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NEWS BACKGROUNDER

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Center for Justice & Democracy Response to AIA Attack on *Premium Deceit: The Failure of "Tort Reform" to Cut Insurance Prices*

Sometime in March 2002, the American Insurance Association (AIA) published a "critique" of the Center for Justice & Democracy's 1999 study *Premium Deceit: The Failure of "Tort Reform" to Cut Insurance Prices*, co-authored by J. Robert Hunter and Joanne Doroshow. The study was conducted to test the effectiveness of "tort reform," which a majority of states enacted to bring down insurance rates in response to a severe liability insurance crisis in the mid-1980s. *Premium Deceit* examined rate activity in every state since that time. It found there to be no correlation between the enactment of tort restrictions and insurance rates. States with little or no tort law restrictions experienced the same level of insurance rate increases as those states that enacted severe restrictions on victims' rights.

Premium Deceit's* conclusions are fairly simple and consistent with many other studies of insurance rate activity, all described in *Premium Deceit. For example, the Ad Hoc Insurance Committee of the National Association of Attorneys General concluded after studying the last "crisis" in 1986,

> The facts do not bear out the allegations of an "explosion" in litigation or in claim size, nor do they bear out the allegations of a financial disaster suffered by property/casualty insurers today. They finally do not support any correlation between the current crisis in availability and affordability of insurance and such a litigation "explosion." The available data indicate that the causes of, and therefore solutions to, the current crisis lie with the insurance industry itself.

These prior studies consistently found that the severe liability insurance crisis of the mid-1980s, which led many states to enact "tort reform," was caused not by legal system excesses but by the economic cycle of the insurance industry. Large rate increases and cut backs in coverage characterized insurance rates in all states in the mid-1980s. By the late 1980s, the insurance cycle turned again and prices began to fall everywhere. The nation enjoyed a relatively "soft" insurance market for over a decade, with rates of liability insurance not only stable but also down in some years. That is until now, as the market once again is turning "hard."

AIA's critique, which took the organization three years to produce, is a flimsy response to *Premium Deceit's* exhaustive analysis of 14 years of rate activity in every state. Moreover, it actually says very little that conflicts with *Premium Deceit's* conclusions. AIA makes no state-by-state comparisons. The trends it discusses are national in scope, merely confirming *Premium Deceit's* point: that interest rates and the economy drive rate increases and decreases, irrespective of tort limits imposed in a particular state. Just as the liability insurance crisis was found to be driven by the insurance underwriting cycle and not a tort law cost explosion as many insurance companies and others had claimed, the "tort reform" remedy pushed by these advocates has failed.

AIA's lead point is not a criticism at all, but rather, validates *Premium Deceit's* findings. AIA boldly states, "The insurance industry never promised that tort reform would achieve specific premium savings, but rather focused consistently on the benefits of fairness and predictability." Anyone following the current medical malpractice debate knows that "premium savings" is the precise reason lawmakers are considering enactment of "tort reform," as they have during prior liability insurance "crises." This is not only well-documented in *Premium Deceit*, it is obvious to just about everyone besides AIA. As recently as March 19, 2002, Pennsylvania Governor Mark Schweiker announced that he would be signing tort reform legislation in Pennsylvania stating that it will "save doctors as much as 20 percent on insurance premiums." AIA's face-saving pronouncement is just another way of saying that the industry did not cut, and has no plans to cut, premiums as a consequence of enacting restrictions on victims' rights, exactly the point of *Premium Deceit.*

AIA completely ignores the insurance industry's response to the well-established economic cycle, exaggerated by repeated pricing errors, as the cause of current rate increases. It is not a matter of debate that the insurance industry's profits and underwriting practices are cyclical, often characterized by sharp ups and downs, with rates up 100% or more in a short period of a year or two followed by flat to down prices over the next decade or so. This phenomenon is precisely documented in *Premium Deceit* and not addressed at all by AIA.

> Insurers make their money from investment income. During years of high interest rates and/or excellent insurer profits, insurance companies engage in fierce competition for premiums dollars to invest for maximum return. Insurers engage in severe underpricing and insure very poor risks just to get premium dollars to invest. But when investment income decreases because interest rates drop or the stock market plummets or the cumulative price cuts make profits become unbearably low, the industry responds by sharply increasing premiums and reducing coverage, creating a "liability insurance crisis." A crisis happened in the mid-1970s, precipitating the first wave of "tort reform" in medical malpractice insurance and product liability insurance, particularly. A more severe crisis took place in the mid-1980s, when most liability insurance was impacted. Again, in 2002, the country is experiencing what has become known as the "hard market" part of the cycle, this time impacting property as well as liability coverages with some lines of insurance seeing rates going up 100% or more.

> Each time this happens, the insurance industry tries to cover up these pricing errors by blaming lawyers and the legal system for the liability insurance price jump.

It is completely absurd to blame lawsuits and lawyers. AIA says that the stable insurance market the county has experienced for the last 15 years "has only recently come to an end, in part due to increasing litigation pressure by an aggressive trial bar."

> Under this theory, one would have to believe that trial lawyers have timed their "aggression" to precisely coincide with the insurance industry's economic cycle, so that the aggression impacts just when the market turns hard. Thus, to buy AIA's position, one would have to accept the notion that lawyers were aggressive in the mid 1970s, then non-aggressive for a decade, then aggressive in the mid-1980s, non-aggressive for 17 years and are now aggressive again. This is ludicrous on its face. There is absolutely no empirical evidence to support such a finding (even on a national basis), which is why AIA provides no support for this.
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> Tort suit filings in state courts, where most are filed, have dropped 18 percent since 1996. Since 1990, there has been essentially no change in the number of tort cases filed. *Examining the Work of State Courts, 1999-2000; A National Perspective from the Court Statistics Project* (2001), p. 25. Moreover, taking a look at what insurance companies actually pay out in the medical malpractice lines, for example (as opposed to sensationalized verdicts that get headlines and are rarely paid in full), average payouts have stayed virtually flat for the last decade. Between 1991 and 1998, med mal payouts average only around $30,000 per claim. Letter from J. Robert Hunter to Joanne Doroshow (October 13, 2001)
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> In addition, if tort costs were the cause of rate increases, we should see a steady increase in rates rather than gyrations evident in AIA's own Table 1 (p.3) This table of A.M Best data clearly shows the national cycle at work, with premiums stabilizing for 15 years following the mid-1980s crisis. It also clearly shows that there was no tort "crisis" in this country from 1986 to 2000. It makes absolutely no sense to assert that the underlying tort system and the behavior of the trial bar has suddenly changed in 2001/2002 to create a "crisis."

Insurance Services Office (ISO) data are precisely what must be examined to evaluate the impact of tort limits. AIA is wrong to suggest that ISO data is "too limited, leading to erroneous conclusions." ISO data examined in *Premium Deceit* are loss costs. They are the actual losses examined on a common basis and are the purest data to chronicle losses as a result of the legal system. They show what the underlying tort system does to claims. The "myriad of factors" listed by AIA, like deductibles exclusions, endorsements, etc., have nothing to do with the tort system. These things are decided by policyholders, not by the tort system or trial lawyers considering whether to pursue lawsuits.

Premium Deceit's **analysis of state-by-state "tort reforms" reflects the industry's own classifications.** In deciding which tort limits to evaluate in *Premium Deceit,* the authors looked at the package of proposals that "tort reform" groups present to lawmakers. In lobbying for such bills, these groups do not argue that enacting one "tort reform" will bring down rates and another will not. They state the need for all of them. We took them at their word. Courts do not "erode" these laws; they find them unconstitutional. As we made clear in *Premium Deceit*, if a court did so, we took that into account.

AIA illogically asserts that if "tort reform" has not reduced claims costs and premiums, it is because other factors are responsible for keeping costs and premiums high. For example, they argue that fraud, medical inflation, expenses, taxes, "trial lawyer efforts" or differences in juries can drive up premiums as well. According to this logic, these factors would somehow need to rise faster, or be more powerful, in states *with* major "tort reform" in order to offset those savings. This makes no sense. The opposite should be true, according to AIA's own argument. There is certainly no reason to believe, and none presented, that any of these factors would be greater in states with more tort restrictions.

There are many reasons why "tort reform" is a failed policy in addition to its failure to improve the affordability of liability insurance. This discussion is beyond the scope of *Premium Deceit.* However, to respond to a few AIA points about the costs of the tort system and its impact on innovation and competitiveness:

> **Ernst & Young and the Risk & Insurance Management Society's annual survey of business liability costs recently found such costs to be miniscule and *the lowest in over a decade.*** In fact, the study, which calculates annual insurance and claims costs for U.S. businesses, including property damage, workers compensation and all other liability and lawsuit costs, found liability costs to be in steep decline only $4.83 for every $1000 in revenue in 2000! *2001 RIMS Benchmark Survey*, produced jointly by Ernst & Young LLP and RIMS (2002).
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> **Proposals to limit public access to the civil justice system do not eliminate injuries or the need for compensation; they merely shift the costs away from the wrongdoer onto someone else.** If someone is brain damaged, burned or rendered paraplegic as a result of the misconduct of another but cannot obtain compensation from the culpable party, he or she may be forced to turn to taxpayer-funded health and disability programs. This causes significant new burdens on taxpayers. Moreover, the amount of money saved as a direct result of the deterrence function of lawsuits — injuries prevented, health care costs not expended, wages not lost, etc. — is incalculable. Some have estimated this savings to be perhaps a trillion dollars a year.
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> **The United States is the most competitive nation in the world and companies with high liability exposure are having great success innovating and competing in world markets.** In its 1998 report, the Institute for Management Development in Switzerland, which each year publishes a report on international competitiveness, found that the United States is the world's most competitive economy, almost 20 percent above its closest competitor, Singapore. If the civil justice system were significantly harming U.S. innovation and competitiveness, companies in sectors with high liability exposure would be having a difficult time developing new products or succeeding in markets worldwide.

> But evidence suggests otherwise. Take a pharmaceutical company like Pfizer, for example. According to a 1991 report, “Pfizer’s marketplace victories ultimately stem from massive research investments. Over the past decade, even when its stock price and profit margins were under siege, the firm poured $3.5 billion into new product development.… Two years ago, new products accounted for just 13 percent of sales; today that figure is up to 42 percent, and by the mid-1990s it is expected to reach 50 percent.” Pomice, Eva, “The Toughest Companies in America,” *U.S. News & World Report*, October 28, 1991
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> **Liability laws are not negatively affecting the competitiveness or economics of individual U.S. businesses.** In its 1990 study of U.S. manufacturing competitiveness, Congress' Office of Technology Assessment found that the greatest influences on U.S. competitiveness were capital costs, the quality of human resources, technology transfer and technology difficulties. Liability laws were not even mentioned as a factor. The business-backed Conference Board stated affirmatively in its 1987 report that product liability laws do not have significant adverse effects on competitiveness. It found that for more than two-thirds of the companies surveyed in their study, liability costs amounted to less than 1 percent of total costs. The Conference Board concluded, “For the major corporations surveyed, the pressures of product liability have hardly affected larger economic issues, such as revenues, market share or employee retention.… Product liability and insurance availability have left a relatively minor dent on the economics and organization of individual firms, or on big business as a whole.”
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> Moreover, the Board found, “Where product liability has had a notable impact — where it has most significantly affected management decision-making — has been in the quality of the products themselves. Managers say products have become safer, manufacturing procedures have been improved, and labels and use instructions have become more explicit.” Weber, Nathan, *Product Liability: The Corporate Response, Research Report #893*, The Conference Board (1987).

Other studies. To challenge *Premium Deceit’s* methodology on the basis of a study whose own authors admit suffers from “serious methodological flaws” is disingenuous, as best. Yet AIA does just that by citing a 1993 Office of Technology Assessment report (published six years before *Premium Deceit*), in which the authors state:

> Our review demonstrates that empirical evidence regarding the impact of state tort reform on the malpractice cost indicators is quite limited. We focused on six studies …All of these studies had serious methodological flaws.

Another study cited by AIA was conducted by Mark J. Browne and Robert Puelz. CJ&D does not know this study, but it does know that both authors consult for the insurance industry, raising obvious credibility issues. See, e.g., http://www.mackinac.org/bio.asp?ID=57; http://faculty.cox.smu.edu/rpuelz.html

The point is that no other study goes nearly as far as *Premium Deceit* to examine the impact of “tort reform” on costs and rates.