance claims in that state. We then merged the closed-claim files, adjusting for the probability that a claimant who received compensation under one auto insurance policy would have also received compensation from a collateral claim for the same injuries or losses against another auto insurance policy.⁸³

We used the IRC consumer-panel data to extend the database to accident victims who received no auto-insurance compensation. AIRAC provided data on the experiences of households in which someone had suffered an injury in an auto accident between October 1982 and March 1986.⁸⁴ We weighted the IRC consumer-panel observations according to their stratified sample design and the response rate within each stratum. We then extracted the observations for accident victims who received no compensation from any form of auto insurance and merged them with the closed-claim data. In merging the data, we adjusted the weights for the observations

81. For a description of the surveys, see *COMPENSATION FOR AUTOMOBILE INJURIES IN THE UNITED STATES* (All-Industry Research Advisory Council, Schamburg, Ill., 1989).

82. For a description of the survey, see *ATTORNEY INVOLVEMENT* (All-Industry Research Advisory Council, Dec. 1988).

83. For example, someone compensated under another driver's BI coverage might also be compensated under his or her own MedPay coverage. The models used to estimate these probabilities are presented in *CARROLL ET AL.*, *supra* note 3, App. C.

84. National Family Opinion, Inc. screened 200,000 households in a national panel to identify those in which a member had suffered an injury in an auto accident within the previous three years. A follow-up survey of households identified as having been involved in an injury-producing accident obtained detailed information on the accident and the amounts and sources of any resulting compensation.

drawn from the consumer-panel survey so that the final weighted database in the proportion of accident victims who received no compensation is the same as it was in the consumer panel survey.

The database encapsulates the accidents and resulting injuries and losses of a representative sample of people injured in auto accidents in states with the traditional tort system. It also encapsulates the compensation each person obtained from auto insurance, by coverage.

We combined data from several sources to estimate insurers' transaction costs. A. M. Best, Inc.,⁸⁵ provides nationwide ratios of total insurers' transaction costs to compensation (including both allocated and unallocated claim costs⁸⁶) for all lines of private-passenger auto liability insurance combined. The Insurance Services Office (ISO)⁸⁷ provided us with estimates of ratios of transaction costs to compensation, disaggregated by property damage versus personal injury coverages and by allocated versus unallocated transaction claim expenses. The ISO also provided us with data on average insurers' transaction costs and compensation paid on a very large national sample of claims, by line, for personal-injury auto-insurance coverages.

We adjusted the ISO ratios to match the A. M. Best national average data to estimate nationwide allocated-cost-to-compensation ratios and nationwide unallocated-cost-to-compensation ratios for auto personal-injury auto-insurance coverages, by line of insurance.

B. Compensation Costs Under the Tort System

We began by estimating the costs insurers incurred in compensating each person in the sample under the traditional tort system. We used actual compensation outcomes for reported claims. We developed a series of models to estimate the outcomes of claims for which actual compensation was not reported.⁸⁸ We applied the adjusted ratios of transactions costs to compensation, by coverage, to each person in the sample. The result was an estimate of the costs

85. BEST'S AGGREGATES AND AVERAGES: PROPERTY-CASUALTY (A.M. Best Co., 1989).

86. Allocated claim expense is defined as claim expense specifically allocated to an individual claim such as the expense and time of adjusters and lawyers to work on a given case. It is distinguished from unallocated claim expense which includes general overhead costs for such things as maintenance of the claims department, claim files, etc. Both are exclusive of other costs such as production expenses (sales commissions or other acquisition costs), taxes or expenses for policy writing, recordkeeping, etc.

87. Insurance Services Office, Industry-Wide Expense Experience Released—Personal Auto, Exh. 6, at 3 (Jan. 31, 1990) (circular).

88. See CARROLL ET AL., *supra* note 3, App. D, for details.

insurers incurred in compensating a representative sample of people injured in auto accidents under the traditional tort system. We aggregated these costs over all persons in the sample to estimate the total costs of compensation for the people included in the sample.

We assumed an insured motorist rate (a fraction composed of one minus the uninsured motorist rate) and divided the assumed rate into the estimate of total compensation costs. The result, if multiplied by the ratio of auto accident victims to drivers, was the amount insured drivers would have to be charged, on average, to recover the costs of compensating all accident victims eligible for payment under the traditional tort system and supplementary coverages thereunder.

C. *Compensation Costs Under the Choice Plan*

The next step was to estimate the compensation costs that would be incurred on behalf of drivers who opted for tort or for PIP under the choice plan. We assumed that the election of insurance status under the choice plan is independent of driver behavior—that is, there is no adverse selection in drivers' insurance choices and the election of an option does not affect the probabilities that a driver will be involved in an accident and incur or cause the resulting injuries and losses.⁸⁹ Accordingly, the accidents and resulting injuries and losses observed under the choice plan would be the same as those observed under the tort system. Our database thus represented what would be the distributions of accidents, injuries, and losses under the choice plan. We could estimate compensation costs under the choice plan by estimating the compensation that would have been provided each person in the sample had the choice plan been in effect when they were injured.

The amount and source of compensation provided someone injured in an auto accident under the choice plan depends on the insurance choices they, and each other person involved in the accident, made (or had made on her behalf). Accordingly, we estimated the compensation costs that would be borne by insurers on behalf of tort and PIP insureds, respectively, in four steps.

First, we computed the amount and "source" of compensation that would be provided each victim under each possible combina-

89. On the pros and cons of whether there will be adverse selection under a choice plan, see O'Connell & Joost, *supra* note 41, at 88 n.74; Jack L. Carr, *Giving Motorists A Choice Between Fault and No-Fault Insurance: An Economic Critique*, 26 SAN DIEGO L. REV. 1087, 1091-93 (1989).

tion of insurance choices. In this context, the term “source” refers to whether the purchaser of the policy under which the compensation is provided has elected tort or PIP coverage.

Second, we assumed rates at which persons who were either insured or uninsured, respectively, under the traditional tort system would shift to PIP coverage when that option was available to them.⁹⁰ Given those assumed rates, we estimated the probability that each possible combination of insurance choices would obtain.

Third, we computed expected compensation costs, by source, for the sample. We multiplied the compensation costs, by source, associated with each combination of choices multiplied by the probability of that combination. We then added up all possible combinations of choices and all victims in the sample. The results of this step were the total expected compensation costs incurred by insurers on behalf of tort insureds and total expected compensation costs incurred by insurers on behalf of PIP insureds.

Fourth, we divided the total expected compensation costs incurred on behalf of tort insureds by the assumed number of drivers who opted for tort coverage under the choice plan. (The number of tort insureds under the choice plan was obtained as the product of two assumed numbers: the number of insured drivers under the traditional tort system—that is, before adoption of the choice plan—and the rate at which tort insureds shift to PIP coverage under the choice plan.) The result, if multiplied by the ratio of auto accident victims to drivers, was the amount drivers who opted to remain in the tort system under the choice plan would have to be charged, on average, to recover the compensation costs insurers incurred in compensating accident victims on their behalf.

Fifth, we computed the relative savings in compensation costs per driver, on average, for drivers who remained in the tort system under choice. That is, we computed the percent changes in compensation costs per driver, on average, for the drivers who opted to remain under tort in the choice plan compared to average compensation costs per driver for the same drivers under the tort system.

90. Persons who purchased BI insurance under the traditional tort system clearly prefer third-party coverage to being uninsured. There is no reason to believe that the availability of PIP coverage would reverse that preference. Hence, we could assume that persons insured under the traditional tort system would either opt to remain under tort or elect PIP coverage under the choice plan. Similarly, people uninsured under the traditional tort system have demonstrated a preference for being uninsured rather than purchasing third-party tort liability coverage. Hence, we could assume that motorists uninsured under the traditional tort system would either continue to be uninsured or elect PIP under the choice plan. *But see supra* text following note 67.

The result was the percentage changes in what insurers would have to charge the average driver who elects to remain in tort under the choice plan to recover their compensation costs relative to what they would have had to charge her under the tort system. If insurance premiums are correlated with insurers' compensation costs,⁹¹ this ratio shows whatever savings the average driver who elects tort under the choice plan would realize relative to what that same driver had to pay under the traditional tort system.

Sixth, we repeated steps four and five for PIP insureds under the choice plan. That is, we divided the total expected compensation costs incurred on behalf of PIP insureds by the assumed number of drivers who opted for PIP coverage under the choice plan to estimate the amount insurers would have to charge drivers who opted for PIP coverage under the choice plan, on average, to recover the compensation costs incurred in compensating accident victims on their behalf. We compared these estimates to what insurers would have had to charge the same drivers to recover compensation costs incurred on their behalf under the traditional tort system. The result was the relative savings on compensation costs incurred on behalf of the average driver who elected PIP coverage under the choice plan. If insurance premiums are correlated with insurers' compensation costs, this ratio shows the costs of the choice plan to the average driver who elects PIP relative to what that same driver had to pay under the traditional tort system.

SURREBUTTAL

JEFFREY O'CONNELL & MICHAEL HOROWITZ⁹²

There is neither time nor space to reply extensively to Professor Arlen's ambitious condemnation of our proposal to substitute a system whereby motorists can opt out of tort law for auto accidents, with its fault-finding and payment for non-economic loss, in return for automatic payment for economic loss alone. But let us make a few points.

Professor Arlen backs herself into the rather curious position—especially for an economist—of opposing changes in automobile insurance that will reduce costs. She does so on the ground that even

91. See *supra* text accompanying note 53.

92. We undertake this reply alone, relieving our co-authors from RAND of any obligation to defend a proposal they explicitly neither endorse nor oppose.

the present system—for all its legendary expense—does not sufficiently internalize auto accident costs.

. . . [R]eplacing negligence liability with . . . no-fault liability would lead to greater activity levels because it would lower insurance premiums: both the number of motorists and the frequency each motorist drives could be expected to increase. Given that under negligence liability activity levels are [already] too high, the increase in activity levels brought about by replacing negligence liability with [the proposed new] . . . system would clearly be undesirable.⁹³

But in fact the high costs of auto insurance that Professor Arlen extols as promoting internalization (though still not high enough by her reckoning) also promote gross, unfair (and *deeply* resented) externalities. Tort liability costs today are so great that millions of poor and relatively impecunious motorists cannot afford *any* automobile insurance.⁹⁴ In addition, with few or no assets to protect, their decision to go uninsured under tort liability makes eminently good economic sense. Facing large unmet needs for essentials for themselves and their families, why should they annually spend hundreds of dollars—indeed often in the range of \$1000 or more in urban areas—to buy an arcane piece of paper providing highly contingent payment to strangers far in the future? Admittedly, uninsured motorists violate state laws requiring liability insurance, so one might urge that a solution here is better law enforcement to “get the uninsured off the road.” Professor Arlen has herself effectively provided the rebuttal to that solution: criminal laws regulating the conduct of motorists, she assures us, are not—and cannot be⁹⁵—adequately enforced. “[D]espite stringent drunk driving laws,” she tells us, “Georgia has tens of thousands of repeat offenders, and . . . judges do not take away drivers’ licenses even when a driver has 15 drunk-driving convictions.”⁹⁶ If those charged with law enforcement ignore egregious conduct such as chronic drunk driving, they certainly won’t—and don’t—punish the relatively in-

93. Jennifer H. Arlen, *Compensation Systems and Efficient Deterrence*, 52 MD. L. REV. 1093 (1993).

94. The percentage of uninsured motorists vastly exceeds 50% in the inner cities of many major metropolitan areas. S.F. CHRON., Oct. 4, 1989, at A9; L.A. TIMES, Nov. 23, 1986, at 1. Professor Arlen acknowledges the problem, see Arlen, *supra* note 93, at 71, but offers no solution.

95. See generally, Arlen, *supra* note 93.

96. *Id.* at 79.

nocuous offense of driving without insurance.⁹⁷ But that brings us back to the externality of the present system, which has millions in ever-increasing numbers paying nothing into the insurance pool, while retaining their rights to claim from it. Professor Arlen complains that our proposal will allow motorists to escape from internalizing non-economic losses, while herself failing to deal with the huge numbers of people who, given the costs and structure of the present system that she defends, pay for *neither* economic nor non-economic losses.

At least under the choice system, those who opt out of the tort system lose their right to be paid for non-economic damages, which ought to internalize more of their losses and thus, under an economist's view, have a deterrent effect. Similarly, those who are uninsured will internalize more costs in that they are precluded from collecting for non-economic losses in their tort claims against PIP insureds. A deeply disturbing system, based on Professor Arlen's own criteria, would seem to be the one she defends—one which, by its very high costs and third-party structure, induces more and more motorists to escape *any* contribution to accident compensation while nonetheless making claims therefor.

On a broader scale, a basic difficulty with Professor Arlen's piece—a difficulty plaguing much economics-and-law as it applies to the law of torts—is the assumption that courts, in deciding who ought to pay whom and how much after accidents, get it right—or at least more right than alternative schemes such as we have proposed. (In her appendix, Professor Arlen purports to buttress her thesis by hypothesizing that “Both individuals and courts . . . possess perfect information which is costlessly obtained. Litigation and settlement costs are assumed to be zero. As in the current system, it is assumed that damages are paid only if an individual suffers a physical injury and that people with identical injuries collect identical damages.”⁹⁸) As economist David Friedman tells us, the model on which most economic analysis of accident law is premised is one in which, pursuant to Professor Arlen's assumptions above, courts can make and enforce decisions, both as to levels of care and activity, relatively effortlessly and accurately. But as Friedman stated, “When we drop these assumptions, efficiency goes with them. So does most of the

97. Steven L. Myers, *Suspensions Don't Slow Drivers: Repeat Traffic Offenders Who Ignore Summonses*, N.Y. TIMES, Apr. 25, 1993, at 43.

98. Arlen, *supra* note 93, App.

existing [economic] theory of accident law.”⁹⁹ Friedman is very pessimistic about how much help law-and-economics can provide accident law as long as it extrapolates from such assumptions.¹⁰⁰ It would be helpful to have Professor Arlen’s further response to the writings of economist-lawyer Gordon Tullock who has emphasized how very costly and wasteful is tort law as applied to personal injury in light of (a) its expensive and manipulative adversarial attempts to prove or disprove defendant and claimant fault, (b) its likelihood of erroneous determinations of fault, and (c) its failure to redistribute many essential losses. Tullock goes further and criticizes how legal-economic analysis generally fails to recognize the beneficial—and indeed economically efficient—results flowing from reforms that eliminate payment for non-economic losses in return for automatic payment of economic losses.¹⁰¹

99. David Friedman, *Book Review*, 97 J. POL. ECON. 497, 499-500 (1987). David is Milton Friedman’s son.

100. *Id.* at 500; see Jeffrey O’Connell, *Two Tier Tort Law: Neo No-Fault & Quasi Criminal Liability*, 27 WAKE FOREST L. REV. 871, 872-76 (1992).

101. Gordon Tullock, *Negligence Again*, 1 INT’L REV. L. & ECON. 52 (1981); *Welfare and Law*, 2 INT’L REV. L. & ECON. 151 (1982).