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HB 222

Premium Deceit
The Failure of the "Tort Reform" to Cut Insurance Prices
Center for Justice & Democracy
By: J. Robert Hunter and Joanne Doroshow

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HB 232

PREMIUM DECEIT

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CENTER FOR JUSTICE & DEMOCRACY
CJ&D

BY J. ROBERT HUNTER AND JOANNE DOROSHOW

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PREMIUM DECEIT --The Failure of "Tort Reform" to Cut Insurance Prices
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PREMIUM DECEIT

THE FAILURE OF "TORT REFORM" TO CUT INSURANCE PRICES

EXECUTIVE SUMMARY

From the mid-1980s until today, the nation's largest businesses have been advancing a legislative agenda to limit their liability for causing injuries. One of the principal arguments on which they rely is that laws that make it more difficult for injured people to go to court (i.e., "tort reform") will reduce insurance rates. This report analyzes these claims, and concludes they are invalid.

The "tort reform" movement largely originated in the mid-1980's while the nation was suffering through a severe "liability insurance crisis."[1] Small businesses, doctors, non-profit groups and others were hit with dramatic increases in insurance premiums, reduced coverage and arbitrary policy cancellations. The situation received extensive media attention, such as *Time Magazine's* 1986 cover story entitled, "Sorry, Your Policy is Cancelled."[2]

The insurance industry and other large corporations blamed the crisis on the legal system and lobbied extensively for what they called "tort reform" – laws that restrict the rights of injured consumers to sue and obtain compensation from corporate lawbreakers and other wrongdoers. They claimed that enactment of "tort reform" would cause insurance rates to stabilize and even fall.

Great pressure was brought to bear on state legislatures around the country to restrict the rights of innocent victims to recover for their injuries and to hold wrongdoers accountable in court. Many states succumbed to this pressure and passed "tort reforms." Moreover, states have continued to adopt these laws. As recently as the spring of 1999, Florida passed an extensive "tort reform" package. And some New York lawmakers are considering a similarly broad proposal.

This study – the most extensive review of insurance rate activity in the wake of the liability insurance crisis ever undertaken – was designed to test the impact on liability

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[1] On January 17, 1986, a number of business, professional and insurance trade organizations announced the formation of the American Tort Reform Association (ATRA).

[2] George J. Church., "Sorry, Your Policy Is Canceled," *Time Magazine*, March 24, 1986.

insurance rates of "tort reforms," specifically those that were passed by state legislators (or voters by ballot initiative) in reaction to the liability insurance crisis of the mid-1980s, and in the years since.

We obtained data on insurance rate and loss cost movement in every state from 1985 through 1998.[3] We then segregated the states into three categories: states that enacted the fewest number of tort law changes over the period; states that passed a mid-range level of tort law limits; and states that enacted the most "tort reform."

The hypothesis we tested was simple: if tort law limits succeed in reducing insurance costs for consumers of insurance, that should be evident in the trends of insurance costs. As tort law limits get more severe, the trends in rates and underlying loss costs should be less.

We tested this hypothesis for the lines of insurance subject to general tort reform and to product liability and medical malpractice separately, since states often enact separate tort law restrictions to be applied just in those areas.

We found that the trends in rates/loss costs do not support the hypothesis that "tort reform" has succeeded in holding down insurance costs or rates. Despite what "tort reform" proponents promised lawmakers, tort law limits enacted since the liability insurance crisis of the mid-1980s have not lowered insurance rates in the ensuing years. States with little or no tort law restrictions have experienced the same level of insurance rates as those states that enacted severe restrictions on victims' rights.

The "liability insurance crisis" of the mid-1980s was ultimately found to be caused not by legal system excesses but by the economic cycle of the insurance industry. Given large rate increases and cut backs in coverage, the insurance cycle soon turned again and prices began to fall. The nation has enjoyed a relatively "soft" insurance market for over a decade now – with rates of liability insurance not only stable but down.

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 failed. As the findings of this report confirm, legal system restrictions are based upon a false predicate. "Tort reforms" do not produce lower insurance costs or rates.

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[3] "Loss cost" is the term for the portion of each premium dollar taken in, that insurance companies use to pay for claims and for the adjustment of claims. Insurers use other parts of the premium dollar to pay for: their profit, commissions, other acquisition expenses, general expenses and taxes. Loss costs represent the largest part of the premium dollar for most lines of insurance.

BACKGROUND

THE "LIABILITY INSURANCE CRISIS" OF THE MID-1980S AND ITS PROGENY

From 1985 through the late 1980s, manufacturers, municipalities, doctors, nurse-midwives, day-care centers, non-profit groups and many other commercial customers of liability insurance, found themselves in the midst of a "crisis." Insurance rates were skyrocketing, up 300 percent or more for some. Many could not find coverage at any price.

Insurance companies said that their costs were being driven up by a so-called "explosion" in litigation, claiming "frivolous lawsuits" and "out of control" juries were suddenly forcing insurers to make insurance unaffordable and sometimes unavailable. They told state legislatures around the country that the only way to ease this crisis was to limit "tort" or liability laws, to make it more difficult for sick and injured consumers to sue and be compensated by wrongdoers in court (also known as "tort reform").

In 1986 alone – the year of the American Tort Reform Association's founding -- 41 states passed legislation to limit the liability of wrongdoers, restrict the amount of monetary damages injured consumers could receive in court, or make it more difficult for the injured to obtain attorneys to represent them against insurance companies. In a few states, legislatures enacted across-the-board tort law limits, overturning years of common law that for generations had afforded harmed citizens the right to challenge corporate wrongdoing in court.

For the most part, these new "tort limits" have remained on the books. Moreover, in every year since, states have enacted additional "tort reforms," based on the same rationale first advanced in the mid-1980s -- that restricting victims' rights will lead to more affordable liability insurance rates. (See Appendix A for list of "tort reforms" enacted in each state since 1985.)

But what ultimately proved to be the true cause of the "liability insurance crisis" of the mid-1980s was not the legal system at all. Study after study that examined the property/casualty insurance industry found that the "insurance crisis" was actually a self-inflicted phenomenon caused by the mismanaged underwriting practices of the industry itself.

The insurance industry's profits and underwriting practices are cyclical, often characterized by sharp ups and downs. In fact, these underwriting practices and the insurance cycle caused a similar, less severe "insurance crisis" in the mid-1970s. 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 lower prices and insure very poor risks just to get the premium dollars. In the mid-1980s, the cycle's effects were exacerbated by a particularly exaggerated underwriting response to the high interest rates of the early 1980s, characterized by such risky underwriting as insuring the MGM Grand Hotel months *after it burned down in a fire*.[4]

By 1985 when interest rates had dropped and investment income had decreased accordingly, the industry responded by sharply increasing premiums and reducing availability of coverage, creating a "liability insurance crisis."

As *Business Week* magazine explained a January, 1987 editorial:

> Even while the industry was blaming its troubles on the tort system, many experts pointed out that its problems were largely self-made. In previous years the industry had slashed prices competitively to the point that it incurred enormous losses. That, rather than excessive jury awards, explained most of the industry's financial difficulties.[5]

The Ad Hoc Insurance Committee of the National Association of Attorneys General concluded after studying the "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." Instead, the available data indicate that the causes of, and therefore solutions to, the current crisis lie with the insurance industry itself.[6]

State commissions in New Mexico, Michigan and Pennsylvania reached similar conclusions.[7] Even the insurance industry admitted this internally. In 1986, Maurice R. Greenberg, President and Chief Executive Officer of American International Group, Inc., one of the country's leading property/casualty companies, told an insurance audience in Boston that the industry's problems were due to price cuts taken "to the point of absurdity" in the early 1980s. Had it not been for these cuts, Greenberg said, there would not be 'all this hullabaloo' about the tort system."[8]

But to the public and to lawmakers, insurers told a different story. In fact, coming out of their bottom year of 1984, insurance companies began a "massive effort to market

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[4] One actuary at this time was quoted as saying "we don't need premiums anymore," relying instead on tax credits coupled with high interest rates.

[5] "What Insurance Crisis?," *Business Week*, January 12, 1987, p. 154.

[6] Francis X. Bellotti, Attorney General of Massachusetts, et al., *Analysis of the Causes of the Current Crisis of Unavailability and Unaffordability of Liability Insurance* (Boston, Mass.: Ad Hoc Insurance Committee of the National Association of Attorneys General, May, 1986).

[7] See, e.g., New Mexico State Legislature, *Report of the Interim Legislative Workmen's Compensation Comm. on Liability Insurance and Tort Reform*, November 12, 1986; Michigan House of Representatives, *Study of the Profitability of Commercial Liability Insurance*, November 10, 1986; Insurance Comm. Pennsylvania House of Representatives, *Liability Insurance Crisis in Pennsylvania*, September 29, 1986.

[8] Greewald, "Insurers Must Share Blame: AIG Head," *Business Insurance*, March 31 1986, p. 3.

the idea that there is something wrong with the civil justice system."[9] The goal, in the words of one of the industry's leading spokespersons, GEICO's chairman John J. Byrne, was "to withdraw [from the market] and let the pressure for reform build in the courts and in the state legislatures."[10] Evidence gathered by over a dozen state attorneys general for an antitrust class action filed in 1988, and settled in 1995, found that a number of insurance companies actually conspired to create this insurance crisis by restricting coverage to commercial customers and raising prices, creating an atmosphere intended to coax states into enacting "tort reform."[11]

To support this effort, the Insurance Information Institute purchased $6.5 million worth of print and television ads in 1986, designed to reach 90 percent of all U.S. adults, in order "to change the widely held perception that there is an 'insurance crisis' to a perception of a 'lawsuit crisis.'"[12] The ads targeted groups that were having difficulty obtaining affordable insurance. Headlines read, *The Lawsuit Crisis is Bad for Babies, The Lawsuit Crisis is Penalizing School Sports* and *Even Clergy Can't Escape the Lawsuit Crisis,* and they appeared in *Readers' Digest, Time* and *Newsweek*, as well as in Sunday magazine supplements.[13] In 1986, after Congressman John J. LaFalce (D-N.Y.) asked the Insurance Information Institute to submit information to Congress to back up the "clergy" ads, he stated:

> The information they gave us would lead us to conclude that there are only about a dozen of these religious malpractice cases pending throughout the country, and that the only one that has gone to trial was dismissed in favor of the defendant. In other words, ... at the time these ads were run, the insurance industry had not yet paid out one cent pursuant to any court judgment in any of these cases. Yet, they form an integral part of its national advertising campaign.[14]

Insurance companies and other insurance trade associations complemented the Insurance Information Institute campaign with their own ads. For example

- Johnson & Higgins ran several ads in 1985 and 1986. One that appeared in the *Wall Street Journal* on November 19, 1985, stated, "the mounting wave of losses, which last year cost insurers more than $116 for every $100 of premium taken in, has forced insurers to act defensively. Most have stopped offering pollution insurance entirely

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[9] *National Underwriter,* December 21, 1984, p. 2.

[10] *Journal of Commerce,* June 18, 1985, p. 10A.

[11] *In re Insurance Antitrust Litigation*, MDL No. 767, No. C 88 1688 [CAL], N.D. Calif.); "Final Approval Given To Insurance Antitrust Settlement," *Mealey's Litigation Reports,* April 18, 1995.

[12] Herbert, "$6.5 Million In Ads Targets Lawsuit Crisis," *Journal of Commerce*, March 19, 1986, p. 1.

[13] *Ibid.*

[14] *The Liability Insurance Crisis, Hearings before the Subcomm. on Economic Stabilization of the Comm. on Banking, Finance and Urban Affairs*, House of Representatives, 99th Cong., 2d. Sess., Part 1, July 23, 1986, p. 2.