THE AUTO CHOICE REFORM ACT OF 1997

HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCE AND HAZARDOUS MATERIALS

OF THE

COMMITTEE ON COMMERCE HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTH CONGRESS

SECOND SESSION

ON

H.R. 2021

MAY 20, 1998

Serial No. 105–86

Printed for the use of the Committee on Commerce

U.S. GOVERNMENT PRINTING OFFICE
55CC WASHINGTON : 1998

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-057137-5

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WEDNESDAY, MAY 20, 1998

HOUSE OF REPRESENTATIVES,
COMMITTEE ON COMMERCE,
SUBCOMMITTEE ON FINANCE AND HAZARDOUS MATERIALS,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2123, Rayburn House Office Building, Hon. Michael G. Oxley (chairman) presiding.

Members present: Representatives Oxley, Gillmor, Deal, Largent, Bilbray, White, Lazio, Cubin, Bliley (ex officio), Manton, Stupak, Sawyer, DeGette, and Pallone.

Staff present: Robert Gordon, majority counsel; John LePore, majority counsel; Mike Flood, legislative clerk; Bruce Gwinn, minority counsel; and Chris Knauer, minority professional staff member.

Mr. OXLEY. The subcommittee will come to order. The Chairman would like to welcome our two panels of witnesses who have joined us today to discuss H.R. 2021, the Auto Choice Reform Act of 1997, and particularly welcome our panel of Members, and we will introduce you formally at the end of the opening statements.

From 1987 to 1994, the average cost to the American family for automobile insurance rose by 44 percent. By 1995, these costs had skyrocketed to $757 per policy, with much higher rates being charged to urban drivers. These outrageous premiums charged to consumers have two direct causes, increased fraud and attorneys' fees.

FBI Director Louis Freeh estimates that the typical American household is burdened by $200 in premium surcharges to make up for fraudulent claims. A 1995 RAND study estimated that 35 to 42 percent of automobile insurance claims filed were excessive, resulting in a total bill to consumers of some $13 to $18 billion. Americans cannot afford this level of fraud.

Attorneys' fees eat up another $17 billion annually. According to the California Department of Insurance, 40 cents out of every premium dollar paid for bodily injury and uninsured motorist coverage goes to attorneys. Our current system works well for compensating lawyers, but not for compensating consumers. In fact, while attorneys typically take away up to a third of a victim's coverage for injuries, those victims with economic damages in excess of $100,000 collect on average less than 9 percent of such losses. That is simply wrong.

The members of the first panel have authored legislation to address these problems. H.R. 2021 allows consumers to choose between their current system of insurance coverage or a new personal

protection insurance alternative. This new PPI option allows consumers to choose their own level of coverage for damages, regardless of who is at fault in an accident, with lower rates and quicker compensation expected in return for an end to noneconomic pain and suffering claims.

On the second panel, we are pleased to welcome two gentlemen from Texas who were involved in a large-scale automobile insurance fraud ring. Mr. Blizzard is a local prosecutor who brought down the crime ring, and Mr. Taormino is an actual insider in the fraud ring who is now cooperating with the law enforcement personnel to help us better understand how fraud is undermining the soundness of our insurance protection system.

We also have four seasoned experts on no-fault insurance for the second panel. Peter Kinzler is the president of the Coalition for Auto Insurance Reform, and as a former Hill staffer will not only tell us how H.R. 2021 reduces the significant fraud incentives in the current system, but he will also educate as to the political history of this legislation.

Mr. Rosenfield has opposed no-fault insurance reforms in California and will enlighten us regarding the dangers of no-fault insurance and why some of the claims of its proponents should be viewed with a certain degree of skepticism.

Mr. Gladstone will give us the attorneys' perspective and discuss the alternative solutions in the traditional tort arena for reducing insurance fraud and excessive attorneys' fees.

Mr. O'Connell is the original inventor of no-fault automobile insurance, and he will explain for us the substantive evolution of no-fault insurance, and the experience of the States in reforming their insurance systems.

That ends the Chair's opening statement. I now turn to the ranking member, the gentleman from New York, Mr. Manton.

Mr. MANTON. Thank you, Mr. Chairman. You have to bear with me. I don't have much of my voice left. I don't know if it is the pollen season here in Washington.

Thank you for holding this hearing and giving us an opportunity to learn more about Majority Leader Armey's Auto Choice Reform Act legislation. The idea of providing consumers with the option of purchasing no-fault insurance is an interesting one, and I look forward to learning more about how it will work in practice.

This legislation seeks to reform the auto insurance system in order to lower premiums, speed up the processing of claims, and reduce incentive for fraud, all very worthy goals that I fully support. I hope that we spend adequate time looking closely at this proposal so that we thoroughly understand the full implications of such a change.

One of my initial concerns with this legislation is the fact that it federally preempts State laws dealing with motor vehicle insurance. After spending the last year working on H.R. 10 and working hard to preserve States' rights to regulate the business of insurance, we all understand the importance of allowing States the ability to oversee their insurance companies and the marketplace.

My feeling is that while a no-fault system may work well in some States, it is still unclear whether such a model will work well in all 50. This legislation would automatically convert all States to a

no-fault system. Right now any State already has the option to enact such a law if they choose. In light of the fact that some States have variations of the no-fault system, although nothing like the pure no-fault system proposed by H.R. 2021, it would be most helpful to look at their experience on the State level and see how successful their systems are in practice before deciding to go to a national system.

I am also interested to hear more about the cost savings this legislation will bring about for consumers. I have heard quotes that this bill could save as much as $193 billion over 5 years, and I am curious to learn more about how such calculations are made and who is likely to benefit.

As a Member representing an urban district in New York City, I am receptive to all ideas on how we can facilitate the lowering of car insurance costs for consumers. In doing so we should not eliminate the rights of injured parties to receive full and just compensation when they suffer serious injury.

Thank you for holding this hearing and giving us a chance to hear from our esteemed colleagues, Senator Mitch McConnell and Representatives Dick Armey and Jim Moran.

Mr. OXLEY. The gentleman's time has expired.

The Chair now recognizes the chairman of the full committee, the gentleman from Richmond, Mr. Bliley.

Chairman BLILEY. Thank you, Mr. Chairman.

According to the U.S. Department of Transportation, our current automobile insurance tort system "...ill serves the accident victim, the insuring public and society. It is inefficient, overly costly, incomplete and slow." Thirty percent of all auto accident victims recover nothing under the current tort system. Accident victims with serious injuries get as little as 9 percent of their economic losses covered. This is a travesty.

With insurance premiums going up almost every year and hundreds of billions of dollars spent on automobile insurance, what happens to all of our consumer money? Well, according to the FBI, $200 per consumer pays for other people's fraudulent claims, up to three-quarters of which are typically so-called noneconomic pain and suffering claims.

According to the California Department of Insurance, another 40 cents on the dollar for bodily injury and uninsured motorist premiums goes to attorneys, to keep them well compensated. In fact, almost twice as much money is paid to lawyers then for legitimate medical bills and lost wages for consumers. Lawyers get fat; consumers get Band-Aids.

Unfortunately, the weight of this unfair tort tax falls primarily on the poor, who are forced to spend a disproportionate amount of their income on automobile insurance. In some communities, poor families spend almost a third of their household income on automobile insurance premiums, resulting in many drivers who can't afford insurance at all.

For these reasons I am pleased that my dear friend and my leader, Dick Armey, has come forward with a credible idea to jump start this debate. I welcome our two panels who have come to testify on the Auto Choice Reform Act and look forward to hearing their statements. Thank you, Mr. Chairman.

Mr. OXLEY. The gentleman's time has expired.

The gentleman from New Jersey.

Mr. PALLONE. Thank you, Mr. Chairman. As a representative of New Jersey, I come to this hearing with a very different perspective, I think, than my colleagues. New Jersey is the State with the highest auto insurance rates in the country. It is also the State where a very popular Governor was almost voted out of office over the issue of auto insurance rates, and one of the minority of States that already operates under a system of auto insurance choice.

Under the New Jersey system, all car owners are required to be insured for liability, personal injury protection otherwise known as no-fault, and uninsured motorist coverage. However, car owners have a choice about the type of no-fault insurance that they get. First, if they are willing to pay a higher rate, motorists can elect what is called a no threshold, which means that they can sue for any type of injury or noneconomic damage. Or if motorists are willing to give up some of their right to sue for noneconomic damages, they can elect a verbal threshold and enjoy a lower insurance rate, thereby getting less coverage for less money.

New Jersey has this choice system: Pay more, get your day in court; pay less, give up your rights, and that is pretty much what the Armey bill would do, in my opinion. And that to me begs the question why do we need an Armey-type bill at all?

New Jersey and several other States have choice. If other States want it, they can have it, too, but that should be a State's decision, not something forced upon them by Congress. The New Jersey situation also begs a more important question, which is why model a Federal auto insurance system after the most costly and potentially most controversial system in the country? For years now New Jersey has been like a laboratory for an automobile insurance choice system similar to that of Mr. Armey's, and the results are definitive. The rat essentially died.

New Jersey residents are so up in arms over their exorbitant auto insurance rates that just yesterday Governor Whitman signed an auto insurance reform bill into law that is supposed to cut auto insurance rates by an average 15 percent, but there is much skepticism about what the new law will actually deliver by way of rate cuts to the consumer. In fact, one of my colleagues in the New Jersey Legislature likened the bill to the new impotency drug Viagra saying, "It makes everyone feel good for a while, but the question is how long will it last."

And that's another question that I think we have to ask about this bill. Is it really going to reduce auto insurance rates? Will consumers reap any economic benefit from the new system? Some consumers may be able to pay less for auto insurance under the new choice system, but they are also going to get a lot less. They are going to be giving away the right to sue for nonincome damages, and even worse, these consumers probably won't even understand what they are giving up when they choose the cheaper no-fault option. And unfairly, if someone with no-fault is the cause of an accident with another vehicle that has chosen insurance under a tort system, the innocent driver must seek noneconomic damages from their own insurance company.

I guess, Mr. Chairman, in conclusion, my constituents and I have lived under an Armey-like auto insurance system in New Jersey, and we have said, enough is enough. Why force others to suffer the same exorbitantly high rates that we suffer in New Jersey? In deference to the Majority Leader, I understand, Mr. Armey, that your model is not exactly the same as New Jersey, but again, I see no reason why it would be any less a failure based on what we have seen in our own State.

Thank you, Mr. Chairman.

Mr. OXLEY. The gentleman's time has expired. The committee has a strict rule against Viagra jokes here.

The gentleman from Ohio.

Mr. GILLMOR. I waive.

Mr. OXLEY. The other gentleman from Ohio, Mr. Sawyer from Akron.

Mr. SAWYER. Thank you, Mr. Chairman. I was going to associate myself with the remarks of the gentlemen from New Jersey, but I'm going to waive that opportunity.

I will associate myself with our colleague from New York, the ranking member. These kinds of approaches have a good deal of initial appeal, and perhaps may be working in some places in the country. However, I don't think it is any accident that auto insurance has typically been regulated at the State level across the country. It is not only a product of rights, although that is an important part of this, but it is a question of a broadly diverse experience base. It is particularly true as we encounter greater latitude in traffic laws which are enacted at the State level, particularly with regard to speed limits and the enormous variations in the quality of road surfaces and terrain that yield substantially different kinds of experience from State to State.

In my own case, Ohio is the seventh largest State in the country, and at the same time only about a dozen other States have lower auto insurance premiums. I'm not suggesting that is a difference in the quality of insurance or even the cost of the product, but may well in fact be a product of a variety of differences between jurisdictions that become difficult to cram into a single format, insurance format, that would work effectively across the Nation.

Having said that, I think this is an interesting enough approach that it is worth the kind of time that we will devote to it. I think it will illuminate a number of the kinds of concerns that have prompted the introduction of the legislation and may well, in fact, be useful either on this level or to each of the States as they consider their options with regard to automobile insurance.

With that, Mr. Chairman, I yield back the balance of my time.

Mr. OXLEY. The gentlemen yields back.

The gentleman from Long Island.

Mr. LAZIO. Just a brief statement, Mr. Chairman. I wanted to thank my neighbor Senator McConnell, and my good friend Mr. Moran, and my very dear friend and Majority Leader Mr. Armey for their very significant work in this area to try to provide some relief on a tax on mobility which is particularly regressive because it does hurt the people who most need a car to get to work, for example, at the lowest rungs of the economic ladder.

With that being said, I think we need to keep in mind and balance through this thoughtful approach with the consequences, the broader consequences in society as we consider the tradeoff of eliminating sort of general damages and what that might mean relative to the help and assistance it provides to the individual to be able to afford to get around to get to a job, get to a place of employment, get to school. So I just want to thank the three gentlemen here for their work in the area. I yield back.

Mr. OXLEY. The gentleman from Michigan Mr. Stupak.

Mr. STUPAK. Thank you, Mr. Chairman, and thank you for holding this hearing.

I come from maybe a little different perspective. Michigan in the 1960's passed the first no-fault law in the Nation. It is a true no-fault State in that you can only sue for death, permanent disfigurement or permanent incapacitating injury.

Being a former State trooper, I have dealt with it. Being a former State legislator, I dealt with it. Being a former trial lawyer who practiced in both Michigan and Wisconsin, and in Wisconsin it is a more comparative no-fault, but I dealt with it there. And so I come from a little different perspective, but I am opposed to this legislation based on what I have seen, but also, I think, first of all, it is completely unnecessary.

If any State wants to adopt a no-fault system, it can do so. In Michigan, the State legislature has debated changes to no-fault ever since enacted in the 1960's. A number of other States have adopted no-fault proposals. There is no reason for a national system.

Second, this legislation may be unconstitutional. Although the Majority Leader may claim that this legislation allows an opt-out provision, the provision, I believe, is illusory and may violate the 10th amendment. In order to avail itself to opt out, States must pass a law within 90 days stating they wish to opt out with no other provisions. Some legislatures, such as Wisconsin, only meet part time in certain years, so will those legislatures who do not meet within 90 days, will they have any constitutional provisions? For instance, what is the effective date of the act in that particular State?

In addition, the administrative process for opting out may not be able to reach conclusion if the State, whatever State it is, if their administrative procedures act allows for appeals that last longer than the 90-day period to opt out.

Finally, I don't believe it will work. In Michigan we have seen auto rates continue to soar since the adoption of no-fault insurance. So have the insurance profits.

In 1992, think about the race for the Presidency in 1992. This country was in a recession, yet Michigan auto insurers enjoyed a 21.3 percent increase in all rates, and they have made that kind of profit. It was the highest in the country.

Not allowing that, in Michigan when we did our no-fault, we set up a thing called a Catastrophic Fund, because everyone said it is the medical costs that put so much burden on the companies. So we set up a Catastrophic Fund. If your injuries are more than $250,000, you go to the Catastrophic Fund to keep the costs low so everybody can enjoy the insurance.

Well, the Catastrophic Fund right now in Michigan has $2-$3 billion in it. The Michigan Legislature is trying to figure out how to rebate the Catastrophic Fund back to the insured people in Michigan. I insure four automobiles. Right now they are talking that I would get $182 per automobile per year because the Catastrophic Fund is so overfunded. Rates going up 20 percent a year, you can understand how these well-conceived ideas just have not worked. Michigan insurance remains one of the highest in the Nation.

So there is ample opportunity, and there is little evidence that no-fault really reduces premium costs, and there is ample evidence that people who refuse to choose the national policy, I believe, will really see their premiums rise because they will pit the State law against the new so-called national no-fault auto insurance.

Also the legislation should be entitled the no-fault, no choice bill because actually it forces motorists into a largely untested nationwide insurance system that prohibits injured persons from recovering damages, such as loss of productive rights, loss of consortium, and pain and suffering. I believe this legislation is ill-advised. However, I do look forward to the testimony. It is an interesting area. I have spent a lot of time as a police officer, legislator and an attorney practicing in this area.

I am looking forward to the debate. I would like to see some of the suggestions. Maybe there is something that we can do so we do not face the Michigan decision where we see rates going up and up and up, and then we realize that we didn't need the system and we have restricted people's rights. In Michigan we also have caps on pain and suffering and everything else. I don't see how this system is going to benefit us, definitely not in Michigan, definitely not nationwide. Thank you.

Mr. OXLEY. The gentleman's time has expired.

The gentleman from California, Mr. Bilbray, do you have an opening statement?

Mr. BILBRAY. Mr. Chairman, this issue is one that a lot of people don't talk about publicly across the country, except when husbands and wives sit down and look at the cost of making sure that their liability is covered just for the privilege to be able to use the American roadways.

I am also impressed by my colleague who raises an issue that is not raised enough. I did not know that anyone around here knew what the 10th amendment was after being here 3 years and after serving 20 years in local government. I appreciate that the issue of the 10th amendment has been raised here.

The fact is in modern times the use of the American roadways are something that is not just a State issue. I am sure that the most honorable gentleman from Virginia will point out that his residents cross State lines to go to work, shopping, to go to the park and the seashore. This is something that we don't see in California.

Frankly, I think that we need to address this, and I want to commend my colleagues for starting this dialog. I can't help but not mention that in California we have mandatory insurance, and the fact is if you want to be able to drive a vehicle on the public roadways, you have to figure out who is going to insure you. It is not a choice, it is a mandate that the government places on you, and

those in government at least should be able to take a look at that issue seriously.

On the flip side, in many areas it is not the problem of how we get insurance, but who has insurance. At the same time that California and many border States mandate insurance, you have as many as 20 percent of the vehicles on the road totally uninsured and totally exempt from State regulations because those vehicles claim registration in adjoining countries, and I think that is an issue that I have to raise to the leadership that is here because they are interested in the issue. .

We need to address that, too, somewhere down the line, and hopefully the Commerce Committee will be addressing issues like H.R. 8, which specifically will help to address that problem where you have one group of citizens and people in the world mandated to have insurance, and a group that is totally exempt because they are using the international border as a legal boundary. I don't think that this bill addresses that, but it starts a dialog that is healthy and is needed, and I wanted to commend my colleagues for bringing it up.

Mr. OXLEY. We now turn to our distinguished panel. The first witness is the distinguished Majority Leader, Mr. Armey from Texas. Welcome. You are the lead sponsor here in the House, and you have been associated with this issue for some time, and we are pleased to have you here and have you testify.

STATEMENT OF HON. RICHARD K. ARMEY, MAJORITY LEADER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. ARMEY. Thank you, Mr. Chairman. I want to thank you for holding these hearings. Already from what I have heard, I am very encouraged. It is very clear to me that my cosponsors and I have found an issue of interest and currency among the voters of America. From seeing the extent to which you and your colleagues on the committee have so thoroughly familiarized yourself already with the subject, it is clear that we have come upon an important subject.

I would ask, Mr. Chairman, that my prepared remarks be included in the record, and in that case I would then be able to be more brief.

Mr. OXLEY. Without objection.

Mr. ARMEY. I should tell you that during the period of time that I have had the privilege of being the Majority Leader of the House of Representatives, I have only introduced three pieces of legislation in this House: The flat tax bill, and the DC school choice bill and this bill.

A common feature that I found in all three of these bills that was attractive to me is that it afforded us an opportunity to give the American people a chance to exercise their personal responsibility, and by so doing obtain a greater degree of freedom in the manner in which they manage their lives. That is exactly what I think is so important about this choice. It is respectful of the American people.

I might also say that I was particularly pleased when I found that the legislation was referred to your committee for its jurisdic-

tion. I am familiar with the thoroughness and the workmanship of this committee, and I am confident on one hand that the legislation will stand up to even the rigorous scrutiny it will be given in this committee, but I am also confident that in those areas where the legislation might be improved, that would happen through the exercise of your jurisdiction.

But I should say it is my intention to the best of my ability and in all consideration for all of my colleagues to encourage this process to the point that we are able to sign this legislation into law before this year is over. It is my hope that we can have the bill on the floor in the House of Representatives no later than July, sometime in July, and I have spoken to the Majority Leader in the Senate, and he has assured me that he shares that intention for the legislation in the other body.

Let me try to put this into perspective without running over all of the numbers that we see yourself familiar with by your opening statements.

Today we are having a big to-do across the Nation. Every newscaster is talking about something called Powerball—is that correct—Powerball? It is a lottery, and the stories are full of the millions of people who have gone out and bought lottery tickets. Part of the story that we are not hearing is all of the people who didn't buy lottery tickets, people who are prudent; and before I buy a lottery ticket, I check the odds. And I will have to tell you right now, to buy a lottery ticket for Powerball I consider to be a foolish choice, but people are making it.

These are people who we know in my discipline of economics as having a higher risk preference than my own risk-adversive behavior.

Nevertheless, an important part of the story is, and the part that we ought to focus on is, they have the choice to exercise their discretion in that manner which they best believe enables them to maximize the opportunities for more prosperity for their family.

And while I have in my own case substantial reservations about lotteries in general and State-run lotteries in particular, particularly because of the inevitably regressive nature of lotteries in terms of populations from whom they most likely take their revenue, I can at least respect the fact that this is voluntary.

The problem with auto insurance today is we take the fact that it is a prudent and responsible thing to insure your automobile before you put it on the road, something my father told me when I was 16 and bought my first 1937 Chevy, and the fact that when you find yourself in an accident, you ought to claim your real damages and be made whole, and we carry it to a step that I believe goes beyond what most prudent people would do, and that is to automatically and mandatorily sign yourself up for the great pain and suffering lottery.

I must confess there are a great many people who do not choose to enter that lottery for a variety of reasons: One, to pay extra money to make yourself available for that lottery is not a prudent choice if you go against the natural odds that you would have an opportunity in your life to exercise that option. And, of course, the natural odds are not very endearing, and that is exactly the reason that this mandatory lottery has invited so much premeditated graft

and corruption in the form of insurance fraud, which you will hear about later.

I can't resist the temptation to say at least for myself, and I suspect for millions of other people, I think the whole pain and suffering practice is undignified. I would not put myself through the personal embarrassment of participating, but I may be strange and unique in that regard.

Neither I nor any of the other people for whatever variety of reasons they would otherwise voluntarily choose not to participate should be compelled by the law that forces us to do the prudent, necessary thing of insuring our automobile, to buy insurance which is excessive beyond what we want, need or use, and against all odds for any responsible recovery in a normal course of the normal automobile accident. And so what we are saying with this legislation is let every auto consumer in America have the opportunity to lower their insurance rates by exercising their personal choice to forsake that option of a pain and suffering lawsuit; get for their family the more optimal use of their income, especially the poorer families, especially in the inner cities where the auto insurance rates are higher, to put that money to some voluntarily better use than the mandatory subscription to auto insurance at that level.

We believe that that is a fair and prudent thing to do. The rights of the States are respective in this legislation. Every State has the opportunity to opt out, and if the committee sees a need to further massage those opt-out provisions, we would welcome the committee's hand in them.

The legislation is carefully crafted on behalf of freedom and dignity and responsibility for the American people. There is no doubt about it—if I may say in closing, there is no doubt about it that the most visible organized resistance to this legislation comes from the tort bar.

Let me just simply respond to that by making two predictions. The first is I will predict with some high probability that our efforts here will be successful and that this legislation will be signed into law before the year is passed. I will predict with some higher probability that once that is done, the majority of States will opt to avail their citizens of these opportunities made possible here.

I will predict with an even higher degree of probability that once the majority of the citizens of America in the majority of the States of the Nation have this choice, that 90 percent of the legal profession will choose auto insurance that preempts them from the requirement to buy a ticket to the pain and suffering lottery.

And I am fascinated by people that would require so much, to force everybody to buy what they would not voluntarily buy for themselves, and I thank you for your time.

[The prepared statement of Hon. Richard K. Armey follows:]

PREPARED STATEMENT OF REP. RICHARD K. ARMEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. Chairman and distinguished members of the subcommittee, I appreciate the opportunity to testify before this panel.

Mr. Chairman, the Auto Choice Reform Act, which we are here to discuss today, is common sense legislation that is rooted in freedom and responsibility. Those who will testify today on its behalf represent the political spectrum. And their presence here, along with endorsements from such individuals as Steve Forbes and Mike Dukakis, attests to the broad support Auto Choice enjoys.

The reason for this broad support is simple: Auto Choice could reduce auto insurance premiums by 24 porcent on average and put nearly $200 billion back in the pockets of real people—without costing the government a single penny.

And it does more than that. Auto Choice promotes two ideas that are fundamentally important to every American—freedom and responsibility.

All automobile owners are expected to be responsibile for their actions by purchasing auto insurance. At the same time, however, our current auto insurance system denies them the full freedom to purchase a policy that best fits their needs and the needs of their families. Instead, they are forced to buy expensive premiums to cover contingencies they will likely never face.

The culprits behind the high cost of auto insurance are expensive, excessive pain and suffering lawsuits, and the rampant fraud and abuse that too often accompany those suits.

Between 1987 and 1994, these forces had combined to drive rates up 44 percent—one-and-a-half times the rate of inflation.

Now we here in Congress are fond of using numbers to make a point. And sometimes these numbers sound abstract and seem to take the edge off the point we are trying to make. So let me translate the percentages and comparative figures into everyday terms: by 1995, American drivers were paying more than $750 for an average auto insurance policy. If a family had two cars, that means they were paying roughly $1,500 on auto insurance every year.

For a hard-working family trying to make ends meet, this represents a huge (and often painful) part of their budget. And the poorest Americans—those who are struggling just to make ends meet and can least afford high auto insurance premiums—suffer the most under the current system. Studies show that those in the bottom 20 percent of income earners typically pay nearly three times the percentage of their household income on auto insurance premiums as compared to the top 20 percent of income earners.

Some people, confronted by policy premiums they cannot afford, are faced with a Hobson's choice—either forego some necessities of life or break the law and drive without insurance. This is not much of a choice.

Auto Choice would lower insurance rates. Before I discuss how it would do so, it's important to understand how the current system works. When people are involved in auto accidents, they can sue for two types of damages. Economic damages are real, tangible damages that include things like lost wages, medical bills and the like. The other types of damages for which people can sue are non-economic damages, commonly known as "pain and suffering." According to the Joint Economic Committee, every dollar of economic damages translates into an additional three dollars in non-economic awards.

Because claimants stand to "hit the jackpot" with pain and suffering awards, there is a great incentive to inflate their claims for economic damages. This is where fraud and abuse come in. According to the FBI, fraud in the insurance industry costs every American household more than $200 in insurance premiums.

On the flipside of this coin are the attorney fees, which make up the bulk of lawsuit transaction costs. A California study reported that for every dollar paid for bodily injury liability and uninsured motorist protection, *over 40 cents goes to attorneys.* I would venture to guess that most people do not buy insurance with the idea that they are paying attorneys. And if they did, I believe they would not be happy about it.

And here is another point we need to remember: since plaintiffs' attorneys usually receive at least one-third of awarded damages, it is not surprising that they have an incentive to exaggerate economic damages. Conversely, since defense attorneys are generally paid by the hour, they have an incentive to drag out a case as long as possible. So not only do fraud, abuse and litigation lead to higher premiums, they also result in delayed compensation for those who are seriously injured.

In essence, Auto Choice was designed to address the rising costs of personal injury lawsuits by reducing the number of suits for non-economic damages. But, Mr. Chairman, allow me to dispel one bit of disinformation that the subcommittee will likely hear today: Auto Choice *does not take away anybody's right to recover pain and suffering damages.*

On the contrary, under this legislation, individuals are given the freedom to choose between the current tort regime, under which their options to claim for economic and pain and suffering damages are preserved, or a new primarily first-party system in which they decide to forego their option to sue (or be sued) for pain and suffering in most cases. Simply put, those who choose the new option, called personal protection insurance, or PPI, will see quicker compensation and lower overall premium rates—at least 24 percent lower.

Again, let me translate percentages into real numbers that affect real people. The 24 percent savings that we project means that drivers would save an average of $184 a year on each auto insurance policy. Drivers in some states could see even greater savings. But whatever the amount, families should have the freedom to choose an auto insurance policy that best fits their needs and lets them keep more of their hard-earned pay.

Nationwide, the savings are even more spectacular. The JEC reports that we could see a potential savings of $35 billion the first year, and $193 billion over five years.

Mr. Chairman, this is like a $193 billion tax cut.

And it's not just those who live in suburbs and drive Volvos, Mercedes and BMWs who will benefit from Auto Choice. The fact of the matter is, lower income families who live in urban areas where liability premiums are higher would see the greatest benefits of Auto Choice.

If Auto Choice becomes law, low-income drivers could see their auto insurance rates cut by more than a third.

Auto Choice is for the men and women, the moms and the dads, who sit at the kitchen table every month with the family checkbook trying to balance the family needs with the family budget. They should have the freedom to choose an auto insurance policy that best fits their needs and lets them keep more of their hard-earned pay to meet their obligations and pursue their dreams.

And while we're on the topic, Mr. Chairman, the concept of freedom upon which Auto Choice is built does not apply exclusively to individuals; it applies to the states as well. Unlike other proposals that emanate from Washington, the Auto Choice Reform Act is not a mandate on states, nor does it usurp their authority to regulate automobile insurance. Nor does it employ a "carrot and stick" approach to coerce states to participate. The cherished principle of federalism is preserved. The fact of the matter is, states are free to opt out of Auto Choice at any time—and without fear of federal reprisal.

Finally, Mr. Chairman, let me just make a personal observation. Since I became Majority Leader, I have, by and large, refrained from sponsoring legislation. In fact, until I introduced the Auto Choice Reform Act, I had introduced only two personal legislative initiatives during my tenure as Majority Leader—both of which promote freedom and responsibility.

I introduced the Auto Choice Reform Act because it is also about freedom and responsibility—the freedom of individuals to choose what's best as they take responsibility for themselves and for their families. And with that freedom, they will make responsible decisions. We should always bear that in mind as we in Congress do the people's business.

Thank you.

Mr. OXLEY. I thank the gentleman. No predictions about the Cowboys, though?

Mr. ARMEY. No. I was tempted to say that I was trying to figure out what this Viagra is about.

Mr. OXLEY. We now turn to our distinguished panelist, the junior Senator from Kentucky Mr. McConnell.

STATEMENT OF HON. MITCH McCONNELL, A UNITED STATES SENATOR FROM THE STATE OF KENTUCKY

Mr. MCCONNELL. Thank you, Mr. Chairman. I appreciate very much the opportunity to be here. As you know, I am the principal sponsor of the auto choice bill in the Senate. The principal cosponsors are Senator Moynihan from New York and Senator Lieberman from Connecticut. We do have strong bipartisan support. As Majority Leader Armey has mentioned, the Majority Leader of the Senate does intend for this to be on our agenda this year.

The current automobile liability insurance system is broken down and must be repaired. The tort system forces consumers to pay punishingly high premiums for inefficient, inequitable coverage. The average low-income family is forced to pay more for auto insurance in just 2 years than the entire value of their car.

Why are consumers forced to pay so much? Because our Nation's auto insurance system is clogged and bloated by fraud, wasteful litigation and abuse. In 1995, the FBI announced a wave of indictments stemming from Operation Sudden Impact, a wide-ranging investigation of criminal fraud schemes involving staged car accidents and massive fraud in the health care system. The FBI uncovered criminal enterprises staging bus and car accidents in order to bring lawsuits and collect money from innocent people, businesses and governments.

A recent episode of ABC's 20/20 also focused on the rampant fraud that plagues our Nation's auto insurance system. This expose shined a bright light on the current system of corruption, perversion and human tragedy. It is my understanding that today's hearing will allow the committee to hear firsthand from a former conspirator in a staged accident scam as well as from a prosecuting attorney who has worked to stamp out these dangerous and costly criminal enterprises.

Gordon Stewart, the president of the Insurance Information Institute, has estimated that auto insurance fraud is a $25 billion business. And FBI Director Louis Freeh has estimated that every American household is burdened by an additional $200 in unnecessary insurance premiums to cover auto insurance fraud.

In addition to the pervasive criminal fraud that exists, the incentives of our litigation system encourage injured parties to make excessive medical claims to drive up their damage claims in lawsuits. The RAND Institute for Civil Justice has concluded that 35 to 42 percent of claimed medical costs in car accident cases are excessive and unnecessary. Let me repeat that in simple English: Well over one-third of doctor, hospital, physical therapy and other medical costs claimed in car accident cases are for nonexistent injuries or for unnecessary treatment. The value of this wasteful health care then, $4 billion annually.

I don't need to remind anyone of the ongoing local and national debate over our health care system. While people have strongly held differences over the causes and solutions to that problem, the RAND data make one thing certain: Lawsuits and the potential for hitting the jackpot, which the Majority Leader mentioned, drive overuse and abuse of the health care system. Reducing those costs by $4 billion annually without depriving one person of needed medical care is clearly in our national interest.

Why would individuals engage in staged auto accidents? Why would injured parties inflate their medical claims? It is simple arithmetic. For every $1 of economic loss, a party stands to recover $3 in pain and suffering awards. In short, the more you miss work, the more you go to the chiropractor, the more you stand to get from the jury; and the more you get from the jury, the more money your lawyer puts in his pocket.

One estimate found that attorneys receive approximately $17 billion a year from auto accident litigation. In fact, the Insurance Information Institute has found that 28 cents of every insurance dollar ends up in the pockets of lawyers. This is two times the amount of money that injured parties receive in medical bills and lost wages. Surely we would all agree that a system is fundamentally

flawed when it pays lawyers more than it pays injured parties for economic losses.

Let me conclude by spelling out the cost of auto insurance fraud in economic terms. The 20/20 episode that I mentioned earlier focused on a man named Paul Langman. At the age of 70, Mr. Langman had just bought his first new car. What Mr. Langman didn't know was that, unfortunately, the new car made him a target for a staged accident. Why, you might ask? Well, it is because new cars are typically well-insured and offer a good pot of pain and suffering dollars.

Sure enough, Mr. Langman was forced into a staged accident and tragically killed. According to 20/20, the perpetrator of the staged accident even had the nerve to make up a story about holding a dying Paul Langman in his arms so he could collect money for posttraumatic stress disorder and seek pain and suffering dollars. Mr. Langman's daughter concluded this tragic story lamenting that, and I quote her, "My father was worth a lot more money than $10,000 or whatever they thought they were going to get." I don't think I can add a single thing to that story.

Auto choice seeks to take away the fraudulent incentives of today's system. If there is no pain and suffering lottery, then there is no reason to play the game.

I would like to thank you, Chairman Oxley, for inviting me to testify today. We are going to try very hard to move this issue in the Senate, and Majority Leader Dick Armey's resolve to do likewise in the House is very reassuring.

Thank you for the opportunity to be here. We are going to be voting shortly in the Senate. You have some real experts to hear from who are the true inspiration behind these proposals.

Mr. OXLEY. It is always good to have you here, and we understand the voting procedures over there.

[The prepared statement of Hon. Mitch McConnell follows:]

PREPARED STATEMENT OF HON. MITCH MCCONNELL, A U.S. SENATOR FROM THE STATE OF KENTUCKY

The current automobile liability insurance system is broken down and must be repaired. The tort system forces consumers to pay punishingly-high premiums for inefficient, inequitable coverage. The average low-income family is forced to pay more for auto insurance in two years than the entire value of their car.

Why are consumers forced to pay so much? Because our nation's auto insurance system is clogged and bloated by fraud, wasteful litigation and abuse.

In 1995, the F.B.I. announced a wave of indictments stemming from Operation Sudden Impact, a wide-ranging investigation of criminal fraud schemes involving staged car accidents and massive fraud in the health care system. The F.B.I. uncovered criminal enterprises staging bus and car accidents in order to bring lawsuits and collect money from innocent people, businesses and governments.

A recent episode of ABC's "20/20" also focused on the rampant fraud that plagues our nation's auto insurance system. This expose shined a bright light on the current system of corruption, perversion and human tragedy. Today's hearing will allow the Committee to hear first-hand from a former conspirator in a staged-accident scam, as well as from a prosecuting attorney who has worked to stamp out these dangerous and costly criminal enterprises. F.B.I. Director Louis Freeh has estimated that every American household is burdened by an additional $200 in unnecessary insurance premiums to cover auto insurance fraud.

In addition to the pervasive criminal fraud that exists, the incentives of our litigation system encourage injured parties to make excessive medical claims to drive up their damage claims in lawsuits. The RAND Institute for Civil Justice has concluded that 35 to 42 percent of claimed medical costs in car accident cases are excessive and unnecessary. Let me repeat that in simple English: well over one-third of doc-

tor, hospital, physical therapy and other medical costs claimed in car accident cases are for nonexistent injuries or for unnecessary treatment.

The value of this wasteful health care? Four billion dollars annually. I don't need to remind anyone of the ongoing local and national debate over our health care system. While people have strongly-held differences over the causes and solutions to that problem, the RAND data make one thing certain—lawsuits, and the potential for hitting the jackpot, drive overuse and abuse of the health care system. Reducing those costs by $4 billion annually, without depriving one person of needed medical care, is clearly in our national interest.

Why would individuals engage in staged auto accidents? Why would an injured party inflate their medical claims? It's simple arithmetic. For every $1 of economic loss, a party stands to recover up to $3 in pain and suffering awards. In short, the more you miss work and the more you go to the chiropractor, the more you stand to get from the jury. And, the more you get from the jury, the more money your attorney puts in his own pocket.

One estimate found that attorneys receive approximately $17 billion a year from auto accident litigation. In fact, the Insurance Information Institute has found that twenty-eight cents of every insurance dollar ends up in the pocket of attorneys. This is two times the amount of money that injured parties receive in medical bills and lost wages. Surely we would all agree that a system is fundamentally flawed when it pays lawyers more than it pays injured parties for economic losses.

I introduced Auto Choice in the 104th Congress, and again in this Congress, to deal with these very problems. Auto Choice offers consumers a way out of the current system of fraud and abuse. Moreover, it helps to ensure that more of the insurance dollar goes to injured parties, not to lawyers. Which, of course, explains why the *New York Times* has endorsed Auto Choice concluding that "everyone would win—except the lawyers."

Auto Choice seeks to take-away the fraudulent incentives of today's system. Insuring on a first-party basis for economic loss will significantly reduce the current incentives for criminal fraud and for padding medical claims in the hopes of hitting the jackpot. If there's no pain-and-suffering lottery, then there's no reason to play the game.

In closing Mr. Chairman, I'd like to point out that Auto Choice can be summed up in two words: choice and savings. Consumers need and deserve both.

I would like to thank the Chairman for inviting me to testify at this important hearing today. I have had a long-standing interest in this issue and am particularly honored to have Congressman Moran and Majority Leader Armey leading the fight here in the House. They are doing a terrific job, and I am grateful for their support and leadership.

Mr. OXLEY. Our next witness, the gentleman from Northern Virginia, Jim Moran, who represents a lot of Members when the Congress is in session, so it is always good to have him here with us, and we now recognize the gentleman from Virginia.

STATEMENT OF HON. JAMES P. MORAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VIRGINIA

Mr. MORAN. Thank you very much, Mr. Chairman. I know that we are going to get an opportunity to get into some of the points made by some of your colleagues on the panel.

I would suggest to my friend and colleague Mr. Stupak that with regard to Michigan, the premiums would be considerably higher, at least 20 percent higher, if there were not no-fault legislation in effect. But still, 50 percent of the premiums go to pain and suffering litigation because you have got a verbal threshold. The same thing with New Jersey. That is not the case with the legislation that we are proposing.

One other thing that needs to be clarified. States can opt out any time. It doesn't matter that they don't go into session but once every 2 years. A State can opt out 5 years from now, 10 years. The 90 days applies to the insurance commissioner. If he can show that it would not reduce premiums by at least 30 percent, then within

90 days they can opt out of the system. So that is how the 90 days applies, but we will be able to get into some of those specific responses in a moment. Let me lay out the overall context here.

In a day when the automobile has become an indispensable part of virtually everyone's way of life, we are still dependent on a tort system that is based on centuries old English common law to seek and obtain compensation when an accident involves two or more vehicles. That system worked well when buggies outnumbered cars, but in today's environment when most families have two automobiles, it is a very inefficient system. The statistics dictate that the greater number of cars and the more miles they are driven, the greater the chances of an accident occurring. Senator Moynihan would go so far as to say it is an inevitable result of this transportation system. So they are not really accidents, they are—a certain number of collisions are bound to occur, and the problem is that we are attempting to find fault where fault oftentimes does not occur.

Why should we be dependent on an 18th century concept and a judicial system to assign fault before compensation can be awarded? At some point the tort system will collapse under its own weight of pending cases.

And equally troubling, the opportunity to collect compensation for pain and suffering has encouraged massive fraud and claim buildup that has driven premiums upwards at much higher than the rate of inflation. Today 1 in 7 drivers, as Mr. Bilbray cited, drives illegally without automobile insurance because they have to have their car, and they can't afford these higher insurance premiums. According to the FBI, every American household is paying $200 in unnecessary insurance just to cover fraud and abuse within the system. So while paying $200 just to cover the fraud and abuse that other people are exacting on the system, there are a dramatic increase of nuisance suits claiming losses which are clogging our courts despite the fact that the number of serious automobile accidents has actually decreased nationwide.

In the District of Columbia, the automobile accidents over the last 12 years declined by 22 percent, and yet the number of lawsuits went up 137 percent. What's wrong with the system?

And perhaps the most troubling aspect of the present tort-based system is that it fails to provide compensation for those who need it the most. Twenty cents out of every insurance dollar goes to injured people, only 20 cents out of the insurance dollars. Twenty-eight cents goes to the trial lawyers.

According to the RAND Institute, seriously injured automobile accident victims, those with economic damages in excess of $25,000 on average, recover only half of their economic losses. And accident victims who are really injured, those who have legitimate claims of over $100,000, collect only 9 percent of their economic losses. So given the fact that most accident victims with serious injuries fall way short of recovering full compensation for their economic damages, they have little chance of receiving anything for pain and suffering, but lawyers get 100 percent compensation.

The Auto Choice Reform Act—I want to turn to some of my trial lawyers behind me, and I think they know. The Auto Choice Reform Act offers the consumer an alternative that offers lower rates

and better, more timely compensation. In short, Auto Choice provides drivers first party insurance coverage for their full economic damages up to the policy's limits in return for waiving the right to sue and collect any monetary award for pain and suffering. Policyholders will be guaranteed compensation within 1 month of submitting their claim and would still retain the right to sue and collect from an at-fault driver for economic damages that exceed their policy limits because most compensation would occur outside of court without the need for attorneys.

Auto Choice can provide a reduction in bodily injury premiums of about 45 percent. That is where we are getting the savings that would apply to all drivers. For the single male driver from Los Angeles with a clean record, the savings would be more than $1,000 a year. That is because in Los Angeles 99 times out of every hundred times there is an accident, there is a lawsuit, when statistically only 1 in 10 times is there a legitimate injury. If the savings don't materialize, the State Insurance Commissioner can ban Auto Choice from being offered.

Because Auto Choice eliminates the incentive for fraud and claim buildup by limiting the option to sue for pain and suffering, Auto Choice will reverse the compensation paradigm that overcompensates victims with minor injuries and undercompensates victims with serious injuries. The bottom line is that even though Auto Choice drivers waive their right to sue for pain and suffering, they would actually increase the amount of money they would get and shorten considerably the time. Right now it takes 16 months before they can get compensated. They get compensated more money within 1 month if they are involved in a serious accident.

And I want to stress the importance of this legislation to cities and the urban poor. Cities and their residents suffer the distinction of paying the highest premiums, experience the greatest incident of fraudulent claims, and receive mostly inadequate compensation for serious accidents. City residents pay auto insurance premiums that are more than a third higher than those charged to nonurban residents. That is one of the reasons that people are moving out of the cities to the suburbs. For the working poor, the cost of insurance if often higher than the value of the automobile and can rob families of up to a third of their total annual income. The Auto Choice bill offers urban residents a chance to reduce their premiums by at least a quarter and thereby reduce the premium differential between urban and suburban jurisdictions by half. That means a lot in terms of trying to rebuild our cities, and it certainly offers relief from the rising number of lawsuits brought against government agencies.

According to the U.S. Bureau of Justice statistics, automobile tort cases make up the single most common type of tort litigation brought against governments. It accounts for almost half of all tort cases in which the government is the primary defendant. Governments were the defendants in about a third of all of the jury verdicts in excess of a million dollars even though they represented only 8 percent of all such cases. What is wrong here? What is wrong is that people recognize that it is cities that have the deepest pockets. It is not because city-owned vehicles and their drivers

are notoriously reckless drivers. They are prime targets for fraudulent lawsuits.

The present system and the opportunity to get cash back in excess of any quantifiable economic loss has contributed to a moral decay and a disrespect to our system of justice. For the average law-abiding citizen, the incentives to cheat on a minor accident and inflate claims are often too great to resist. From their perspective, the automobile insurance companies are too liberal in raising rates and too stingy in providing compensation, and so this is an opportunity to get payback from a minor accident. And so people have this attitude oftentimes when they are on the street, "Hit me, I need the money." That has got to be changed. We all suffer. We are all threatened by that kind of an attitude.

Now, we think we need to give drivers a real choice. Those who stay in the current tort-based system and play the pain and suffering lottery, they can continue to do so. But those who want to leave the system would have a choice.

Denver, Colorado, Mayor Wellington Webb, he is chair of the U.S. Conference of Mayors Advisory Board, he endorsed this legislation. He said, "Auto Choice replaces waste and fraud and inefficiency with consumer choice and faster and fuller compensation for injuries." He said a lot more profound things, but I am not going to take up your time because I think the fact that a mayor who is that successful and responsible, his endorsement should speak for itself.

I urge this committee to support the Auto Choice Reform Act. I think it is the right thing to do, and it could not be done too soon.

Thank you.

[The prepared statement of Hon. James P. Moran follows:]

PREPARED STATEMENT OF HON. JAMES P. MORAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VIRGINIA

Chairman Oxley, Members of the Subcommittee, thank you for allowing me to come before you today to speak on behalf of the Auto Choice Reform Act that I am sponsoring with Majority Leader Dick Armey.

While the Auto Choice Reform Act is a relatively new proposal, the concept has been around since the 1960s when it was first developed by Virginia Law Professor Jeffrey O'Connell. The only real change between the time the concept first appeared and today is that the reasons for adopting this proposal have only grown more compelling. In a day when the automobile, for better or worse, has become an indispensable part of our way of life, we are largely dependent on the tort system that is based on centuries old English Common Law to seek and obtain compensation when an accident involving two or more vehicles occur.

This system may have worked well when the buggies outnumbered cars, but in today's environment where there are 1.9 cars per family it is an inefficient system. The law of statistics dictates that the greater the number of cars and the more miles they are driven, the greater the chances of an accident occurring. Senator Moynihan, a cosponsor of the companion Senate bill, would go so far as to state that traffic accidents are not accidents per say, but that they were "perfectly predictable outcomes of a particular transportation system utilizing a specific technology." Given this inevitable outcome, should we still be dependent on an 18th century concept and the judicial system to assign fault before compensation can be awarded? At some point in the not too distant future, the tort system will collapse under its own weight of pending cases.

Equally troubling, the opportunity to collect compensation for pain and suffering has encouraged massive fraud and claim "buildup" that has driven premiums upwards at one-and-a-half times the rate of inflation since 1987. (Today, one in seven drivers drives illegally without automobile insurance most of these illegal drivers need their car but cannot afford the high premiums.) According to the FBI, every American household pays an additional $200 in unnecessary insurance premiums to

cover fraud and abuse within the system. Dramatic increases in nuisance suits claiming inflated losses are clogging our courts, despite the fact that the number of serious automobile accidents has actually decreased nationwide.

Perhaps the most troubling aspect of the present based tort system is that it fails to provide compensation to those who need it the most. According to the Rand Institute, seriously injured auto accident victims, those with economic damages (medical bills and lost wages) in excess of $25,000 on average recover only 56 percent of their economic losses. Accident victims with economic damages greater than $100,000 collect on average less than 9 percent of their economic losses. Given the fact that most accident victims with serious injuries fall far short of recovering full compensation for their economic damages, they have little chance of receiving anything for pain and suffering.

The Auto Choice Reform Act offers the consumer an alternative that guarantees lower rates, and better, more timely, compensation. In short, Auto Choice provides drivers first party insurance coverage for their full economic damages up to their policy's limits in return for waiving the right to sue and collect any monetary award for pain and suffering. Policy holders would be guaranteed compensation within 30 days of submitting their claim and would still retain their right to sue and collect from the at fault driver for economic damages that exceed their own policy limits. Because most compensation would occur outside of court without the need for attorneys, who collect more than 28 percent of every premium dollar under the present tort-based insurance system, Auto Choice can provide a reduction in bodily injury premiums of approximately 45 percent. The resulting savings on a driver's overall premium would be reduced by at least 24 percent. For the single male driver from Los Angeles, with a clean record, the saving's would be more than $1,000 per year. If the savings don't materialize, the state can ban Auto Choice from being offered.

Because Auto Choice eliminates the incentive for fraud and claim buildup, by limiting the option to sue for pain and suffering, Auto Choice will reverse the current compensation paradigm that overcompensates victims with minor injuries and under-compensates victims with serious injuries. The bottom line is that, even though Auto Choice drivers waive their right to sue for pain and suffering, they would actually increase the amount and timeliness of compensation they receive, if involved in a serious accident.

I would like to stress the importance of this legislation to cities and the urban poor. Cities and their residents suffer the distinction of paying the highest premiums, experience the greatest incidence of fraudulent claims, and receive grossly inadequate compensation for serious injury. City residents pay auto insurance premiums that are 32 percent higher than those charged to non-urban residents. As a result, urban areas suffer a number of significant and costly consequences. The cost of living and the high cost of doing business in cities causes many residents and businesses to relocate to the suburbs. Opportunities for mobility and access to better paying jobs for moderate and low-income city residents are limited because of the high cost of auto insurance. For the working poor, the cost of insurance is often higher than the value of the car and can rob families of up to one-third of their total annual income.

The Auto Choice offers urban residents a chance to reduce their premiums by at least 25 percent and thereby reduce the premium differential between urban and suburban jurisdictions by at least 50 percent. Auto Choice also offers cities relief from the rising number of lawsuits brought against government agencies. According to the U.S. Bureau of Justice Statistics, automobile tort cases make up the single most common type of tort litigation brought against governments, accounting for 44 percent of all tort cases in which the government is the primary defendant. Governments were the defendants in close to one-third of all jury verdicts in excess of $1 million, even though they represented less than eight percent of all such cases. Either city own vehicles and their drivers are notoriously reckless or they are prime targets for fraudulent lawsuits since they often have deep pocket liabilities.

This observation raises my final point. The present system and the opportunity to get cash back in excess of any quantifiable economic loss has contributed toward a moral decay and disrespect to our system of justice. For the average law-abiding citizen, the incentives to cheat on a minor accident and inflate claims are often too great to resist. From their perspective, automobile insurance companies are too liberal in rate increases and too stingy to provide adequate compensation. The opportunity to get "payback" following a minor accident can be very tempting. We all know in our hearts that the "hit me, I need the money," is rampant in reality. How else can one account for a situation as reported in the *Washington Post* last year that, while the number of serious car crashes in the State of Maryland decreased by 12 percent between 1997 and 1985, the number of accident-related suits was up 71 percent. In the District, auto accidents fell by 22 percent over the same time pe-

riod, but the number of lawsuits increased by 137 percent. Nationwide, between 1987 and 1993 the number of serious automobile accidents decreased by 7 percent, while the number of liability claims increased by more than 36 percent.

Let's give drivers a real choice. Those who want to stay in the current tort-based system and play the pain and suffering lottery can do so. Those who want to leave that system should be given that choice. As Denver Mayor Wellington Webb, who recently endorsed this legislation, said, "Auto Choice replaces waste and fraud and inefficiency with consumer choice and faster and fuller compensation for injuries."

Let's give the American people a choice; I urge you to support the Auto Choice Reform Act.

Thank you.

Mr. OXLEY. Thank you, gentlemen. We appreciate your testimony.

Let me ask both of you, if this bill passes and is signed into law, take us through how that effects the States, the average consumers. Is it phased in? How does it work in a practical way?

Mr. ARMEY. Well, my guess would be that the State on a State-by-State basis would say, let's give it a try. The insurance industry would then be marketing a new product in the State. They would be selling a PPI. If I go in to buy automobile insurance and they say—my agent says, I have this new option called a PPI. It is personal protection insurance. Here is the deal, you pay lower rates, but you forsake your choice to sue under pain and suffering should you have an accident, and you collect from your own insurer, from us.

Obviously they are going to have to lower the rate on that policy by enough to convince me that this is the better deal than the insurance that I have been buying that gave me all of those wonderful whistles and bells that I had before.

Now, what I would think the insurance commissioner would do and the State legislature would do would be to monitor the savings. This is essentially what we encourage them to do. If, in fact, you have the savings through the lowering of the rates and the purchase by your citizens, you would probably find it in the best interest to stay in the option.

If you don't find the savings, you may choose to opt out. On the other hand, if you are a State like—well, I'm from Texas, a State of great wisdom and respect for the individual's rights, you are naturally going to opt in right away. But other States may not be so devoted; let's say Arkansas just for a choice. Arkansas may opt out right away. Their unfortunate luck will be that folks from Arkansas talk to folks from Texas, and they are going to find out about those lower rates, and my guess would be that States that may have made the decision to opt out early might find themselves convinced by their citizens to opt back in later.

Mr. OXLEY. What happens in a situation where that motorist from Arkansas is traveling in Texas or vice versa and has an accident in a different venue; what happens under your legislation, either one of you?

You might want to answer that, Jim, because it was particularly raised about Virginia.

Mr. MORAN. They would be immune from a lawsuit. Once you choose this personal protection insurance coverage, you are safe from being sued for pain and suffering. Now, other drivers in a State that has this personal protection insurance coverage can elect

to get tort insurance coverage themselves so that they can be compensated for pain and suffering, but you are protected against suit.

Mr. OXLEY. So if I am insured by an Ohio company, and I have got an Ohio driver's license, and I am involved in an accident in McLean, Virginia, I have got some kind of immunity of being sued?

Mr. ARMEY. If I may, and this may be one of the areas where your committee may want to examine the legislation, as I understand it under current law, there is a choice of law with respect to the State. That is to say the States—the laws of the State in which the accident takes place are the laws that would govern the manner in which the claims would be resolved in the State.

If you were a person that preferred to stay in the pain and suffering lottery, and if you were absolutely convinced that the golden ring was just right around the next corner you turned, you would probably move to a State with that opt out and be careful never to drive in a State that opted in. My guess would be, in the end, those States that opted out would be the States that would have the high incidence of insurance fraud, and the States that opted in would have the low incidence of insurance fraud, because obviously, if it is your desire to defraud the system, you would move to that State that makes it more defraud-friendly, according to that term.

Mr. OXLEY. Well, we do have a mobile society. That seems to be rather a stretch, at best.

Mr. ARMEY. But, again, what we are searching for is a uniform standard of opportunities across the country, and we have a high confidence in the legislation. But what we have today is different standards in different States, so as you move your automobile from State to State, you move your automobile, as it were, from the State of Virginia to the State of Tennessee, and your liability and your settlement circumstances are governed by the different States.

Mr. OXLEY. Well, I can understand that. Of course, that has been the traditional law; that is, if you are—where the accident occurs becomes the venue for the lawsuit, but if I am involved in an accident as an Ohio driver in Virginia, I am not sure that I can all of a sudden make myself immune from legal actions in the Commonwealth of Virginia under any circumstances.

Mr. ARMEY. What we expect to see happen here is more States complying with a more uniform standard than what you have today. But there is the dilemma of reconciling your coverage purchase in one State against the laws of the State in which you have the accident with a greater diversity of configurations than we would anticipate would be consequent to this adoption of this legislation and the more uniform application of its provisions across all States, or most States.

Mr. OXLEY. My time has expired.

The gentleman from the Upper peninsula.

Mr. MORAN. Mr. Chairman, may I respond to that further, because this is going to be, perhaps, the most controversial issue, particularly during a transition period. Massachusetts has no-fault insurance. They have a threshold, so it doesn't work effectively, but they have some form of no-fault insurance. If they get hit in Virginia, which does not have no-fault insurance, the State's laws apply, so they could be sued for pain and suffering if that is what you are asking. But wherever the accident occurs, people are going

to be vulnerable for pain and suffering if there is not a no-fault system in effect in that State, even if they have no-fault insurance in their State of origin.

Mr. OXLEY. Under current law.

Mr. MORAN. Yes, that is under current law, that is right. But that would continue to be the case. If you get hit in a State that has opted out, you could still be sued for pain and suffering, if it is a pain and suffering—you know, if it is a——

Mr. OXLEY. Under your bill.

Mr. MORAN. Under this bill, yes. So State laws continue to apply. It is just that the reason for trying to make it uniform nationwide is you would have less incidence of that occurring. You would have less disparity from one State to another.

Mr. OXLEY. The gentleman from Michigan.

Mr. STUPAK. Thank you, Mr. Chairman.

With all due respect to the Majority Leader, people are not going to move so they can go sue in some other State for pain and suffering. That is just not going to happen. Let's take a look at this. If no-fault is such a wonderful deal, why has no State passed a no-fault law since 1976? In fact, three States have repealed no-fault.

And this proposal that you are proposing here today was actually put forth before the voters of California, and by a 2 to 1 margin, they rejected it, and the reason is this. You know, you say that you are going to save 30 percent. Well, why don't we put in a proposal or mechanism in this bill that says your rates will go down 30 percent, and they will remain down 30 percent, and if it doesn't work in 3 years, we repeal the whole thing. And if you really believe that is going to happen, I would ask you to put that in there because the same thing with the product liability bill, the cost of a ladder is $20 more just for liability. Well, then, reduce it 20 percent. It is not going to happen; it just doesn't happen.

In fact, if you take a look at it—and I will take the health insurance—excuse me, National Association of Insurance Commissioners, who administer this auto insurance in their States, the highest premium, the average auto insurance premiums are no-fault states at $729. Traditional law where you can sue for pain and suffering is $619. A hybrid of the two, if you will, where you can opt out or opt in, however you want to call it, it is $657.

Take Michigan, and go back to it, Mr. Moran. You brought that one up. We have it. We have caps on how much you can sue for, we have caps on when you can sue, and yet our policies are going up 21 percent a year. I mean, I just don't see it, and we are a no-fault State in the truest sense. Would you be interested in putting in a provision that says everyone's insurance would be reduced by 30 percent?

Mr. MORAN. But we have a provision that is very much like that, Bart. What we say is that if the insurance commissioner concludes it is not going to save at least 30 percent in insurance premiums, then they opt out.

Mr. STUPAK. And that's section C, a finding described under paragraph A, where the insurance commissioner makes that decision, and any review of such finding under subparagraph B occurs not later than 90 days of the enactment of the act.

Mr. MORAN. Sure, but then the legislature can opt out anytime.

Mr. STUPAK. Pardon?

Mr. MORAN. The legislature can opt out anytime. The legislature is not bound by that 90 days.

Mr. STUPAK. Well, then, will you put in there a D that says you can opt out anytime the State legislature wants to?

Mr. MORAN. There is nothing precluding the legislature from opting out.

Mr. STUPAK. And there is nothing from precluding the legislature from passing your so-called bill if they really wanted it, correct? I mean, States could do it right now if they wanted it, without this Federal legislation; is that correct?

Mr. MORAN. That is correct. There are a lot of things States could do but don't do because their neighbors are not doing them, and at some point, you know, we feel as though we ought to provide some leadership and attempt at uniformity so that it makes more sense for each State. We do the same thing with almost all of our national legislation, whether it be AFDC or whatever. You know, we try to avoid races to the bottom, but we give options to the States. This provides an underlying uniformity, but it gives an option to the State to opt out and have its own system.

Mr. ARMEY. If I might, I would like to respond to two points. First of all, you will have in a subsequent panel a gentleman who at one time made a lucrative living through insurance fraud, and I would suggest you ask that gentleman if he would have been willing to move from one State to another State to ply his trade, and it will be interesting for me to see what his reaction to that question might be.

What we are trying to do with this legislation is right now, by mandate, for all insurance purchasers across the country, the coin has turned up tails; that is, you are going to buy all this coverage, whether you want it or not, whether you use it or not, or whether you can afford it or not, by mandate of the State law. And the State legislative bodies have periodic efforts in the different States to turn that coin over to heads saying, you have a head, make your choice, be responsible, and your fate is in your own hands. The tort lobby, of course, is very effective in State legislatures and often prevents that coin from being turned over.

We are simply saying let's turn the coin over, heads up, and then let the burden of proof before the State insurance commissioner, before the State legislative body and on the tort lobby be—to turn it the other way, it is fair enough. It has been sitting there on tails long enough, let us have our chance for heads and see if it works out. If it doesn't work out, every State has got a right to go back to their mandatory requirement of all people in the State that they buy insurance, and in that insurance they pay additional funds for protection that would allow them to sue for pain and suffering, even if, in fact, their insurance users do not intend and would never use that option.

Mr. OXLEY. The gentleman's time has expired.

Mr. STUPAK. Mr. Chairman, if I may.

We passed a bill last night on the floor which said there is no unfunded mandates more than $100 million. If you pass this no choice scheme that you have here, it is going to be more than $100

million, and wouldn't it be contrary to the bill you passed last night on the floor because it included also private?

Mr. ARMEY. Well, I don't understand where you get that this is a mandate. What we are saying is we are saying we will not mandate to the consumer of auto insurance that they must buy coverage that they don't oftentimes, most oftentimes, I would argue, don't want, don't need and won't use, and we are saying to the State, you have an opportunity now to opt out from providing this to your citizens if they will let you get away with it.

Mr. STUPAK. If you opt out, you are mandating this piece of legislation. This is the only place they can opt to if they choose to take this. And even if half the States, if 10 States did this, you got more than $100 million, and you are in violation of the law you passed last night.

Mr. ARMEY. What we are doing is we are setting a uniform standard across the Nation that is respectful of the consumption rights of the individual citizens relative to the responsible exercise of their automobile privileges, and we are saying to those States that would prefer not to accept that uniform standard, you are free to opt out and to mandate to your citizens what coverage they must buy.

Mr. STUPAK. So the answer is yes——

Mr. OXLEY. The gentleman's time has expired.

The gentleman from Georgia.

Mr. ARMEY. Mr. Chairman, I'm sorry, I just got a note that apparently I have to leave for another responsibility. I want to thank you.

Mr. OXLEY. I thank the Majority Leader for his time and appreciate the testimony.

Mr. ARMEY. Thank you again for holding the hearings, and I look forward to watching your markup.

Mr. OXLEY. Thank you.

Mr. ARMEY. Thank you.

Mr. OXLEY. Can you stay, Jim?

Mr. MORAN. Yes.

Mr. OXLEY. The gentleman from Georgia.

Mr. DEAL. Thank you, Mr. Chairman.

I realize the questions I may have are somewhat technical, but anytime you depart from our common law system of fault, it becomes very difficult to fill in all of the gaps. But I think there are some very practical questions we need to consider as we move through this legislation, things like if we are moving to look into your own insurance carrier as the party responsible for compensating you, rather than the fault, the party at fault, I would like to ask the question, what happens to a passenger in a vehicle? Does the passenger look to the insurance coverage purchased by the driver of the vehicle rather than an individual policy that the passenger may have for their individual vehicle? Jim, do you know the answer to that?

Mr. MORAN. These are very good questions, Nathan. My understanding is it applies to the driver of the vehicle. It would be based upon his insurance. Although, if the individual was to—I would assume that the individual, if they had opted out of that policy, then they would presumably have the right to sue. The driver would not

have the right to sue if they had chosen this personal protection insurance. So if you maintained a policy or you were sitting in the shotgun seat and you got injured and you were still covered for pain and suffering coverage, and you were hit by somebody that also had pain and suffering coverage, then you could go ahead and sue individually, but the driver would not be involved in that. The driver's compensation would have to come from his own insurance company.

Mr. DEAL. So if the passenger was an uninsured person, did not have a policy——

Mr. MORAN. Oh, uninsured?

Mr. DEAL. If they were an uninsured person that did not have a policy on a vehicle of their own, would they still have the coverage of the driver of the vehicle in which they were riding?

Mr. MORAN. Well, you have got—I don't know why the law would change from the way it is now. There would be coverage if you were uninsured but you are riding in another person's vehicle, the driver's, the owner of the automobile's policy would extend to the passengers, as it does now.

Mr. DEAL. All right. Let's take another individual, a pedestrian who is struck by a vehicle, by an insured vehicle. What happens to the pedestrian? Supposedly if they don't have an insurance policy of their own, to whom do they look for responsibility?

Mr. MORAN. Well, for economic damages, if you have hit somebody, that's normally a criminal case and you——

Mr. DEAL. Not necessarily.

Mr. MORAN. Not necessarily, you're right. If it is a criminal case, obviously, you would know——

Mr. DEAL. Criminal courts don't like to get into the issue of assessing damages. They consider that a settled issue.

Mr. MORAN. The driver—let me say, I am looking through—I am going through in my mind the provisions of the law. I know if there is compensation above your policy limits, you have the opportunity for recovery. And in the situation like that, where there is a significant injury, I would assume that there would be a substantial amount of coverage. But I think what we ought to do, in questions like this that need to be answered comprehensively is to refer to the—refer it to the next panel, who, I have to admit, it is going to take me some time to figure this out to go through in my mind the provisions of the legislation, but these things need to be answered on the record.

Mr. OXLEY. The gentleman's time has expired.

Mr. DEAL. Can I ask one very brief question he touched on, Mr. Chairman? That is, does your bill mandate minimum limits of coverage? For example, you mentioned government vehicles. If I am working for a governmental entity, does your bill mandate the minimum coverage that that governmental entity must provide?

Mr. MORAN. The current law is that the State determines what the minimum coverage limits are, what you have to be insured for in order to be an insured motorist, and the State would continue to make that kind of determination. That part of the law doesn't change.

Mr. DEAL. It is not mandated in this bill?

Mr. MORAN. What changes principally by this bill is the pain and suffering provision. Economic damages essentially remain intact. It is a matter of being able to—whether or not you are able to sue for pain and suffering, noneconomic damages. That is the principal provision that is affected by this legislation.

Mr. OXLEY. The gentlelady from Colorado.

Ms. DEGETTE. Thank you, Mr. Chairman.

Jim, I guess I am having a really hard time grasping why this legislation, why at a Federal level. And let me try to ask you a couple questions. My understanding is that even of the no-fault States, of which my State is one, none of those States have provisions like in this bill that eliminate noneconomic damages altogether; is that correct?

Mr. MORAN. That is correct.

Ms. DEGETTE. So no State has thought that that would be in the best interest of their citizens, even States that have passed no-fault?

Mr. MORAN. They put thresholds.

Ms. DEGETTE. Right, like we have a threshold. But every State allows noneconomic damages, and my experience is the reason they do that is because they are afraid that if you don't allow some noneconomic damages, people will become wards of the State, or it will become a governmental expense. You will simply be cost-shifting for people who are serious accident victims. Have you heard that, or does that ring a bell?

Mr. MORAN. That is an argument that is certainly raised. The problem is that people aren't making that recovery, though. That is the problem. So, you know, if you have a $100,000 claim, in other words, a serious claim, you get back only 9 percent of your claim.

Ms. DEGETTE. I mean, we can argue about the studies because I have seen different studies, but I guess what I am saying is from my knowledge, Congress doesn't normally pass legislation that regulates auto insurance. This would be sort of a first, and I am wondering if no State has passed a law like that, why should we be passing it, especially with all the exceptions, States can opt out; but what is worse, it seems to me, is you are saying States can opt out, but also consumers can opt out. I mean, if this is such a swell idea, why not make all the consumers get insurance?

Mr. MORAN. Because we think consumers seeing the opportunity to be able to insure their automobile in an affordable way will take that option. A lot of people don't have the option to afford the auto insurance premiums that they would be required to for an automobile. That is why I said, 1 out of 7 drivers don't have auto insurance, because they can't afford it.

And, you know, the statistics that we shared with you initially are the reasons for motivating us for this bill. The fact that people aren't getting compensated, it is taking 16 months before they get compensated, they are only getting compensated for half their actual costs, and that is only if it is a $25,000 to $75,000 claim. If it is a major claim, they get compensated much less. Out of every premium dollar, lawyers are getting 28 cents, but the average insured person only gets 20 cents back. That is why we are doing this. It is gotten out of control.

Ms. DEGETTE. I understand there are problems, but it seems to me there are so many loopholes. I will give you an example. If Lino and I, my husband and I, were going to buy insurance here, I can guarantee you we would say, we are going to buy the full policy, we are not going to buy the lower coverage. So let's say somebody comes and hits me, I don't care what State it is in, in what State, they come and hit me, they have this other policy, then I am going to be out of luck under their policy, so I am still going to have to go back to my policy. So I think it could create more litigation. I mean, it hasn't been tried anywhere, so I am not sure it solves the problem.

Mr. MORAN. I don't see how it could create much more litigation when here, where we are located in this jurisdiction, auto accidents went down 22 percent, lawsuits went up 137 percent. How much more litigation can you have?

Ms. DEGETTE. I am not sure what the statistics are in the District of Columbia, but I can talk to you about Colorado. In Colorado, and I think this is a nationwide trend, auto accidents have gone down a lot. A lot is because of the DUI laws and some other good legislation. Lawsuits have gone up, but if you look at it statistically, at least in my part of the world, and I bet it is true here, the number of personal injury lawsuits and number of auto accident lawsuits has actually decreased. I don't know if that is true in the District of Columbia, but the cause at least in my State for the increase in lawsuits is bankruptcies and foreclosures and other kinds of non personal injury lawsuits, so I don't know what the breakdown is here.

Mr. MORAN. This is related to auto accidents. The people are much more likely to sue now, and they are suing for pain and suffering. They are not getting compensated for their economic damages. But everyone's premiums are going up to the point where it is really unaffordable for a lot of people, and most people can't keep their job without keeping their automobile.

Mr. OXLEY. The gentlelady's time has expired.

The gentleman from California Mr. Bilbray.

Mr. BILBRAY. Thank you. I appreciate the gentlelady from Colorado's observation about the reduction of accidents.

In California, we did a very unscientific study that said it was because the legal speed limit was raised to 65, and people were now looking through their windshield rather than their rear-view mirror because they were always worried about getting a ticket for going over 55.

But the gentleman from Virginia raised interesting issues. One that sort of hit home with me, after 2 years as a council member, 6 years as a mayor, and 10 years as a county chairman, is the issue of the impact of these lawsuits on government. I remember every Wednesday afternoon just sitting all afternoon with lawyer after lawyer and lawsuit after lawsuit, and I just think the one thing that really has hit me since coming here to Washington is when we talk about those lawsuits on government, it is like it is out there—it is not a big deal. The insensitivity of a lot of people around the city who claim to care about the poor and the needy and the downtrodden not recognizing that when a government gets sued, when a county gets sued or a city gets sued, it is not the rich

and the powerful that do without, it is the poor and the needy. The rich and powerful always get their share. The trouble is when the lawyers go in there and raid the coffers of local government, it is coming out of the services and the programs that would traditionally serve the poor and the needy. So I appreciate your articulating the impact on local government.

My question to you, though, is how does this affect the consumer who is involved with an accident with an uninsured driver; is there any effect in that, when we get into the issue of liability. It is kind of frustrating, a lot of times, that you get in an accident with an uninsured driver, and then the uninsured driver sues you for pain and suffering. But is there any possibility that your legislation may help to address those issues that we have, along the border, which is even worse because it is a federally sanctioned no uninsured drivers program, but also nationwide?

Mr. MORAN. Well, to some extent it does. If you have personal protection insurance coverage, you are not going to be sued for pain and suffering. You will be sued for economic damages, but not for pain and suffering. So it does protect you for that, whether it be an uninsured motorist or not.

You know, nothing is going to allow people to be uninsured. We are not suggesting that anyone should go without insurance, we are just suggesting they should have an option of a much lesser cost type of insurance, where they can't sue for pain and suffering and they are protected from being sued, if they are in their own State, from being sued by another driver.

In terms of public liability, of cities getting sued, a city is four times more likely to be sued in a case involving more than $1 million than anyone else because they have the deepest pockets, and so it really does hit home. That is why I think we have so much support among the Conference of Mayors for this.

Mr. BILBRAY. I think that is why we have to sit through all those absolutely outrageous proposals, too. The biggest problem you have is that you can't wheel all the poor and the needy into a courtroom before a jury, where they can roll in the fact that somebody was injured in an accident and they are going to get a pound of flesh from somebody.

But getting back to the uninsured issue, my concern is in my neighborhoods, when somebody is in an accident with another person with a Baja California plate, law enforcement specifically tries to assure you to just drop it because you will never get reimbursement, and all you are going to do is have the pain and suffering liability on you; that even though it wasn't your fault, it is better to totally ignore the accident than to try to follow up on it because the exposure of pain and suffering is so huge to the insured driver today.

Mr. MORAN. Absolutely. You know, these are terribly important issues. These are the issues that have to be resolved. We have a panel coming up with people who have studied this for years, and I think rather than me taking up their time when they know more about it than I do, these are the people that have worked on it, one of them has worked on this for a decade, they ought to answer these questions because they have gone into them at greater depth,

and I think your time would be better served to defer to that panel that is going to succeed me.

Mr. BILBRAY. With that lead-in, I will yield back the remainder of my time, Mr. Chairman.

Mr. OXLEY. The gentleman yields back.

The gentleman from Oklahoma Mr. Largent.

Mr. LARGENT. Jim, how would you respond to Bart's question about being an unfunded mandate? How does this cost a State?

Mr. MORAN. There is no legislation that says that it is a point of order if you mandate savings. These are savings we are talking about. The only unfunded cost is on the trial lawyers. And, I mean, I suppose if they want to make a point that they are an industry that would get hurt by this, they may want to make that point, and I don't want to be picking all over the trial lawyers, even though I seem to be doing it, but that is the only real cost.

What this is is a savings of billions of dollars. What was it, like $246 billion or something? What is the figure? On an annual basis we were comparing it to the $500 per child dependent tax credit. It was almost exactly the same amount, 250 over 5 years, but it is about $35 billion just in the first year of nationwide savings, so it is not a mandated cost, it is a mandated savings with the caveat that you can opt out of it, you don't have to recognize those savings.

Mr. LARGENT. The other question Bart raised that I wanted to get your response to, he said in some of the no-fault States, the premiums are actually higher in the no-fault States than in the States that——

Mr. MORAN. You know why that is? New Jersey is a case in point. New Jersey has the most accidents. I don't know why they have so many accidents; then California, places like Los Angeles, but particular places in California, they have an enormous number of accidents. And in Michigan, the study we have been shown shows that if it were not for the no-fault legislation you have, premiums would even be 20 percent higher. But it is a matter of the accident rate within the State. And if you correlate it with the number of accidents per capita in a State, you will see that they are not out of line; that, in fact, there has been some savings.

The problem is that in these States that have no-fault laws, they have compromised, and the compromise has been to put in a threshold. For example, $10,000, you can sue if you get over 10,000, so they will go to enough doctors' visits, they will find enough charges to get over that threshold, and if you look at the numbers, almost everybody gets right up, just over that threshold, so they can go ahead and sue, and that is what erodes the intent of the legislation.

Mr. LARGENT. Let me ask a fundamental question to make sure I have this clear in my mind, is that this legislation, Auto Choice, says that if somebody participates in one of these PPI plans, that they are relinquishing their right to sue for pain and suffering.

Mr. MORAN. That is right.

Mr. LARGENT. That is all it does.

Mr. MORAN. That is it.

Mr. LARGENT. So if they hit somebody else that doesn't have a PPI plan, that person can still sue them for pain and suffering.

Mr. MORAN. They are also protected. They can't be sued either for pain and suffering as long as you are in a State that has this plan operable. But they would recover economic damages through their own insurance company, and they would have to get that recovery within 30 days. Now it takes 16 months on average to get compensation, and if it is a serious accident, they get about 9 percent back, and on average they are getting about half of their actual economic damages. So what we are saying is people are going to be much better off if they get in an accident. Within 30 days they are going to have all their economic damages returned to them because they don't have to pay court costs.

Mr. LARGENT. Bart, did you want to follow up?

Mr. STUPAK. On the unfunded mandates, if you are going to let the trial lawyers do it, then the unfunded mandate is really the rules and regulations to implement this law. So if you are willing to let the trial lawyers do that, I withdraw the objection I have to it. That is where the real unfunded mandate is is who is going to draft the rules and regulations and implementation of this. All 50 states are going to have to do that. You have also said 1 of every 7 people are not insured, and they will now be able to be insured underneath this. Isn't that an unfunded mandate there?

Mr. MORAN. Bart, every time we have to pass any kind of legislation, there are administrative costs to implement it on a statewide basis. We don't consider those to be unfunded mandates. I can show you any number of Federal legislative affairs. If there is an additional cost of implementation, if there is a payment that we have to make to people, if there is an additional program cost that is not compensated, that obviously qualifies as an unfunded mandate.

Mr. STUPAK. The unfunded mandate law that you cosponsored going back to 1995 set a $50 million threshold. Any new program put forth by the Federal Government that costs the States more than $50 million is an unfunded mandate.

Mr. MORAN. What is the cost——

Mr. OXLEY. The gentleman's time has expired.

Mr. STUPAK. One million per State, that is what $50 million is.

Mr. OXLEY. We thank the gentleman from Virginia for his testimony and for being with us for quite some time, and he is now excused.

Mr. MORAN. I thank you, I think. No, thank you very much. I appreciate the opportunity to discuss this. More discussion needs to be had, and we have got another panel coming that can answer the technical questions.

Mr. OXLEY. That is a great segue, and we thank you because we are going to go to the next panel.

If those folks will come forward: Mr. Peter Kinzler, president of the Coalition for Auto Insurance Reform; Mr. Lester Blizzard, assistant district attorney in Harris County, Texas; Mr. Harvey Rosenfield, executive director of The Consumer Projects, from Santa Monica, California; Mr. Jeffrey O'Connell, professor, University of Virginia law school; Mr. Peter Taormino; and Mr. Michael H. Gladstone, attorney at law, from the Defense Research Institute in Chicago.

Gentlemen, thank you for your appearance.

We will begin to my left with Mr. Blizzard

STATEMENTS OF LESTER BLIZZARD, ASSISTANT DISTRICT ATTORNEY, HARRIS COUNTY, TEXAS, ACCOMPANIED BY PETER TAORMINO; PETER KINZLER, PRESIDENT, COALITION FOR AUTO INSURANCE REFORM; HARVEY ROSENFIELD, EXECUTIVE DIRECTOR, THE CONSUMER PROJECTS; MICHAEL H. GLADSTONE, ATTORNEY AT LAW, DEFENSE RESEARCH INSTITUTE; AND JEFFREY O'CONNELL, PROFESSOR, UNIVERSITY OF VIRGINIA SCHOOL OF LAW

Mr. BLIZZARD. Thank you, Mr. Chairman, members of the subcommittee. My name is Lester Blizzard. I am an assistant district attorney for Harris County, Houston, Texas, assigned to the Major Fraud Division. Our office prosecuted 109 defendants in an Operation Sideswipe, which is a major criminal conspiracy which defrauded several insurance companies of $2.7 million through staged auto accidents.

Mr. Taormino, Peter Taormino, who is seated beside me, was convicted in Operation Sideswipe. His testimony as a witness for the prosecution helped convict lawyers, doctors and other participants in an elaborate criminal conspiracy. He is currently serving a 5-year felony probation.

Fraud rings have operated in Houston and other major cities around the country for many years. They are generally based on a network of dishonest lawyers and doctors who profit from injuries that never occur in accidents that are not accidents. They file false claims with insurance companies for medical expenses and other economic damages. Claims for pain and suffering routinely inflate those medical claims by a factor of three.

The subcommittee invited us to describe one type of insurance fraud scam known as a staged accident. It produced insurance payments for those fictitious lawsuits. The kingpin in Operation Sideswipe established what amounted to a factory for manufacturing insurance claims. These demand packets were virtually indistinguishable from legitimate claims submitted by people who were injured in real accidents. Each demand packet included, among other things, the name of a claimant, a description of the accident, a witness statement showing clear liability, the details of medical treatment and the basis for compensating the accident victim for pain and suffering. By statute, insurance companies in Texas need to decide quickly whether to pay the claim or challenge it in court.

With your permission, Mr. Chairman, I would like to use a chart to describe in general the elaborate process through which these materials were assembled and turned into millions of dollars in cash payments, shared by certain dishonest and legal and medical professionals. Then I will ask Mr. Taormino to explain his role as a professional hitter or as a runner in the multimillion-dollar ripoff.

If I could approach a chart, it would greatly help me in describing how it goes about. I can do this very briefly.

Mr. OXLEY. That is fine.

Mr. BLIZZARD. This is Operation Sideswipe. The leader of the criminal organization lived in a fabulous house, and generated millions of dollars. He generated the millions of dollars through the

use of fraudulent demand packets; that is, the actual medical narratives. The medical billings were entirely fraudulent.

This is how basically the system worked and how he was able to make so much money. He would employ recruiters, such as Mr. Peter Taormino, who is before you today. He would have them come and recruit people that are kind of down on their luck, people that sort of are living day to day. Many of them were dope addicts, who could use a rock of cocaine and make a quick 100 bucks. The people are not hard to find in certain sections of our cities throughout the Nation.

Once he attracts them, the people need cars, they need to have insurance policies. He would then—or the recruiter would then organize these people, and have them meet at a restaurant somewhere. Thereafter, they would file blank powers of attorneys and fill out information sheets, putting down their general personal information.

The next step would be for a hitter, or how we described it was the boy car and the girl car. Boy car would bump the girl car. The girl car includes about four people, the boy car has the one person, that is the hitter, and he is insured. Now you go out to a remote location, and at this point they bang the cars together and create some realistic damage. They would go back to a more public location, throw down whatever glass or what have you fell off the vehicles and call the police. All the other people that were now at the restaurant come to the scene, and they make the police report. The driver of the boy car will assume liability. "I hit them. I didn't see them, I didn't know where I was." He will assume the liability. That makes it a better case to present to an insurance company for settlement.

Thereafter, the next stage would be for them to get to one of two, in this case, fraudulent medical practices, medical facilities, where they would go one time, but they would fill out billings for several or more times. Thereafter, a medical narrative would be produced. A doctor who is in on it would sign off on the deal, on a medical narrative. All that would then be submitted to an attorney. The attorney would put together their demand packet, which includes a demand. That demand will include pain and suffering based upon the amount that is based on the fraudulent billing.

Now once it gets to the insurance company, they will look at it. They will pay off. An insurance company and online adjuster, people that will testify in this case, will tell you they have to handle about 60 to 100 cases. They have, at least in Texas, and I believe in many States, a very short period of time in order to make their decision upon whether to go ahead and pay the thing out or not. Whether to go to litigation or whether to settle. So they are under a great deal of pressure. They obviously can't give the study the attention required. They do the best they can.

Thereafter, once the settlement checks are cut, they would come back to the lawyer, and what would happen at that point is on the settlement checks. The various people that were the claimants, their signatures would be forged as endorsement on the checks, and the different lawyers would sign off on the check. It would be taken to a money laundering institution, and in this case it was Lee's Drive-In. It is a meeting point, a very small grocery store.

That grocery store, Mr. Chairman, did $4 million in checks, $2.7 million in insurance-related checks. Everything is converted into cash at this point. Then some would be—well, all of it would go back to the ringleader. He would use some of the portion in order to fund his fabulous life-style and use the rest and remaining portions to fund this criminal organization, and it just feeds itself.

This is just one example. I know that there are several operating, at least in my town. They are probably operating across the Nation.

Having said that, I will pass the microphone to Mr. Taormino to give you an explanation as to how he did it.

[The prepared statement of Lester Blizzard follows:]

PREPARED STATEMENT OF LESTER BLIZZARD, ASSISTANT DISTRICT ATTORNEY, HARRIS COUNTY, HOUSTON, TEXAS

Mr. Chairman, Members of the Subcommittee, my name is Lester Blizzard. I am an Assistant District Attorney for Harris County, Houston, Texas, assigned to the Major Fraud Division. Our office prosecuted 109 defendants in Operation Sideswipe, a major criminal conspiracy which defrauded several insurance companies of $2.7 million through staged auto accidents.

Mr. Peter Taormino, who is seated beside me, was convicted in Operation Sideswipe. His testimony for the prosecution helped convict lawyers, doctors and other participants in an elaborate criminal conspiracy. He is currently serving a five-year felony probation.

Fraud rings have operated in Houston and in other major cities around the country for many years. They are generally based on a network of dishonest lawyers and doctors who profit from injuries that never occurred in "accidents" that were not accidental. They file false claims with insurance companies for medical expenses and other economic damages. Claims for pain and suffering routinely inflate those medical claims by a factor of three.

The Subcommittee invited us to describe one type of insurance fraud scam, known as the "staged accident." It produces insurance payments for those fictitious losses.

The king-pin in Operation Sideswipe established what amounted to a "factory" for manufacturing insurance claims. These "demand packets" virtually indistinguishable from legitimate claims submitted by people who were injured in real accidents. Each demand packet included, among other things, the name of a claimant, a description of the accident, witness statements showing clear liability, the details of medical treatment and the basis for compensating the accident victim for pain and suffering. By statute, insurance companies in Texas need to decide quickly whether to pay a claim or challenge it in court.

With your permission, Mr. Chairman, I would like to use a chart to describe in general the elaborate process through which these materials were assembled and turned into millions of dollars in cash payments, shared by certain dishonest legal and medical professionals. Then I will ask Mr. Taormino to explain his roles as a "professional hitter," and as a "runner" in this multi-million dollar ripoff.

Mr. TAORMINO. Mr. Chairman, thank you. If you don't mind if I approach the chart also.

This, sir, is the seven-step process of an organization such as the Operation Sideswipe. Here we have a recruiter coming in to find people like the drug addicts, those that are hard on their luck. My job was to recruit them at first, and then I became like a procurement chief. I would buy them insurance if they didn't have insurance on their car, from the gentleman here or the lady here on the chart. And if they didn't have a car, we would buy a car for them on occasion. Here we would ask them or tell them they would receive a certain amount of money, generally a hundred dollars, and we would then sit down at a restaurant, usually at Denny's, and plan it out. Officers would come in and eat and not even be thinking twice about what we were doing.

We would fill out blank powers of attorneys, there is no name or anything of the attorney on it, and also information sheets which had the bios of the people. Then myself and another driver would take both vehicles, go out behind a building like Mr. Blizzard was saying, and gather the material that was left if we broke a lens, and then bring it back to the individual, and they would set up at a stop sign and say to the police, you know, "we have a wreck." The driver would say, "it is my fault."

The next day they would go to the doctor. I would pay them another hundred dollars, and then the doctor would falsely examine them, if he even did so. They would receive some kind of treatment possibly, and then I would give them their share.

Also, the attorneys would also negotiate with—I am assuming the doctors, okay, and my role, I am right here on the line. And like Mr. Blizzard was saying, there was millions of dollars in Houston alone. The people aren't aware of the checks they were getting because the lawyers would have them forged and then just distributed the money to the doctors as well. And that is all I have on that.

Also, I would coach them on where they were hurting. I would tell them, you know, your arm hurts, your chest, your neck, your back or wherever, usually three points. That was generally the case. The more places you hurt, the more money they would receive, or the doctor and the lawyer would receive, rather.

There would be four people in the girl car. The boy car would have one, the driver. We paid them approximately a hundred dollars per person, and if they referred anybody, we would give them a hundred dollars more per setup that we did. The lawyers and doctors, I like to refer to as they took the peanuts and left us the crumbs. We got a few dollars here, and they went off with thousands of dollars. And that is all I have. Thank you.

Mr. OXLEY. Thank you. The Chair notes there is a vote on the floor, so this would be probably as good a time as any to recess, and we will reconvene after that vote in about 10 minutes.

Mr. GILLMOR [presiding]. Thank you for your patience while we voted. We will proceed with the witnesses, and we would also ask that we follow normal procedure of adhering to our 5-minute rule for remarks.

Next is Mr. Kinzler.

STATEMENT OF PETER KINZLER

Mr. KINZLER. I ask that my formal statement be put into the record.

Mr. GILLMOR. Without objection.

Mr. KINZLER. My name is it Peter Kinzler. I am the president of the Coalition for Auto Insurance Reform. CAR represents a cross-section of leading academics, insurers and businesses that support the adoption of legislation that would give motorists the opportunity to purchase insurance that would, one, pay benefits to all insured automobile accident victims; two, provide better coverage for more seriously injured persons; three, pay benefits promptly; and four, lower automobile insurance premiums.

My involvement with auto insurance reform dates back to the 1970's when I had the privilege of serving as counsel to the then-Consumer Protection and Finance Subcommittee of this committee.

From 1973 to 1978, the subcommittee had four chairmen, John Moss, Lionel Van Deerlin, Jack Murphy and Bob Eckhardt, all of whom worked for enactment of legislation that would have given motorists what they need, lower premiums and better compensation.

The problems with the tort system flow from the system itself. The first chart here identifies something that I will get to in just a second, but the problems of the tort system is a direct by-product of the system itself whose defects have been documented by study after study for over 70 years. First there are large compensation gaps.

The most obvious one is single-car accidents where there is no recovery whatsoever because there is no other driver to sue, and 30 percent of all injured people recover nothing from the tort system.

Second, the system creates tremendous incentives for fraud, as you heard before. The incentive for fraud is the tort system. Since every dollar of medical bills and lost wages is routinely trebled for pain and suffering damages, injured or not injured people have an incentive to run up their medical bills. This is also predictable, both in terms of staged frauds, but also in the everyday padding of bills or filing claims for nonexistent injuries.

The RAND Institute has estimated that 35 to 42 percent of all medical claims are fraudulent as a result of the incentives of the tort system. Ironically, as this chart shows, this fraud is helpful only to the people at the lowest amount of loss. As the chart shows, people with economic losses between roughly $1,000 to $5,000 recover on average, as you see there, almost 2½ times their economic loss, and that is because of the threat of this suit.

Unfortunately, as economic loss mounts, the right to sue becomes illusory. It becomes illusory largely because of limitations on people's insurance policies. There are far more uninsured drivers and drivers with the minimum amount of insurance than there are the Bill Gates of the world. As a result, as you can see, the losses between $25,000 and $100,000, the average recovery is only 56 percent of economic loss and not a penny on average for pain and suffering, and above $100,000 it drops to 9 percent. These are truly tragic numbers.

The tort system also takes months and months to pay, because since you have to maintain a lawsuit, you cannot recover damages unless you prevail, and that can take many years even.

Fifth, and the second chart here shows this, frankly attorneys from both sides take far too many dollars, and not nearly enough is paid to injured people. As you can see from this chart, attorneys from both sides recover 28.4 cents from every insurance premium dollar; 12.6 cents is paid for fraudulent claims, and only 14.5 cents ends up in the pockets of injured people for economic losses, the first requisite of any decent system.

Unless H.R. 2021 is adopted, the driver's only option in 37 States will be the failed tort and liability system.

How do we know that 2021 will improve the system? The answer lies, in fact, from the lessons learned from the successes and failures of 16 States that have experimented with no-fault laws over the past 27 years.

First, all State no-fault laws provide faster, more complete compensation to all accident victims. They solve some of the basic problems in terms of compensation.

Second, though, many of them have experienced higher premiums than they should have because of the weaknesses of those laws, and those weaknesses largely relate to a subject Mr. Moran referred to earlier, which is the dollar thresholds where you can sue for pain and suffering if your losses exceed $2,000 for economic loss. The problem is that it encourages fraud, and those who have undermined these laws, the trial bar and their allies, should not now be permitted to benefit from their actions.

The red light is on, but let me finish very quickly.

H.R. 2021 builds upon the lessons of these States. It maximizes individual choice by giving people an option to buy low-cost insurance coverage, but it makes sure that there will not be excessive premium cost because the pain and suffering dollars would be eliminated from the system.

The final point, let me just say that the people choose—this is a choice. People choose to remain in the State system. If it is a tort system, they would be able to purchase insurance that would provide for compensation for their economic and noneconomic damages. It would be fault-based and would pay them approximately the same dollars for economic and noneconomic loss with the same premium.

Thank you, Mr. Chairman.

[The prepared statement of Peter Kinzler follows:]

PREPARED STATEMENT OF PETER KINZLER ON BEHALF OF THE COALITION FOR AUTO-INSURANCE REFORM

My name is Peter Kinzler. I am President of the Coalition for Auto-Insurance Reform (CAR). CAR represents a cross-section of leading academics, insurers, consumer activists and business groups that support the adoption of legislation that would give motorists the opportunity to purchase insurance that would:

* Pay medical, rehabilitation, wage loss and replacement services benefits to all insured automobile accident victims, and provide better coverage for more seriously injured persons.
* Pay benefits within 30 days of submission of a bill or claim.
* Lower automobile insurance premiums.

H.R. 2021, the Auto Choice Reform Act of 1997, would give drivers throughout the United States the opportunity to purchase such insurance. It is legislation that would provide enormous benefits—lower premiums, better compensation and more choice—to American motorists.

WHY AMERICAN DRIVERS NEED AUTO INSURANCE REFORM: THE FAILURES OF THE TORT AND LIABILITY INSURANCE SYSTEM

My involvement with auto insurance reform dates back to the 1970s when I served as Counsel to the then-Consumer Protection and Finance Subcommittee of this Committee, which had jurisdiction over auto insurance reform. From 1973 through 1978, the subcommittee considered auto insurance reform bills that would have set federal standards for no-fault automobile insurance. The Subcommittee had four different chairs—John Moss, Lionel Van Deerlin, Jack Murphy and Bob Eckhardt—and every one of them supported and worked for enactment of the legislation.

Why did this Committee consider auto insurance reform legislation then and why should the Congress address the issue now? The answers lie in the ongoing defi-

ciencies of the tort system and the lessons learned from more than 27 years of state experiments with different forms of no-fault insurance.

The seminal work on the deficiencies of the tort and liability insurance system in the 1970s was a 26-volume study completed by the U. S. Department of Transportation (DOT) in 1971. The study concluded that the tort system:

> ...ill serves the accident victim, the insuring public and society. It is inefficient, overly costly, incomplete and slow. It allocates benefits poorly, discourages rehabilitation and overburdens the courts and the legal system. Both on the record of its performance and the logic of its operation, it does little if anything to minimize crash losses.[1]

Recent studies by the RAND Institute for Civil Justice document that these problems remain today. These deficiencies define the reality of the tort and liability insurance system, which will remain drivers' only option in 37 states unless H.R. 2021 is adopted.

The shortcomings of the tort system are the inevitable byproduct of a system which requires an injured person to jump through hoops to recover compensation. First, an injured person must identify and show that the other driver was at fault. Second, an injured person must show that he was without fault or only partially at fault. Third, he must obtain a settlement or prevail in a lawsuit. And, fourth, even if the injured person successfully makes it through the first three hoops, he can only recover his damages if the other person has sufficient insurance or other financial resources to pay for his loss.

The Tort System Has Significant Compensation Gaps

A person injured in an automobile accident is not entitled to recover under the tort system unless he can establish that someone else was responsible for the accident. By definition, a person in a one-car accident cannot recover under the tort system. While such accidents are the single largest category of cases where there is no compensation under the tort system, the same result will occur under other circumstances, such as if both parties are free from fault. In total, *30 percent of all auto accident victims recover nothing* under the tort system.[2]

People with No Injuries or Minor Ones Receive Far More than their Economic Losses While the Seriously Injured Receive Inadequate Compensation for their Losses

For those fortunate enough to be able to recover under the tort system, the pattern of recovery is perverse. Chart 1 demonstrates that people with minor injuries are vastly overcompensated, while the seriously injured, on average, recover only a small fraction of their medical bills and lost wages and nothing for pain and suffering.

There are two reasons for high recoveries for small injuries under the tort system. First, lawyers know the value of a nuisance suit for small or feigned injuries. Plaintiffs, with the encouragement of their lawyers, submit inflated claims for injuries and sometimes even claims for nonexistent injuries in order to build up medical costs to increase their recoveries. Attorneys know insurers will settle these small claims because it is cheaper to settle than to pay their attorneys to fight it out in court. Second, because of the difficulty of quantifying pain and suffering damages, juries routinely make such awards as a multiple of three times the amount of economic damages. When an attorney knows the other driver has enough insurance to cover the claim, an attorney can encourage the injured person to run up medical bills in order to hit the pain and suffering jackpot. As a result, *people with economic losses up to $2,000 recover, on average, about two and a half times their losses.*[3]

The greatest shame of the current tort system is the treatment of the seriously injured, such as those with permanent and total disability. The primary reason for inadequate recovery is the policy limits of the other driver's coverage. About 15 percent of all American drivers have no auto insurance coverage,[4] with the figure as high as 30 percent in some states. Many other motorists carry only the minimum amounts of liability insurance needed to meet state law, about $15,000 to $20,000, and many more carry levels that are well below the amounts needed to compensate

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[1] *Motor Vehicle Crash Losses and Their Compensation in the United States, A Report to the Congress and the President,* United States Department of Transportation (March 1971), 100.

[2] Steven J. Carroll, Allan F. Abrahamse, *The Effects of a Choice Automobile Insurance Plan on Insurance Costs and Compensation, An Updated Analysis* (Santa Monica, CA: RAND Institute for Civil Justice, 1998), 11 at footnote 9. [Hereinafter, Carroll and Abrahamse]

[3] Stephen Carroll, James Kakalik, Nicholas Pace, John Adams, *No-Fault Approaches to Compensating People Injured in Automobile Accidents* (Santa Monica, CA: RAND Institute for Civil Justice, 1991), 21-22. [Hereinafter Carroll, Kakalik, Pace and Adams].

[4] Carroll, Abrahamse, *supra* note 2 at 13, footnote 16.

a seriously injured victim. Of course, no matter how simple the case, the plaintiff's attorney will take at least one-third of any recovery.

As a result, *a victim with medical expenses and lost wages between $25,000 and $100,000 recovers on average only 56 percent of those losses and nothing for pain and suffering. For persons with catastrophic injuries and losses of over $100,000, average recovery drops to 9 percent.*[5]

The Tort System is Slow to Pay Injured Persons

Because of the need to prove fault under the tort system, it does not provide for speedy compensation. The DOT study found that it took 19 months to receive payment in serious injury cases.[6] In areas with crowded court dockets, the wait can be much longer. The delay in payment puts pressure on the seriously injured, particularly the poor, to settle their claims for less than they are worth.

The only money auto insurance provides in the interim is a few thousand dollars for those who have medical payments coverage, which is the only part of the personal injury portion of the premium that presently pays benefits without regard to fault. Of course, people who are fortunate enough to have good health insurance, another such coverage, can recover quickly.

The Tort System Pays Too Many Dollars to Lawyers and Too Few to Injured Persons

A system that requires lawyers and courts to adjudicate fault will always be an expensive, inefficient means for compensating accident victims. Contingency fee attorneys are usually paid about one-third of an injured person's recovery as a fee. Attorneys for insurers are paid on an hourly basis. As a result, as Chart 2 reveals, more than 28 cents out of every premium dollar drivers pay for bodily injury liability and uninsured motorist coverage goes to attorneys. That is almost twice the 14.5 cents that are paid to victims for legitimate medical bills and lost wages.

Massive Insurance Fraud Raises Premiums for All Drivers

Outright fraud has driven insurance rates sky high, hitting most cruelly at the poorest members of our society. The problems have worsened over the last quarter of a century.

The incentive for the fraud is the tort system. First, damages are awarded for all medical bills and wage losses of a victim, without regard to whether the victim has already received compensation for the losses from other sources, such as health insurance. This provides an incentive for people to run up their medical bills because they often can be paid twice for the same bills.

Second, victims receive compensation for their noneconomic damages, such as pain and suffering. Because it is difficult, if not impossible, to quantify these losses, persons simply collect some multiple of their economic losses—typically three times—as compensation for pain and suffering.

Under antitrust law, willful wrongful conduct results in trebled awards. Under tort law, conduct that Senator Moynihan has characterized as "the perfectly predictable outcomes of a particular transportation system utilizing a specific technology"[7] often results in quadrupled awards. The path to maximum recovery under the tort system is obvious—run up medical bills, necessary or not, because they are, in effect, quadrupled.

The results are predictable—both staged fraud and the everyday padding of bills. People injured in California, a fault jurisdiction, have about 250 soft-tissue injuries (sprains, strains, pains and whiplash) to 100 verifiable "hard" injuries (such as broken bones). In sharp contrast, people in Michigan,[8] a good no-fault insurance state, have about 70 soft-tissue injuries for every 100 hard injuries. The reason for the difference is that in Michigan there is no incentive to run up medical bills because you are only paid once for those bills.[9] With little incentive to file false claims or to build up claims, the lower filing level approximates the true injury level. It is

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[5] Carroll, Kakalik, Pace and Adams, *supra* note 3 at 21-22.

[6] *Motor Vehicle Crash Losses and Their Compensation in the United States, A Report to the Congress and the President,* United States Department of Transportation (March 1971), 43.

[7] Daniel P. Moynihan, Forward to Jeffrey OConnell, *The Injury Industry* (University of Illinois Press, 1971) at ix.

[8] Stephen Carroll, Allan Abrahamse and Mary Vaiana, *The Costs of Excess Medical Claims for Automobile Passenger Injuries* (Santa Monica, CA: RAND Institute for Civil Justice, 1995), 13. [Hereinafter Carroll, Abrahamse and Vaiana]

[9] Michigan law permits injured people to sue for noneconomic damages but only in cases of serious or permanent injuries. Michigans threshold reduces the incentive of injured people to inflate medical bills because the right to sue is contingent on the nature of the injury, not the amount of the medical bills. Even in Michigan, some people inflate their medical bills in an effort to cross the threshold.

interesting to note that the 18 states with the highest ratio of soft-tissue to hard injury claims are all tort states.[10]

What is the cost of these excess claims? A 1995 RAND Institute for Civil Justice (ICJ) study estimated that 35 to 42 percent of claims filed were excessive. Using 1993 data, the ICJ estimated that "excess consumption of health care in the auto arena in response to tort incentives accounted for about $4 billion." Noneconomic and other losses from excessive claiming behavior cost another $9-13 billion. The total bill to driving consumers was some $13 to $18 billion.[11] These excess claims also raise the costs of private health insurance, Medicare and Medicaid.

Chart 2 shows that the amount of fraudulent and excessive claims—12.6 percent of the bodily injury premiums in tort states—nearly equals the amount paid for legitimate medical bills and lost wages, 14.5 percent.

STATE EXPERIENCE WITH NO-FAULT AUTOMOBILE INSURANCE IDENTIFIES THE PATH TO BETTER AUTO INSURANCE COVERAGE

It is 27 years since the first no-fault insurance law, authored by Michael Dukakis, went into effect in Massachusetts. Today 13 states have some form of no-fault insurance[12] and they have accomplished their role as laboratories of auto insurance reform. We now know what combination of benefits and restrictions on lawsuits works best to lower premiums and provide better protection for accident victims.

The state experience with no-fault or first party, non-fault-based auto insurance was not a radical departure in the law. Most insurance in the United States is first party, non-fault based insurance in the sense that a person's own insurer pays benefits based on the occurrence of an insurable event rather than a determination of fault. All health insurance, including Medicare, is first party insurance. When an elderly woman has treatment for a fractured hip, Medicare does not first make her prove that someone else was "at fault." It pays her bill, no questions asked.

Homeowners coverage is another form of first party insurance. So is workers' compensation. Neither of these coverages forces an injured person to engage in a costly and pointless exercise to find that someone else was at fault before compensation for losses is paid. Even most kinds of coverage under an automobile insurance policy in a tort state are first party—"collision" for damage to the car and "comprehensive" for other damage such as fire and theft. First party insurance should be extended to the personal injury portion of automobile insurance.

First party, non-fault-based automobile insurance is simple and inexpensive. People give up an uncertain opportunity to recover inadequate compensation for serious injuries, slowly, under the tort system. In return, they receive an assured right in all cases to receive prompt payment for their economic losses, up to the limits they choose for themselves and their families. More people can be paid more dollars for a lower premium because the tort incentives to file fraudulent claims disappear, because attorneys and their fees are no longer needed as a predicate to compensation and because overpayment of small claims is eliminated. *First party auto insurance replaces the right to sue with the right to recover.*

State No-Fault Insurance Laws Provide Fast and Full Compensation

How has first party insurance worked at the State level? Twenty-seven years of experience echoes the conclusion of a 1977 DOT study that "State no-fault plans... provide more adequate and equitable benefits than the tort liability system."[13] A follow-up DOT study in 1985 found that: "Significantly more motor vehicle accident victims receive auto insurance compensation in no-fault states than in other States;... compensation payments under no-fault insurance are made far more swiftly than under traditional auto insurance; [and]... no-fault insurance systems pay a greater percentage of premium income to injured claimants than do traditional liability systems."[14]

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[10] Carroll, Abrahamse and Vaiana, *supra* note 8 at 14.

[11] Carroll, Abrahamse and Vaiana, *supra* note 8 at 23.

[12] No-fault automobile insurance is a form of insurance that combines first party benefits, paid by ones own insurer for economic loss without the necessity of proving fault, with some restrictions on lawsuits. The following states have laws that both provide for the payment of first party benefits and contain some form of restrictions on lawsuits for noneconomic damages: Colorado, Florida, Hawaii, Kansas, Kentucky, Massachusetts, Michigan, Minnesota, New Jersey, New York, North Dakota, Pennsylvania and Utah.

[13] *State No-Fault Automobile Insurance Experience,* 1971-1977, United States Department of Transportation (June 1977), 78.

[14] *Compensating Auto Accident Victims,* United States Department of Transportation, (May 1985), 3-4.

It was the deficiencies of the tort and liability insurance system, combined with the success of the Michigan no-fault law in addressing these faults, that led former Subcommittee Chairmen Moss, Van Deerlin, Murphy and Eckhardt and Senators Phil Hart, Warren Magnuson and Ted Stevens to champion federal no-fault auto insurance reform in the 1970s. The Consumer Federation of America, Consumers Union, the National Consumers League, the American Association of Retired Persons (AARP) and the AFL-CIO endorsed federal standards auto insurance legislation that would have required all states to adopt no-fault laws. The standards would have required states to offer consumers an insurance system with more than $100,000 in first party benefits and the right to sue for pain and suffering in cases of serious and permanent injury. John Martin, testifying before the Consumer Protection and Finance Subcommittee on behalf of the AARP in 1977, said that the AARP is "convinced that the principal of no-fault automobile insurance is sound and that it will result in better benefits and prompt payments as opposed to the operations of the tort liability system with its delays and consumption of premiums and fees and litigation costs."[15]

State No-Fault Laws' Cost Savings Have Been Undermined by the Trial Bar

Despite the benefits of first party insurance and broad early consumer support, only 13 states have no-fault laws today. No state has enacted a law since 1976.[16] While no-fault has delivered on its promises of fast and better compensation for all, many of the State laws have failed to deliver on the promise of lower premiums.

The basic problem with most state no-fault laws is that they permit too many lawsuits. As a result of the power of the trial bar's opposition, the restrictions on lawsuits have been weakened to the point that the cost of the cases in which one can sue, when combined with the no-fault benefits that are payable to all injured persons, becomes very expensive.

Eight of the laws rely on "dollar" thresholds that permit suits for pain and suffering when a person incurs $2000 or so of medical expenses. These thresholds are easily breached, particularly with the encouragement of plaintiffs' lawyers, so that the essential trade off of no-fault auto insurance—prompt and certain compensation for economic losses for all injured people in exchange for restrictions on the legal lottery system—is gutted.

Dollar thresholds often produce the most expensive of all worlds—a no-fault system on top of a barely restrained tort system. Dollar thresholds are targets, giving the unscrupulous even greater incentives to file fraudulent claims than under the tort system.

It is the height of hypocrisy that those who have worked hardest to weaken thresholds and then taken advantage of the loopholes they have created to increase the costs of the system are now arguing against H.R. 2021 on the grounds that the state no-fault experiments have failed to keep costs down.

Adoption of a predominantly first-party insurance system with tight restrictions on lawsuits will eliminate a huge amount of fraud.

H.R. 2021: A PRESCRIPTION FOR LOWER PREMIUMS, BETTER BENEFITS AND MORE CONSUMER CHOICE

What we have learned from nearly 100 years of experience with the fault and liability insurance system is that it cannot be repaired. Changes are costly and do not address gaps in compensation and slow payments. The only consistent winners under the fault and liability insurance system, regardless of how modified, are lawyers and the providers of unnecessary medical services.

By contrast, 27 years of state experience with no-fault auto insurance shows what works and what does not. All of those laws provide timely benefits to injured persons. They pay all injured persons. They all provide better compensation for more serious injuries. In these fundamental respects, they all are better than the tort system.

The record on costs is different. Dollar thresholds do not work in states with aggressive trial bars. They simply provide a target for the unscrupulous. The result is all motorists pay higher premiums for the dishonesty of the few. It is important, however, to reemphasize that the responsibility for the failure of some no-fault laws to lower costs lies not with the proponents of no-fault, but with the trial bar. When

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[15] Hearings before the Subcommittee on Consumer Protection and Finance of the Committee on Interstate and Foreign Commerce, House of Representatives, *Federal Standards for No-fault Motor Vehicle Accident Benefits Act* (1977), 537.

[16] In the 1970s, 16 states adopted no-fault laws. Nevada, Georgia and Connecticut subsequently repealed them. Pennsylvania repealed its law in 1984 but adopted a "freedom of choice" law in 1990. Many states have modified their no-fault systems in the intervening years.

they could not stop the adoption of no-fault laws, the trial bar weakened them by encouraging dollar thresholds. Then, they exploited them.

Tight verbal thresholds do reduce the number of lawsuits enough to enable people to receive high levels of no-fault benefits for a somewhat lower premium. However, they do not address the problems of the poor, who can no more afford the Lincoln Town Car of insurance than they can afford to own a Lincoln Town Car. The poor need the option of a low cost product, even if it means lower benefits than wealthy people can afford.

The state experience provides a road map for both better benefits and lower premiums. The key to achieving these goals is the elimination of all lawsuits except those for any excess economic loss. H.R. 2021 offers drivers such an option, an option that does not exist in any state today.

A Right to Consumer Choice Under H.R. 2021

H.R. 2021 builds upon the experience of the states. It maximizes individual choice by permitting drivers an option they do not have now—to buy low cost insurance that provides accident victims with better, speedier compensation for their injuries.

It would not eliminate the tort system. Instead, it would expand drivers' insurance options so that they could choose between either a modified version of the system that exists in their state today or the new personal protection insurance (PPI) option.

The PPI Option: Better Coverage at a Lower Premium

Drivers who want to opt out of the lawsuit lottery can elect the new option—PPI coverage. They would be able to choose the level of PPI benefits they need and can afford, so long as they choose a level at least equal to the minimum amount of insurance required in their state. They could even purchase first party benefits for noneconomic loss, if they wished. When they were injured, instead of having to prove fault, they would simply file claims for their losses directly with their own insurer. It would be similar to filing a claim with a health or workers' compensation insurer. The insurer would be obligated to pay them within 30 days.

Fault would not be abolished. If the PPI driver suffers a loss that exceeds his first party coverage, he would still be able to sue any at-fault driver for uncompensated economic loss. He could, in turn, be sued by other drivers for his fault but only for uncompensated economic loss.

According to the Joint Economic Committee (JEC), drivers who elect the PPI option would see an average 24 percent reduction in their overall auto insurance premium. For the bodily injury portion of the premium, the only part affected by this legislation, the average reduction would be 45 percent. The JEC estimates the overall annual reduction would be $35 billion if all drivers elected the PPI option.[17] State no-fault insurance experience shows that eliminating lawsuits for pain and suffering will produce dramatic decreases in premiums.

This combination of better compensation for serious injuries and lower premiums is not a magic trick. It is accomplished by eliminating the fraud associated with the tort system's incentives, unnecessary attorneys' fees and pain and suffering. Chart 3 compares the costs and benefits of the tort system with the PPI system.

The PPI option is of particular benefit to the poor. In some areas of the country today, poor people are faced with a Hobson's choice —pay as much as 30 percent of their disposable income to buy auto insurance[18] or violate the law and drive without insurance. Under the PPI option of H.R. 2021, the poor would see their premiums reduced by the most, an estimated 36 percent.[19] PPI insurance is progressive insurance because its cost depends upon the potential loss of the insurer's insured. A poor person has a lower potential work loss and that lower potential can be reflected in significant cuts in premiums. The poor would also receive better benefits than they do today in the event of a serious injury.

Rights of Drivers Who Choose Not to Switch

People who want to remain under their present state law could choose a modified version of that system, one that will assure them greater likelihood of compensation in the event of an accident for the same cost. Any person who elects this option would see no changes in the rules if he were involved in an accident with another driver who elected to stay under the same system. The system would change only

[17] *Auto Choice: Impact on Cities and the Poor,* Joint Economic Committee, United States Congress (March 1998), 34-36.

[18] Robert Lee Maril, *"The Impact of Mandatory Auto Insurance Upon Low Income Residents of Maricopa County, Arizona,"* unpublished manuscript, 1993, 11.

[19] *Auto Choice: Impact on Cities and the Poor,* Joint Economic Committee, United States Congress (March 1998), 35.

if he were involved in an accident with a PPI driver. In such a situation, the person would insure himself for both economic and noneconomic damages through "tort maintenance coverage" (TMC). This coverage operates just as uninsured motorist coverage operates today. If the injured person can prove the other driver was at fault, then he can recover up to the limits of his own policy. Unlike uninsured motorist coverage, however, if he has any uncompensated economic loss, he can also sue the PPI driver on a fault basis for such losses. While the TMC driver could not sue an at-fault PPI driver for noneconomic loss, in turn he could not be sued by a PPI driver for anything but excess economic damages.

All the state fault rules stay in place. In fact, the chances of recovery for serious injury improve because the injured person would now have two sources of recovery, his own TMC coverage and the other driver's insurance, and his premiums would not change.[20]

State Options

Not only does the bill give drivers options as to which system to choose and what level of benefits to purchase, H.R. 2021 gives the states options as well. A state can simply choose to let the bill go into effect and give their drivers a choice. Alternatively, unlike almost all other federal legislation, the bill permits any state to pass legislation that would prevent the provisions of H.R. 2021 from applying in that state. Finally, H.R. 2021 provides that the law will not go into effect in a state if it would not lower the average bodily injury premium by at least 30 percent.

H.R. 2021 Puts the Choice Where It Belongs—with the Consumer

Mr. Chairman, our economy and our democracy depend upon people having the right to make choices. We decide not only what kind of clothes we will buy, what we will eat and where we will bank (with what kind of account), we decide what long distance telephone carrier to use, what mutual funds we will buy and what health care provider we will use.

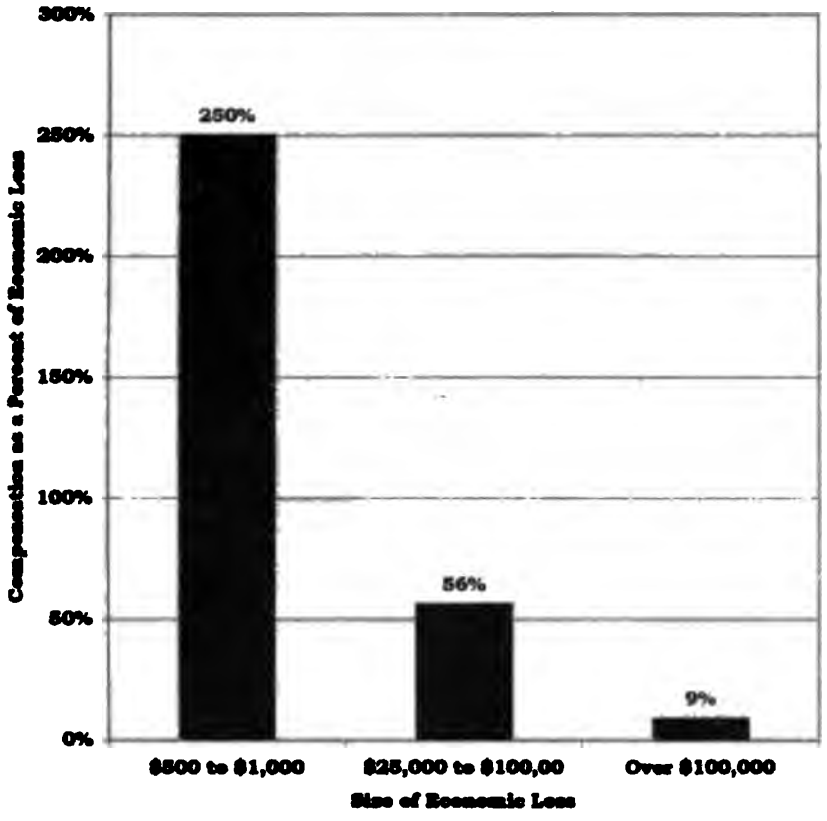
Why should auto insurance be any different? Today's state insurance systems, with three exceptions, do not offer consumers a similar choice. Instead, they give drivers only one option. Four out of five times that option is the tort system, a system that encourages fraud and provides bad compensation at high prices.

H.R. 2021 would offer consumers a better system, the PPI system, and then leave it up to individual drivers to decide between it and a modified version of the system now in place in their state. CAR believes the choice system in H.R. 2021 would be better for individuals and better for society. CAR strongly urges the Committee to report H.R. 2021 expeditiously and let drivers decide the best form of insurance for themselves and their families.

[20] Carroll and Abrahamse, *supra* note 2 at 19.

Chart 1

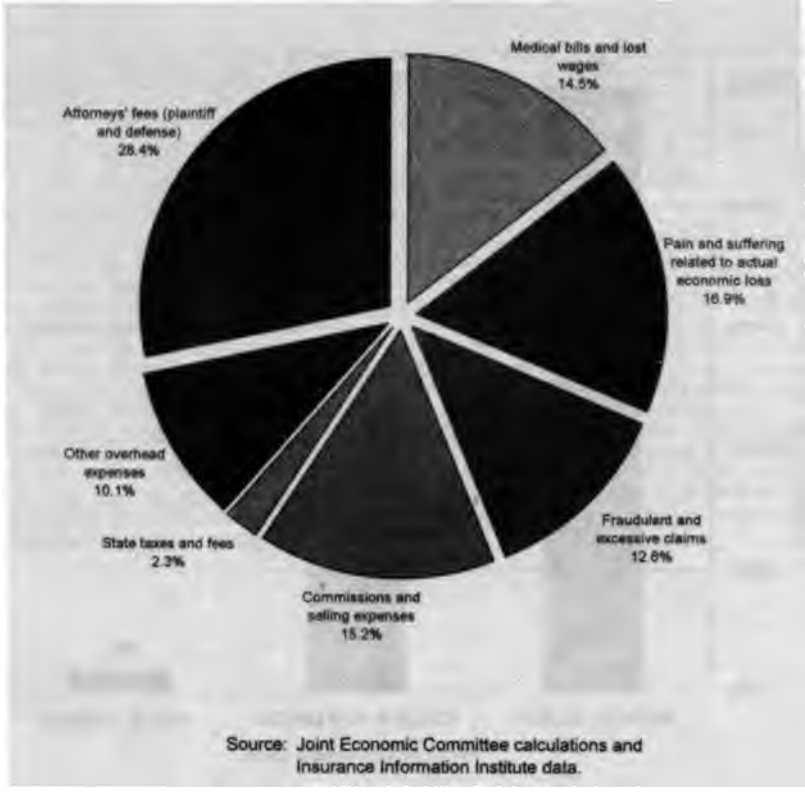
Compensation of Economic Loss under the Tort System



Source: Stephen J. Carroll, James S. Kakalik, Nicholas M. Pace, and John L. Adams *No-Fault Approaches to Compensating People Injured in Automobile Accidents* (Santa Monica, CA:RAND, 1991), 187

Chart 2

Distribution of Bodily Injury Premiums under the Tort System



Source: Joint Economic Committee calculations and Insurance Information Institute data.

Chart 3

Comparison of the Fault and Liability Insurance System and the Personal Protection Insurance System of Auto Choice

	Fault/Liability Insurance System	Personal Protection Insurance System
1.	Pays no benefits to 30% of all accident victims (including the victims of single car accidents).	Pays benefits to all accident victims.
2.	Pays benefits contingent on other driver's fault.	Pays benefits to all accident victims, regardless of fault.
3.	Encourages fraud (one-third of all medical claims are fraudulent).	Eliminates incentives for fraud.
4.	Recovery contingent on other driver's behavior and insurance coverage.	Recovery determined by individual's own choice of insurance coverage.
5.	Inequitable coverage: -- minor injuries compensated at average of 2 to 3 times economic losses. -- serious injuries compensated at average of less than 50% of economic losses.	Equitable coverage: -- all economic losses compensated up to the level of coverage selected. -- may sue for excess economic losses.
6.	In serious injury cases, pays for losses in a lump sum only after trial or settlement, which can take 2 to 3 years.	In all cases, pays for insured losses within 30 days of submission of a bill.
7.	Pays twice as many dollars for lawyers as for legitimate medical bills and lost wages.	Eliminates need for most lawyers. Uses the savings to pay more injured people more equitably and to lower premiums.
8.	$400 for average bodily injury premium.	$216 for personal protection insurance premium.

Mr. GILLMOR. Thank you, Mr. Kinzler.

And we will move to Mr. Rosenfield. And let me say that all of your statements will be part of the record.

You may proceed, Mr. Rosenfield.

STATEMENT OF HARVEY ROSENFIELD

Mr. ROSENFIELD. Thank you, Mr. Chairman.

I am the director of a nonprofit organization based in Los Angeles, California, which works on insurance, health care, utility and other consumer issues. I am here today on behalf of the project that works on auto insurance reform, and I was the author of a proposition approved by the California voters in 1988 known as Proposition 103, which provides a startling alternative to the legislation discussed today, and I will talk about that in a moment.

The issue for the public and the issue posed by even the proponents of choice no-fault is not how much compensation are people going to get. It has been how much is it going to cost to buy auto insurance, and on that score no-fault has been an absolute disaster in every State in which it has been tried. In 1989, of the 10 States with the highest average auto insurance premium, eight were no-fault States. By 1995, three of those States had repealed the mandatory insurance laws, and six of the 10 highest States in 1995 in the Nation were no-fault States.

Compare the growth in the average insurance premium between 1989 and 1995: Tort States around the country, 36.8 percent increase; no-fault States, 45.6 percent.

Repealing no-fault, according to this data, all of which comes from the data collected by the National Association of Insurance Commissioners, repealing no-fault is the quickest way to lower rates. Two States did it, repealed their mandatory no-fault laws, and Georgia experienced an immediate 12.5 percent reduction the next year; Connecticut, 9.7 percent reduction.

H.R. 2021 will reduce rates? That has been the topic of today's discussion. The answer is unequivocally no. First of all, there is nothing in this legislation that mandates one penny of rate reduction. There is a lot—there is a provision which talks about whether the State will opt in or opt out based on a finding by the commissioner which has been written in a way to basically preclude anybody from opting out, but that has nothing to do with reducing rates. Nothing in this legislation requires a rate reduction. Most States or many States have neither the authority nor the resources in the regulating entities' office to order such rate reductions even if there were rate reductions available from the legislation, and then we know from the experience in California that they can't simply order insurance companies to lower rates. They have to have a due process by which that is done, and a blanket 30 percent rate reduction would violate that due process right.

I want to add one more thing about rate reductions. I was startled to see today a report I had not seen before from the Joint Economic Committee about how no-fault would lower premiums for the urban poor. It is very touching to read and hear all of this lip service being paid to the poor when everyone knows that the real problem is in the inner city, in addition to the inability to afford excessive premiums, is that insurance companies will not service those

areas, and nothing in this legislation requires any insurance company to sell any policy to anybody in an urban area. Redlining, territory rating, these practices that have afflicted the poor and urban dwellers are not addressed by this legislation.

I am obviously trying to speed through this in the interest of time. Let me state some other objections to H.R. 2021.

It has been noted that the preemption of State common laws is unprecedented. These are common laws developed over 200 years by the States. It is automatic. Opting out is a difficult process at best. That is why I said that the deck was stacked.

I want to point out that in California the voters have twice in the last 10 years rejected no-fault legislation. Twice. You want to talk about folks getting mad at Congress. Tell the people in California that notwithstanding their action at the ballot box, Congress is going to impose this upon them. I think we will start to see some confusion today in the questions and answers when people try to figure out if you are a State that opted out—does that mean I have to stop?

Mr. GILLMOR. You have to stop soon.

Mr. ROSENFIELD. I have traveled 3,500 miles for this, Mr. Chairman.

The confusion that was obviously part of this process will anger people all over the country.

Second, no-fault addresses and undermines the basic American principles of responsibility and accountability that most of us feel are part of the American tradition.

Third, it eliminates full compensation by eliminating pain and suffering and eliminating the only form of legal recognition of the difference between a human being and a dented fender.

Fourth, limiting attorney involvement, which any proposals to restrict pain and suffering surely do, makes consumers much more vulnerable to abuse by the insurance companies on the economic damages that they have to collect. And it has been noted by many people in the literature that under no-fault laws it is very difficult to get your insurance company to pay your no-fault benefits.

Fifth and final point about this legislation, there is no choice involved in this. I think it is a grave disservice to the otherwise respective sponsors of this legislation to try to portray this as some kind of a choice. If you are a tort driver, if you choose tort, and a no-fault driver runs into you, the no-fault driver's choice overrides your choice, and in effect the tort driver is stuck with no-fault in terms of pain and suffering. It is not accurate to call this choice.

If you can give me 2 more minutes to talk about what happened in California in 1988, I was the author of a ballot measure which took a different approach to insurance reform. It is an approach that addressed two words that haven't been mentioned yet here in this hearing, "insurance companies." Insurance companies regulating their rates, regulating some of their practices, and eliminating barriers to competition, say, for example, their exemption from the antitrust laws which they enjoy at the Federal level.

In 1989, Proposition 103 took effect. Between 1989 and 1995, California's average auto insurance premium went down 1/10 of 1 percent. Compare that to no-fault States, up 45 percent; tort States

up 36 percent. In addition, $1.2 billion in rate refunds were paid, and $14.7 billion in rate increases were blocked.

Proposition 103 did this in a very simple way. It said to insurance companies, you must no longer charge excessive premiums to the public.

Now, you never hear the sponsors of no-fault ever discuss this issue of regulation of rates. It apparently offends their ideology. But in terms of an experiment in insurance reform, it is the most powerful way to lower premiums in the Nation, and it has been demonstrated.

I want to talk for a moment about what it has done about fraud. There is nothing in Proposition 103——

Mr. GILLMOR. We are running over here.

Mr. ROSENFIELD. Okay. There is nothing in Proposition 103 which limited the right of people to go to court and the amount of compensation that they could get, but it stopped the cost plus pass-through mechanism that the insurance companies use in which they simply add their own profit and overhead markup and pay as many claims as they can, and by doing so it gave the insurance companies the incentive for the first time to cut back on fraud, which is one of the reasons why auto accident lawsuits in California have dropped 49 percent since 1989.

I should say finally, and I will conclude with this, today's auto insurance—this week's Auto Insurance Report, which is a respected newsletter, points out that the insurance industry is not only making record profits, but they are sitting on $8 billion in excess reserves, more money than they need to pay claims, way more money.

When will the Congress, Mr. Chairman, hold a hearing on the fact that the auto insurance industry's profits and reserve are at record levels, and they could grant a 10 percent rate reduction minimum around the country if they were ordered to do so without limiting people's compensation and right to go to court at all?

I thank you for the indulgence for the extra time, and I am here for questions if you have any.

[The prepared statement of Harvey Rosenfield follows:]

PREPARED STATEMENT OF HARVEY ROSENFIELD, EXECUTIVE DIRECTOR, THE NETWORK PROJECT

Mr. Chairman and Members of the Committee: Thank you for inviting me to testify today on the subject auto insurance reform, specifically H.R. 2021, legislation which would establish a no-fault auto insurance system for the nation. I am the Executive Director of the Network Project, a California-based non-profit, nonpartisan consumer research and advocacy organization which works on insurance, health care, utility and financial billing issues on behalf of consumers and taxpayers. Operating under the umbrella of the Network Project, the Proposition 103 Enforcement Project monitors the implementation of Proposition 103, the property-casualty insurance industry reform ballot initiative approved by California voters in 1988. I am the author of Proposition 103. The Prop. 103 Enforcement Project also conducts research and education activities on insurance matters in general and assists consumers and consumer organizations in other states in pursuing insurance reform.[1]

I am pleased to provide the Committee with an assessment of no fault systems in general, an analysis of H.R. 2021, and a discussion of an alternative approach to insurance reform: reform of the insurance industry's rate-setting systems and

[1] Approximately 45,000 Californians support the work of the Proposition 103 Enforcement Project. This year, we estimate that roughly 20% of the Prop. 103 Enforcement Project's operating budget will come from donors who can be identified as lawyers.

practices. There is now sufficient historical experience with both approaches to assess their impact upon consumers.

Note that while they are not mutually exclusive, "no fault" and "insurance industry reform" proceed from widely different premises. Proposals such as no-fault fit within the category of so-called tort "reform": they are premised upon the assertion that overuse or abuse of the civil justice system is responsible for premium increases. By banning some or all auto accident litigation—particularly by proscribing payment for non-economic damages—supporters claim that no-fault will reduce the "transactional costs" of the legal system, thereby enabling insurers to reduce their premiums. Like all restrictions on the tort system, no fault regulates public access to the courts.

The alternative approach focuses on the behavior and operation of insurance companies. It calls for limits on their profits and expenses through rollbacks, rate regulation, prohibition of unfair or abusive practices and elimination of barriers to competition in the marketplace. The "insurance industry reform approach views insurance companies as profit-oriented financial institutions. The vicissitudes of the U.S. economy—particularly interest rates—are held to explain the pricing behavior of insurers. This approach also recognizes that although insurance companies are in the business of compensating for loss, they are fundamentally engaged in a profit-making enterprise, dependent upon investment income. As such, insurance companies not only have nothing to gain, but rather have a great deal to lose if accidents or claims decrease. Put another way, insurers typically operate on a "cost-plus" basis: accident costs are passed through to consumers, along with a considerable markup for overhead and profit.[2] Thus, the more accidents and claims, or the higher the medical and car repair costs, the greater the justification for higher rates which, in turn, yield more revenue for investment and ultimately higher profits. In this regard, the present insurance system perversely rewards insurance companies for the very events insurance is designed to protect against.[3]

Moreover, the insurance industry reform approach recognizes the subjective nature of the underwriting process, as revealed by the inherent inability of insurance underwriters to correctly estimate the degree of risk posed by any one policyholder. Lastly, it acknowledges that an imperfect insurance marketplace often frustrates social policy goals—such as ensuring that all motorists have the opportunity to purchase compulsory insurance at a fair price. The insurance industry reform approach views the insurance function as being so directly related to the economy and society that insurers carry a quasi-public responsibility, which in turn, requires public oversight and regulation.[4]

I. RECENT INSURANCE REFORM EFFORTS

With its enormous reliance upon the motor vehicle, California is the single biggest market for auto insurance in the nation. Not surprisingly, California has been a fertile environment for efforts to reform the auto insurance system. In 1988, both approaches to auto insurance reform were presented to California voters.

The 1988 initiative battle. Between 1985 and 1987, auto insurance premiums in California rose dramatically.[5] The increases led to widespread public dissatisfac-

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[2] In 1995, for example, insurance companies paid out a national average of 65 cents for every $1 in auto insurance liability premiums they received. A.M. Best, *Best's Aggregates and Averages, Property-Casualty Edition, United States* at 99, 101 (1996). This figure does not include investment income of nine cents on every premium dollar. *Id.* at 176.

[3] A California insurance industry executive described the situation succinctly: "Who's unhappy? Not the doctors. Not the lawyers. And the insurance companies can pass the costs along. If the public wants to tolerate this abuse, we'll deliver it." *Highway Robbery,* California Lawyer, May 1991, at 29.

[4] In most states, courts have held that insurance companies stand in a unique, fiduciary relationship with their customers. *See* William Shernoff, *et. al.*, Insurance Bad Faith Litigation §§ 1.01-1.05 (1996). Occasionally, the insurance industry itself acknowledges the imperfections of the private marketplace, as when it urges government to subsidize or supplant private insurers in the sale of certain forms of property-casualty insurance, e.g., creation of the California Earthquake Authority, a state agency established to relieve insurance companies of the risk associated with earthquake insurance coverage. California Ins. Code ("C.I.C.") § 10089.40 *et. seq.*, added by Stats. 1995, c. 944 (A.B.13), § 2. Amended by Stats. 1996, c. 124 (A.B. 3470), § 79; Stats. 1996 c. 968 (A.B. 2086), § 12, eff. September 27,1996; Stats. 1996, c. 969 (A.B. 3232), § 3.

[5] Between 1985 and 1986, automobile premiums in California increased by 22%, while the consumer price index increased 3.1%. National Insurance Consumers Organization, *A Consumer Triumph: Proposition 103 Revisited* (1992) at 19, citing National Association of Insurance Commissioners, *Report on Profitability By Line By State,* reports of 1981 through 1991; California Department of Finance, *California Statistical Abstract* 60 (November 1996).

tion.[6] During 1987, California consumer advocacy groups sponsored legislation which would have instituted limited regulation of property-casualty insurance premiums, including auto insurance, and repeal of the industry's exemption from state antitrust laws. Opposition from insurers blocked the measures' passage,[7] and the advocates drafted a ballot proposition entitled, "The Insurance Rate Reduction and Reform Act of 1988," which they placed before California voters on November 8, 1988.[8]

The initiative, which was qualified for the ballot as Proposition 103, addressed the industry's unique financial cycle and its cost-plus nature through a series of short and long-term reforms designed to improve the insurance marketplace, remedy certain industry practices and provide greater protection to policyholders. As described in greater detail below, Proposition 103 mandated a 20% rollback in automobile, homeowner, business and all other property-casualty premiums; instituted stringent controls on insurance company profiteering, waste and inefficiency through a regulatory process subject to public scrutiny and participation; ended monopolistic insurer practices; required insurers to base auto insurance premiums on driving safety record rather than zip code; mandated a 20% good driver discount; and made the insurance commissioner an elective post.

Concerned that it could not defeat Proposition 103, elements of the insurance industry responded by placing three separate measures on the ballot to compete with 103, one of which, Proposition 104, was their chief focus.[9] Proposition 104 called for the establishment of a no-fault auto insurance system in California, modeled upon New York's verbal-threshold based system.

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[6] The increases led to widespread public dissatisfaction. *See, e.g.,* Scott Armstrong, *California Car Insurance Revolt: Soaring Premiums Spark Drive For Reform Initiatives,* Christian Science Monitor, February 22, 1988; Sam Richards, Groups Target Insurance Rates, Tracy Press, January 19, 1988, at 1.

[7] The industry's political prowess in state capitols is well known. *See, e.g.,* Walter L Updegrave, *How The Insurance Industry Collects An Extra $65 Billion A Year From You By... Stacking The Deck,* Money Magazine, August 1996, at 50. According to disclosure reports submitted by insurers and other lobbying associations to the California Secretary of State and the California Fair Political Practices Commission, the insurance industry spent over $108 million on lobbying expenses, excluding campaign contributions, in California alone between 1983 and 1996. Calif. Fair Political Practices Commission, *Report on Lobbying: 1983-1984,* July 1985; Calif. Fair Political Practices Commission, *Report on Lobbying: January 1, 1985-December 31, 1985,* March 6, 1986; Calif. Fair Political Practices Commission, *Report on Lobbying: January 1, 1986-December 31, 1986,* April 1987; Calif. Fair Political Practices Commission, *Report on Lobbying: January 1, 1987 through December 31, 1987,* 1998; Calif. Fair Political Practices Commission, *Report on Lobbying: January 1, 1998 through December 31, 1988,* October 1989; Calif. Fair Political Practices Commission, *Report on Lobbying: January 1, 1989 through December 31, 1989,* March 1991; Calif. Fair Political Practices Commission, *Report on Lobbying: January 1, 1990 through December 31, 1990,* November 1991; Calif. Secretary of State, *Lobbying Expenditures and the Top 100 Lobbying Firms: October 1-December 31, 1991 and Cumulative Totals for Calendar Year 1991,* March 1992; Calif. Secretary of State, *Cumulative and the Top 100 Lobbying Firms; October 1-December 31, 1993 and Cumulative Totals for Totals for Calendar Year 1992,* March 1993; and Calif. Secretary of State, *The Top 100 Lobbying Firms; October 1-December 31, 1993 and Cumulative Totals for Lobbying Expenditures 1993,* March 1994; Calif. Secretary of State, *1994 Lobbying Expenditures and the Top 100 Lobbying Firms,* May 1995; Calif. Secretary of State, *Lobbying Expenditures and the Top 100 Lobbying Firms 1996,* April 1996; Calif. Secretary of State, *Lobbying Expenditures and the Top 100 Lobbying Firms 1996,* June 1996.

[8] C.I.C. § 1861.01 *et. seq.*

[9] Proposition 101, sponsored by Coastal Insurance Company, limited payments for pain and suffering in excess of economic damages unless a specific threshold was met. Proposition 106, also sponsored by insurers, imposed limits on the size of contingency fees a plaintiff could pay to an attorney in any tort case. At the same time, the California Trial Lawyers Association and some consumer advocacy groups sponsored Proposition 100, a less comprehensive version of Proposition 103.

To defeat insurance industry reform, insurers employed a "Trojan Horse" strategy unique to California's initiative process. Included within Proposition 104's text were provisions conflicting with each provision of Proposition 103. Article II, § 10(b) of the California Constitution provides that in the event that two measures with conflicting provisions are approved by the voters, the provisions of the initiative that obtained the great number of voters prevail. With polls indicating overwhelming public support for Proposition 103, the insurance industry's political consultants recognized that the measure would be difficult to defeat. Instead, the insurers hoped to invalidate 103 by getting more votes for Proposition 104, a strategy that was revealed to voters by the official state ballot pamphlet. It noted that Proposition 104, "[c]ancels Prop. 100, 101, 103. Restricts future insurance regulation legislation." Official Title and Summary prepared by Attorney General, California Ballot Pamphlet, General Election, Nov. 8, 1998, at G-88.

To pass Proposition 104 and defeat Proposition 103, insurers spent over $60 million.[10] Most of these funds were expended on electronic and print advertising. The central issue in the campaign was which proposal would lower insurance premiums for motorists.[11] Thus, the two insurance reform alternatives came head to head in a highly visible, albeit financially lopsided, public debate in the nation's largest state. On Election Day, Proposition 104 was defeated by a three-to-one margin. Proposition 103 was approved by 51% of the voters.[12]

Post-Proposition 103 Activity. The passage of Proposition 103 represented a dramatic turning point in the insurance debate throughout the nation. Driven by the California initiative, insurance industry reform occupied the focus of policymakers throughout the United States.

The insurance industrys initial response was stunned, then angry, denial.[13] Determined to discourage the similar efforts underway in other states, various insurers filed nearly one hundred legal challenges to Proposition 103; none succeeded.[14] Meanwhile, Proposition 103's passage inspired similar efforts in nearly every state legislature in the nation.[15] Despite the industry's efforts to blunt further Proposition 103-style reforms, nineteen states enacted insurance industry reforms.[16]

By contrast, the industry's intensive promotion of no-fault as an alternative to insurance industry reform has been a failure. Industry-sponsored no-fault legislation was defeated in high profile battles in several states.[17] A "pure" no-fault ballot measure, one of a package of three tort "reform" measures sponsored by the business community, including insurance companies, was placed before California voters in March of 1996. That contest is described in detail in Appendix A. The no fault measure was rejected by 65% of voters despite a $19 million campaign in its favor.[18]

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[10] Kenneth Reich, *Insurance Fight Cost Initiative Backers a Total of $83.9 Million,* Los Angeles Times, February 7, 1989, at 3. The consumer advocates sponsoring Proposition 103, led by Ralph Nader, spent $2.9 million raised through modest donations from direct mail solicitations to the public. Susan Seager, *Insurance Initiative War Hits Record $63.5 Million,* L.A. Herald-Examiner, October 29, 1988. We spent $2.9 million in support of 103, raised from modest contributions from the public.

[11] *See e.g.,* Ramon G. McLeod, *Voters Angry About Rates for Auto Insurance,* San Francisco Chronicle, June 10, 1988. Consumer advocate Ralph Nader's support for Proposition 103 had a powerful impact upon many voters who found the presence of five insurance related initiatives on the ballot confusing. Arthur Lupia, *Shortcuts Versus Encyclopedias: Information and Voting Behavior in California Insurance Reform Elections,* 88 American Political Science Review No. 1 (March 1994).

[12] California Secretary of State, Statement of Vote, November 8, 1988, at 40.

[13] A typical remark by an industry official portrayed Proposition 103 as "an example of mob rule." *Don't Shoot the Messenger,* Best's Review, January 1990, at 95-96. *See also* Mark Magnier, *California Rate Rollback Incenses Auto Insurers,* Journal of Commerce, November 10, 1988, at 1A. Richard B. Schmitt and Sonja Steptoe, *California's Voters Shake Up Insurers,* Wall Street Journal, November 10, 1988.

[14] Susan Seager, *Insurers' New Policy: Sue to Stop Prop. 103,* Los Angeles Herald Examiner, November 10, 1988; Kenneth Reich and Philip Hager, *Nine Suits Challenge Auto Rate Rollbacks,* Los Angeles Times, November 10, 1988, at 1. As a federal court, addressing a legal challenge by insurers against regulations implementing Proposition 103, later noted:

Insurers doing business in California certainly have a right to challenge any unconstitutional aspects of the rate making process which have been forced on them by the initiative. But the multiple and overlapping assertions of these challenges in state court, before the commissioner, and in this court causes this court to question those tactics. Numerous insurers are involved in these multiple challenges, some represented by the same law firms. Some challenges are filed in state court and some are filed in federal. The challenges are at the same time identical, separate and overlapping. Some of that appears to be coordinated and calculated... *Fireman's Fund Ins. Co. v. Garamendi* (N.D. 1992) 790 F. Supp. at 964.

[15] *See* NICO, *A Consumer Triumph: Proposition 103 Revisited (1992). Richard W. Stevenson, As California Tells Insurers What To Do, the Nation Listens,* New York Times, May 14, 1989.

[16] The most significant efforts were the following: Delaware permitted banks to sell insurance; Florida imposed a rate freeze; Maryland reinstated a "prior approval" regulatory system; New Jersey legislated a rate rollback and partially repealed the industry's exemption from the antitrust laws; Pennsylvania instituted a rate rollback; South Carolina instituted a rate rollback; and Texas repealed the industry's antitrust exemption and created the Office of Public Insurance Counsel to advocate the public interest in insurance matters. National Insurance Consumers Organization, *A Consumer Triumph: Proposition 103 Revisited* 35-36 (1992). It is noteworthy that among the urbanized state where auto insurance premiums are most problematic, and 103-style insurance industry reform proposals have been defeated, none have a process like California's in which voters can circumvent legislative failure by direct ballot access.

[17] Arizona voters rejected a no-fault ballot measure in 1990 by 85.1% to 14%. Professional Insurance Agents Weekly Bulletin, No. 799, Nov. 9, 1990, at 2. The Rhode Island legislature rejected no-fault legislation in 1992 and 1994.

[18] Proposition 200 would have: established a pure no-fault system; abolished fault-based tort liability for economic losses (including losses exceeding the no-fault coverage) unless the motor-

Continued

Indeed, since 1988, there have been serious efforts to repeal no-fault laws in at least six states; three were successful.[19]

II. "CHOICE" NO-FAULT

Confronted with the demise of no-fault systems throughout the nation, various academicians, consultants and institutions associated with the insurance industry are now promoting a no-fault proposal which they call "consumer choice."[20] Like other so-called "pure" no-fault proposals, the "choice" system would completely prohibit claims for non-economic damages.

The issue of "choice." However, to overcome the stigma associated with no-fault, the proposal has been re-packaged to suggest that every motorist will have the option of choosing either tort or "no-fault' coverage. In fact, under H.R. 2021, the "choice" is illusory. Motorists who choose to be covered by the traditional Personal Responsibility System are still prohibited from suing a negligent motorist who has chosen to be covered under the nofault option. To obtain pain and suffering coverage, the motorist operating under the tort system must purchase it as a first-party coverage from her own insurer. Thus, a potentially negligent driver's choice to operate fault-free overrides another driver's choice to operate in a Personal Responsibility System in which negligent drivers may be held accountable. Drivers who choose no-fault impose their choice on drivers who do not.

Federal preemption of state insurance laws. H.R. 2021 calls for unprecedented federal preemption of state tort, insurance and, potentially, even regulatory laws. Preemption is automatic, unless one of two events intervenes. However, in its present form, H virtually guarantees that federal preemption will occur, because the conditions set forth in the legislation are unlikely to arise:

(1) Preemption is blocked if the appropriate insurance regulator in each state issues a general finding, based on evidence adduced at a public hearing, that the measure will *not* reduce the "average" premium by 30% for those choosing no-fault (Section 8(b)(1)(A)). However, H.R. 2021 requires that the regulator compare the cost of liability, medical payment and uninsured and underinsured motorist coverages in the pre-no-fault marketplace against only the estimated cost of no-fault

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ist who caused the accident was engaged in criminal conduct or the shipment of hazardous waste; abolished compensation for non-economic damages in all cases; required that taxpayer-funded public assistance programs and other forms of private insurance coverage bear the costs of auto accident victims before auto insurers are responsible to pay claims; offered a total of $50,000 in benefits; promised substantially lower auto insurance premiums, without providing any statutory rate reduction requirement; eliminated tort lawsuits against insurers who failed to pay no-fault benefits in good faith.

Recognizing that an insurance-industry sponsored ballot measure would have little chance of approval, the no-fault campaign strategy was to rely upon the financial resources of business groups supporting the other two "tort reform" measures to limit the need to accept insurance industry money for the no-fault campaign prior to the election. Nevertheless, the mostly conservative electorate rejected the other measures as well. Prop. 201, limiting lawsuits brought by shareholders victimized by investment fraud, was defeated by 60% to 41%. Prop. 202, which called for limits on contingency fees, lost narrowly: 51% to 49%. Secretary of State, Statement of Vote, March 26, 1996 Primary Election, at 57-58. After the election, insurance companies donated nearly $1 million to help pay debts of the failed campaign. Reports on file with the California Secretary of State and the California Fair Political Practices Commission In Hawaii, a "pure no-fault" measure sponsored by State Farm was approved by the Legislature but vetoed by the Governor. Ann Botticelli, No Reprieve for No-Fault: House Fails to Muster Votes to Override Cayetano Veto, Honolulu Advertiser, June 30, 1995, at A1.

[19] Georgia and Connecticut repealed their no-fault laws. In New Jersey and Pennsylvania, no-fault laws were made optional. Industry opposition blocked major efforts to repeal no-fault systems in Massachusetts (1992) and Hawaii (1995 and 1996). *See, e.g., Groups Push for Auto Insurance Reform,* Brockton Enterprise, Associated Press, September 11, 1992, at 11; Marie Gendron, *Nader: End No-Fault,* Boston Herald, March 5, 1992, at 39; Ann Botticelli, *Maner: Too Late to Use Nader No-Fault Reform Proposals,* Honolulu Advertiser, April 13, 1995, at 8; Mike Yuen, *Senators Doom No-Fault To Legislative Graveyard,* Honolulu Star-Bulletin, July 6,1996, at A3; Christopher Daver, *New Jersey Legislators Propose Bill To Repeal Auto No-Fault Law,* National Underwriter, May 9, 1994, at 2.

[20] *See* Jeffrey O'Connell, Stephen Carroll, Michael Horowitz, Allan Abrahamse, *Consumer Choice in the Auto Insurance Market,* 52 Md. L. Rev.Law Review 1016 (1993); Jeffrey O'Connell, Stephen Carroll, Michael Horowitz, Allan Abrahamse, Daniel Kaiser, *The Costs of Consumer Choice for Auto Insurance in States Without No-Fault Insurance,* 54 Md. L. Rev. 281 (1995); Jeffrey O'Connell, Stephen Carroll, Michael Horowitz, Allan Abraharnse, Paul Jarmieson, *The Comparative Costs of Allowing Consumer Choice for Auto Insurance in All Fifty States,* 55 Md. L. Rev. 160 (1996); and Jeffrey O'Connell, Stephen Carroll, Michael Horowitz, Allan Abrahamse, Bradley Mihauskas, *Consumer Choice in the Tennessee Auto Insurance Market,* 27 U. Memphis L. Rev 539 (Spring 1997). *See also No-Fault's O'Connell Keeps Trying, Offers A Variation On Choice Plan,* Auto Insurance Report, March 13, 1995; Jeffrey O'Connell and Robert Joost, *Giving Motorists A Choice Between Fault and At-Fault Insurance,* 72 Va. L. Rev. 61 (1986).

coverage after no-fault takes effect. Section 8(b)(2). This formula would make it impossible for the regulator to issue an adverse finding. Insurance companies and pro-industry state regulators will have no trouble providing the actuarial "studies" needed to support the 30% reduction. Moreover, the industry is given the right to challenge an adverse finding in court (Section 8(b)(1)). However, there is no right to challenge the failure of the regulator to issue such a finding.

(2) Preemption may also be blocked if the state's legislature passes a law affirmatively rejecting the imposition of no-fault (Section 8(a)). This simply pits the politically-powerful insurance lobby in each state against opponents of no-fault, who have the burden of mustering legislative action. In light of the insurance industry's notorious ability to influence the political process in most states,[21] it is not too difficult to determine how that battle would turn out in most states.

As discussed in more detail below, while the proponents of the legislation have portrayed it as mandating a 30% rate cut, the negative "finding" upon which federal preemption may be avoided is in no way such a mandate. No provision of the legislation requires a reduction of auto insurance rates or premiums. In any case, this provision of the legislation raises substantial constitutional questions.

III. EVALUATION OF NO FAULT SYSTEMS

Initially, no fault was viewed as a form of universal health care: people injured in auto accidents would receive unlimited medical care and wage loss, regardless of fault. Compensation for non-economic damages—"pain and suffering"—would be limited, in minor accidents only, to reduce the associated legal and investigation expenses (the "transaction costs"). However, in recent years, the public has expressed concern about the cost of auto insurance, rather than the desirability of providing universal health care. The insurance industry has therefore sought to defend no fault by attempting to portray it as a means of lowering auto insurance premiums. The industry has re-packaged no fault several times to suggest such savings; the new "consumer choice" proposal is the latest example. Thus, the question of whether no fault raises or lowers the cost of auto insurance is of major importance in the debate over auto insurance reform.

As of 1995, ten states had mandatory no-fault laws. Another eleven states and the District of Columbia had hybrid no-fault systems, under which tort lawsuits and compensation are not restricted. Three of these states, Pennsylvania, New Jersey and Kentucky, presently provide motorists with circumscribed choices for the kind of coverage they may purchase. Since 1989, four states have repealed their mandatory no-fault laws. This section will analyze the merits of no-fault auto insurance.

A. The Impact of No-fault Upon Insurance Premiums

As previously noted, the contemporary policy debate surrounding auto insurance reform has centered upon the pocketbook issue of price. Thus, the question of whether no-fault raises or lowers the cost of auto insurance is of major importance in the debate over auto insurance reform.

The following tables summarize data drawn from annual reports published by the National Association of Insurance Commissioners (NAIC), including *State Average Expenditures & Premiums for Personal Automobile Insurance in 1995* (January 1997). The NAIC report utilizes premium data reported to it by state insurance regulatory agencies. For purposes of this analysis, the NAIC data for "average liability premium," which includes no-fault insurance premiums, is examined because it is the portion of the insurance policy directly affected by distinctions between Personal Responsibility Systems and no-fault systems.

No-fault states have the highest average automobile insurance premiums. Of the ten states where auto insurance was most expensive in 1989, eight were no-fault states. Since then, three of those states—Pennsylvania, New Jersey and Connecticut—have repealed their mandatory no-fault systems. (However, no-fault remains optional in Pennsylvania and New Jersey). In 1995, six of the top ten most expensive states (including D.C.) had no-fault systems.[22] See Table 1. Note that in 1995, New York—the model state for the "verbal threshold" no-fault proposals promoted by the insurance industry earlier in this decade—was the 5th most expensive state in the nation (up from sixth place in 1994).

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[21] Walter L. Updegrave, *How the Insurance Industry Collects an Extra $65 Billion a Year From You By Stacking The Deck*, Money Magazine, August 1996, at 50.

[22] As it has each year since 1991, Hawaii remained the most expensive in the nation.

Table 1. States With Highest Average Auto Premiums

RANK	1989		1995	
1	New Jersey[4]	$650	Hawaii[1]	$737
2	California	$519	New Jersey[4]	$662
3	Connecticut[1]	$473	Massachusetts[1]	$640
4	Hawaii[1]	$468	Rhode Island	$619
5	Dist. of Columbia[2]	$466	New York[1]	$607
6	Pennsylvania[3]	$439	Connecticut[5]	$603
7	Maryland[2]	$429	Delaware[2]	$565
8	Massachusetts[1]	$427	Dist. of Columbia[2]	$548
9	Florida[1]	$421	Louisiana	$547
10	Rhode Island	$408	Nevada	$531

[1] Mandatory No-fault State.
[2] Mixed or Hybrid No-fault State.
[3] No-fault made optional 1990.
[4] No-fault made optional 1991.
[5] No-fault repealed 1993, effective 1994.

No-fault states are consistently among the most expensive states in the nation. For each year between 1987 and 1995, a majority of the states with the highest average auto insurance premium were no-fault states. Note that as several states repealed their no-fault laws, the number of no-fault jurisdictions within the top ten declined. See Table 2.

Table 2. Number of No-fault States Among Top 10 Most Expensive States, 1987-1995

Year	Rank
1987	9
1988	8
1989	8
1990	8
1991	8
1992	7
1993	7
1994	6
1995	6

Premiums in mandatory no-fault states rose nearly 25% greater than in non-no-fault states. The average auto insurance premium in states with mandatory no-fault systems grew an average of 45.6% between 1989-95, a growth rate nearly 25% greater than in Personal Responsibility System states. The latter saw an average 36.8% increase over the same period. California, which implemented insurance industry reform during this period (discussed infra), is included for purposes of comparison. See Table 3.

Table 3. Comparison of Growth of Average Auto Liability Premiums, 1989-1995 [23]

	% Change 1989-95
Average of All Mandatory No-fault States	45.6
Average of All Hybrid No-fault States	37.1
Personal Responsibility States	36.8
California	-0.1

[23] Figures are an average of each state's average auto liability insurance premium. Table excludes states which repealed their mandatory no-fault systems during this period (Connecticut, Georgia, New Jersey and Pennsylvania).

Of the fifteen states with the *greatest increases* in the nation in auto liability premiums between 1989 and 1995, nine states had some form of no-fault—either mandatory or hybrid systems. See Table 4.

Table 4. States With Highest Growth in Average Auto Liability Premiums, 1989-1995

		1989-1995 Growth
1.	South Dakota[2]	78.6%

Table 4. States With Highest Growth in Average Auto Liability Premiums, 1989-1995—Continued

	1989-1995	Growth
2.	Nebraska	68.2%
3.	Texas[2]	67.4%
4.	Kentucky[2]	65.8%
5.	West Virginia	62.9%
6.	Utah[1]	61.4%
7.	Hawaii[1]	57.5%
8.	New York[1]	56.8%
9.	New Mexico	53.3%
10.	Rhode Island	51.8%
11.	Wyoming	50.9%
12.	Massachusetts[1]	49.9%
13.	Delaware[2]	49.1%
14.	Oklahoma	49.0%
15.	Colorado[1]	49.0%

[1] Mandatory No-fault State
[2] Hybrid No-fault State

Repealing no-fault lowers auto insurance premiums. Four states significantly altered their no-fault systems between 1989 and 1995: Georgia, Connecticut, Pennsylvania and New Jersey.

Georgia eliminated its no-fault system effective October 1991, established stringent regulation of rates and mandated a 15% rollback. The average auto insurance premium in Georgia fell 12.5% the next year. The state, once the 16th most expensive in the nation, ranked 37th in 1995. Table 5 below summarizes the changes in Georgia's average liability premium, its national rank and the annual change.

Table 5. Georgia: Average Liability Premium, Rank and % Change

Year	Average Premium	Rank	% change from previous year
1989	$324.93	17th	7.3%
1990	$337.89	19th	4.0%
1991	$341.73	23rd	1.1%
1992	$299.15	32nd	-12.5%
1993	$305.12	33rd	2.0%
1994	$309.34	36th	1.4%
1995	$315.56	37th	2.0%

Connecticut repealed its no-fault system effective January 1994. After six annual increases of 8% or more, the average auto liability premium dropped 9.7% during 1994. The state, which for the four years prior to repeal was one of the three most expensive states in the nation, now ranks 6th. Table 6 below summarizes the changes in Connecticut's average automobile liability premium, its national rank and the annual change.

Table 6. Connecticut: Average Auto Liability Premium, Rank and % Change

Year	Average Liability Premium	Rank	% change from previous year
1987	$391.72	5th	.....
1988	$427.91	4th	9.2%
1989	$473.31	3rd	10.6%
1990	$522.10	3rd	10.3%
1991	$569.26	3rd	9.0%
1992	$614.73	3rd	8.0%
1993	$665.25	2nd	8.2%
1994	$600.93	5th	-9.7%
1995	$603.11	6th	0.4%

Pennsylvania repealed its mandatory no-fault law effective July 1990. The legislation made no-fault coverage optional. Motorists who chose to operate under the tort-based Personal Responsibility System were provided a 10% rollback, while those choosing no-fault were offered a 22% rollback. Insurers were required to fully inform motorists of their options and obtain a written election of the no-fault coverage; motorists who failed to make an election were initially assigned by default to the Personal Responsibility System. Despite the substantially greater refund offered under no-fault, an estimated 60% of motorists returned to the Personal Responsibility System. The reform legislation also included health care cost containment provisions and protections against arbitrary cancellations or surcharges.[24]

Pennsylvania, which had the 6th highest average auto liability insurance premium in 1989, dropped off the top ten chart as a result of repeal of its mandatory no-fault system. It ranked 19th in 1995. Table 7 below summarizes the changes in Pennsylvania's average liability premium, its national rank and the annual change.

Table 7. Pennsylvania: Average Liability Premium, Rank and % Change

Year	Average Liability Premium	Rank	% change from previous year
1987	$372.01	8th	.....
1988	$399.50	9th	7.4%
1989	$438.89	6th	9.9%
1990	$432.72	11th	-1.4%
1991	$413.05	15th	-4.5%
1992	$433.06	15th	4.8%
1993	$433.93	19th	0.2%
1994	$447.02	18th	3.0%
1995	$444.29	19th	-0.6%

New Jersey repealed its mandatory no-fault law in 1989, but instituted an optional system in which all motorists are enrolled in no-fault unless they choose the Personal Responsibility System. New Jersey's new system does not contain the requirement that motorists be fully informed of the opportunity to choose between no-fault and the Personal Responsibility System, nor does it require an express waiver of tort law rights.

New Jersey, which had the most expensive average automobile liability insurance premium in the nation for four years in a row, ranked second highest in the nation in 1995. Table 8 below summarizes the changes in New Jersey's average liability premium, its national rank and the annual change.

Table 8. New Jersey: Average Liability Premium, Rank and % Change

Year	Average Liability Premium	Rank	% change from previous year
1987	$494.59	1st	.....
1988	$623.80	1st	26.1%
1989	$649.73	1st	4.2%
1990	$706.56	1st	8.7%
1991	$583.32	2nd	-17.4%
1992	$649.60	2nd	11.4%
1993	$650.86	4th	0.2%
1994	$639.52	3rd	-1.7%
1995	$662.04	2nd	3.5%

Why no-fault raises premiums. The NAIC data demonstrate that no-fault systems—including mandatory no-fault laws—are more expensive than personal responsibility systems based on tort liability. No-fault's restrictions on tort-based com-

[24] *All is Quiet in Pennsylvania Auto (Except Ferocious Competition)*, Auto Insurance Report, Nov. 17,1997, at 1-2.

pensation for non-economic damages *do not* offset the higher costs of no-fault.[25] There are several reasons for this experience:

1. Under no-fault, both the innocent victim and the motorist who caused the accident are compensated with medical, wage loss and other benefits—regardless of who is at fault. Paying the claims of both parties is inherently more expensive than under the Personal Responsibility System, in which the liability policy of the at-fault driver covers the innocent driver only. This conclusion is affirmed by many insurance industry experts, including advocates of no-fault, who acknowledge that no-fault was not conceived as a cost-saving measure but rather as a more efficient method of providing unlimited accident benefits and avoiding lengthy legal disputes over issues of fault.[26] The nation's largest auto insurance company, State Farm, has stated:

> The adoption of no-fault reparation systems may or may not lead to a reduction in the cost of auto insurance. The advantage of no-fault lies in a redistribution of insurance benefits based on need rather than fault, not its potential cost saving."[27]

2. Under no-fault, insurance companies are required to provide benefits to policyholders on a first-party basis. Thus, no-fault claimants do not face the kinds of corroborative pleading, evidentiary and procedural hurdles that exist under the Personal Responsibility System. As a result, no-fault offers policyholders greater opportunity to maximize their claims. For example, the availability of medical care up to the limits of the no-fault policy encourages greater utilization of health care services. The more generous the no-fault benefits, the greater the incentive to take advantage of them.[28] For the same reason, no-fault creates a fertile environment for inflated or fraudulent claims. For example, individuals who are not covered by other forms of health insurance, or who are hurt at work but seek greater benefits than

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[25] Manifestly, severe limitations on claims and/or compensation might so reduce payouts that insurers could reduce rates and still maintain their desired level of profitability. For example, the federal "choice' no-fault legislation not only eliminates the requirement that insurance companies pay for non-economic losses, but makes other potential sources of compensation—workers compensation and taxpayer-subsidized programs such as Medicare—the primary source for payment of claims. §5(b)(2)(B). Other no-fault proposals would reduce benefits to as little as $15,000 in medical coverage. Such policies might cost insurers less—but would offer little or nothing of value to many motorists. Considerations of product value are a likely reason why no-fault proposals are disfavored by the public, notwithstanding promised price reductions.

[26] The Deputy Insurance Commissioner of Michigan stated that the state's unlimited benefits no-fault law "... was never designed primarily as a savings measure. All of the arguments focused on paying people better and faster and enhancing rehabilitation by giving people money immediately." Morton C. Paulson, *The Compelling Case For No-Fault Insurance,* Changing Times, July 1989 (quoting Jean Carlson, Michigan Deputy Insurance Commissioner). A director of Independent Mutual Agents in New York went out of his way to diminish the importance that consumers should place on getting lowered, or even stabilized, premiums under no-fault. He said, "the no-fault concept was erroneously sold to the public by the legislature, and by a certain segment of the insurance industry, on the basis of cost savings alone" *Agents Blame Inflation For High Rates; Seek Amendments To N.Y. No-Fault Law,* The National Underwriter. Testifying before the California Legislature, an official from New York State's Department of Insurance stated: "... [W]e do not believe that the major impetus for enacting a no-fault law should be the expectation of premium reductions (though they may occur)..." Testimony of Richard C. Hsia, Deputy Superintendent of Insurance, New York State Dept. of Insurance, before Assembly Committee on Finance, Insurance and Public Investment, California Legislature, May 24-25, 1993, at 11.

After the passage of Proposition 103, insurers operating in California proposed no-fault legislation with benefits of $15,000, which would be split between bodily injury and extremely limited wage loss protection. The plan was described as "no frills no-fault." S.B. 941, (March 8, 1991). *See* Kenneth Reich, *Wilson Will Back No-fault Initiative,* Los Angeles Times, June 13, 1991 at 3. However, industry officials admitted that even this radical departure from no-fault's original promise of unlimited coverage would not necessarily lower premiums. According to a California insurance lobbyist, "[t]he new no-fault will not lower rates. No-fault will control rates. We have never said it will lower rates." *ACIC Points Out Nader, Harvey Inconsistencies,* Underwriter's Report, October 3, 1991, at 5.

[27] State Farm Insurance Companies, *No-fault Press Reference Manual,* at (G-402 1992).

[28] Referring to amendments to Massachusetts' no-fault law, an industry expert noted that the "actual additional costs [of] raising the [no-fault benefit] limit were roughly double what the [insurance] commissioner assumed...What lawmakers failed to foresee were the behavioral changes of participants in the system which the auto reform precipitated." National Underwriter, December 23, 1991, at 4. Former Georgia Commissioner of Insurance Tim Ryles told the U.S. Congress: "[N]o matter what proponents tell you about insurance fraud, no-fault will not do anything to control it. On the contrary, no-fault is to insurance fraud what octane level is to gasoline: the more no-fault you have, the greater the fraud." Hearings of the Committee on Commerce, Science and Transportation, U.S. Senate, July 17,1997 (Testimony of Tim Ryles at 2).

their workers' compensation coverage provides, may file claims under the no-fault system for injuries or illnesses not caused by the operation of a motor vehicle.

3. No-fault does not reduce litigation costs. Litigation over property damage—for which the vast majority of car accident claims are filed—continues under no-fault, because no-fault systems typically retain the liability system for property claims. Litigation over whether a particular plaintiff has met the threshold after which lawsuits can be brought is common in no-fault states. Finally, there is anecdotal evidence that suits by motorists against their own insurance company for failure to pay no-fault benefits have skyrocketed.

4. Liability insurance and other coverages remain necessary for many motorists in no-fault jurisdictions. Depending upon the generosity of the available no-fault benefits, motorists must still purchase additional first party coverage to protect themselves against serious accidents caused by uninsured, underinsured or unregistered motorists.[29] Further, some motorists must also purchase additional liability coverage in the event they cause an accident that results in damages to another motorist in excess of the no-fault benefits available to that driver. Absent such insurance, the at-fault motorist risks a potentially devastating civil judgment against his or her home or other assets.[30] Finally, under no-fault systems, motorists must still purchase property damage liability protection, since no-fault typically covers only bodily injury.

5. As discussed in greater detail below, there is significant evidence that the threat of liability acts as a deterrent to dangerous driving. The absence of fault leads to higher accident rates and correspondingly higher losses that must eventually be recouped through rate increases.

Will "choice" no fault lower premiums?[31] Proponents of H.R. 2021 have equated auto insurance premiums with taxes, insisting that "choice" no fault would "cut taxes" by $45 billion nationally.[32] However, nothing in the legislation requires any reduction in premiums.

The requirement that a state regulator find that H.R. 2021 will not lower rates for no fault drivers by 30% in order to block federal preemption, discussed previously, is not a rate reduction. A general finding by a state regulator has no application to specific insurance companies or to specific consumers.

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

Assuming state regulators had the authority, resources and inclination to order a substantial premium reduction, across the board rate reductions are subject to legal challenges by insurance companies, and no insurance company can be forced to reduce its rates if such action would deprive it of a fair return. *See* Calfarm, 48 Cal.3d 805, 815. Because H.R. 2021 provides no empirical basis for the 30% figure, any such reduction, if ordered, would be vulnerable to constitutional attack by the insurers as "arbitrary" and "irrational." Another fatal defect may be the process by which insurers can seek relief from the reduction. If the state statutes which the federal legislation says are to govern the rollback process do not contain the constitutionally-required due process hearing protections, the courts will strike down the rollback. *See Guaranty National Insurance Company, et. al. v. Gates* 916 F.2d 508 (9th Cir. 1990) distinguishing Proposition 103's due process protections. Indeed, as the industry's lawyers surely know, the case law arising from the insurance in-

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[29] Obviously, to the extent no-fault drives up prices, the problem of under- and uninsured motorists is exacerbated.

[30] An analysis by industry actuaries, noting that failure to purchase additional liability coverage "could have disastrous implications for consumers . . .," explained:

Consumers would be faced with the prospect of having no defense or indemnity protection for suits that might be brought against them for non-economic loss and/or for economic losses that exceed [the no-fault benefits] as defined by the statute.

Regardless of whether or not such a claim would have any merit, the consumer (policyholder) would have to personally incur the cost of defending such actions and paying any settlement and judgment (if they are only carrying the basic personal injury protection policy). Even when New York enacted its no-fault law, liability insurance continued to be a mandatory requirement.

Donald McGrath, Gordon Lahti, Harry Lindstrom, *The Automobile Insurance Crisis: A Different Perspective,* Underwriter's Report, October 3, 1991, at 30.

[31] While State Farm and several other large auto insurers support the legislation, other insurance trade associations have stated their opposition, fearing that federal preemption of state auto insurance laws would inevitably be followed by demands for federal regulation of the insurance industry, which insurers have sought to avoid, so far successfully, since the McCarran-Ferguson Act.

[32] Peter Passell, *Rep. Armey to Offer Bill Aimed at Cutting Auto Insurance Costs,* New York Times, June 11, 1997, at B1.

dustry's continuous legal challenges to Proposition 103's rollback requirement would nullify many of the statutory rate reduction requirements proposed by the industry.

Assuming again that state regulators had the authority, resources and inclination to order a substantial rollback, H.R. 2021 does not prevent insurance companies from arbitrarily or unjustifiably increasing rates prior to the effective date of H.R. 2021, thus enabling insurance companies to reduce their premiums while in effect making no net rate reduction. Nor does H.R. 2021 prohibit insurers from raising premiums one day after reducing them.

Insurance companies will not lower premiums voluntarily. Insurers favor no fault precisely because it costs more to pay for both the wrongdoer and the innocent victim of a car accident. Since insurers make most of their profit from the investment of premiums, high-revenue programs like no fault are preferred by insurance companies, particularly in regulated markets, because they can justify passing through to consumers the higher costs, along with their higher markup for profit and other excessive expenses. Higher costs equal higher premiums. Higher premiums provide more capital to invest. More investment capital means higher profits.

Since the Proposition 103 campaign in California in 1988, insurance companies have readily promised rate reductions as the political equivalent of a "loss leader" when sponsoring no fault laws. However, these reductions do not materialize. In the California battle in 1988, insurance companies told voters their no fault proposition (104) would lower premiums by 20%. However, consumer advocates obtained transcripts of confidential briefings by insurance industry executives which revealed that rates would go up—by as much as 35% in urban areas—rather than go down, if no fault was approved by the voters.[33] Hawaii's motorists were promised a 15% rate rollback, "guaranteed" as part of amendments to the state's no fault law enacted in 1992. However, virtually all insurers reneged on their agreement to pay the reductions. In 1995, Hawaii's Governor vetoed a pure no fault bill sponsored by State Farm on the ground that its rate rollbacks were illusory. Governor Cayetano was unwilling to allow the insurance industry to perpetrate a fraud on Hawaii's motorists a second time.

What is a worthless policy worth? Whether or not a rate reduction would be justified under H.R. 2021 is, of course, a separate matter from whether insurers may be compelled to provide it.

While traditional no fault restrictions on non-economic damages do not offset the higher cost of paying the at-fault as well as innocent motorist, H.R. 2021 contains a number of cost-shifting mechanisms which would transfer responsibility for coverage from private insurance companies to public programs. Accident victims must first turn to other programs for payment. Victims of catastrophic accidents would be forced to rely on taxpayer-funded welfare and health care programs to foot the bill for medical and rehabilitation expenses and wage loss before auto insurance coverage applies. H.R. 2021 requires a victim's auto insurance benefits to be reduced by the amount of benefits obtained by such persons from workers' compensation insurance, state-mandated disability insurance, social security disability insurance, or under any similar federal or state law providing disability benefits. Section 5(b)(3).

Indeed, by eliminating the liability of wrongdoers for the pain and suffering (non-economic damage) they cause, and in making virtually all other sources of compensation primary, H.R. 2021 effectively eliminates the need for employed individuals, seniors on Medicare or those with other compensation sources to purchase auto insurance at all. For these individuals, an H.R. 2021 auto insurance policy would be a worthless investment, even at 30% off present rates. Does that mean insurers will voluntarily provide a 30% rate reduction after all? On the contrary. Lowered premiums means lowered investment returns; insurers will not likely accede voluntarily to rate reductions that will reduce their own profits.

The RAND Reports. The California-based RAND Corporation has issued a series of widely distributed reports on no fault auto insurance. Press releases accompanying the reports invariably suggest that no fault proposals, including the federal "choice" no fault legislation, would dramatically lower insurance "costs" in many states. The RAND reports have been widely touted by no fault supporters to bolster their argument that no fault will dramatically lower premiums. However, as discussed in more detail in Appendix B, the studies utilized highly questionable and sometimes severely flawed assumptions; the resulting conclusions are inaccurate

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

and often misrepresented.[34] Moreover, the "savings" described by RAND are in the form of lower costs to insurers, not lower premiums for policyholders—a point omitted from the publicity generated by RAND and the insurance industry.

B. No-fault Contradicts Basic American Principles Of Individual Responsibility And Accountability

No-fault systems explicitly contradict the fundamental principle of American justice that wrongdoers are held responsible for the harm they cause.[35] By eliminating "fault," no-fault effectively treats good drivers and bad drivers the same.[36] This is not merely a philosophical concern. A substantial body of evidence shows that no-fault leads to more accidents because it weakens the deterrent effect of the tort law.[37]

C. No-fault Eliminates the Right to Full Compensation

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

Much has been made of alleged abuses in claims for "pain and suffering" compensation, to the point where no-fault advocates rarely acknowledge the legitimacy of any such compensation, or, if they do, consider the trade-off worthwhile.[38] However, H.R. 2021 contains a total ban on all compensation for pain and suffering, regardless of the seriousness of the injury, the irresponsibility of the person who caused the crash, the inadequacy of the victim's own insurance coverage (which, under H.R. 2021, is determined by the usually inadequate minimum financial re-

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[34] RAND has previously acknowledged that over 50% of the RAND Institute for Civil Justice's funding is derived from the insurance industry. In addition, the insurance industry is heavily represented on the ICJ Board of Overseers: board members include representatives from State Farm (two), Kemper, Aetna, GEICO, Travelers, Allstate, SAFECO, USAA, CNA, the Alliance of American Insurers (two), John Hancock, and the Property-Casualty Insurance Council. Of the numerous law firms and associations represented on the board, only one is identified as a plaintiff law firm. Industry sponsorship raises concerns that may explain RAND's choice of presentation of the data to suggest that no fault will lower insurance rates or otherwise benefit consumers. Insurer funding may also explain why RAND has *never* studied the need for insurance rate regulation, the discriminatory redlining and territorial rating practices of insurers, the waste and inefficiency in the industry, the compensation of its executives, the need for private suits to force insurers to settle claims and the investment practices of the industry.

[35] No-fault also conflicts with a central tenet of American democracy: that any individual may have access to the judicial system—the one branch of government in which a citizen is accorded stature equal to that of any corporation, no matter how powerful—to hold wrongdoers fully accountable for the harm they cause. However, American courts have generally upheld most legislated restrictions on common law tort rights, including no-fault laws. *See generally* Joost at § 2:21.

[36] This philosophical objection should not be discounted as an explanation for the popular aversion to no-fault. Irresponsible behavior which leads to deaths and injuries may nevertheless fall outside the scope or prosecutorial resources of the criminal justice system. Addressing such matters is a singular purpose of the civil justice system, the viability of which distinguishes civilized society from lawless rule or even anarchy. Arbitrary restrictions on the right of accident victims to hold wrongdoers accountable subverts this important function of the judicial branch, contributes to public frustration and undermines confidence in our democratic institutions.

That no-fault eliminates the distinction between good and bad drivers is not mean to suggest that insurance companies do not discriminate between such drivers for the purpose of determining product prices through "rating plans." Carriers routinely assess fault for purposes of setting premiums. The constraints, if any, upon the ability of insurance companies to unilaterally assign fault for rating purposes are a function of state regulatory requirements, and vary widely.

[37] Sloan, et. al, *Tort Liability Versus Other Approaches for Deferring Careless Driving*, 14 International Rev. L. Econ, 53, 60, 66-67, 68, 69 (1994). Sloan, et. al., *Effects of Tort Liability and Insurance on Heavy Drinking and Drinking and Driving*, Frank A. Sloan, Bridget A. Reilly, Christoph Schenzler, 38 Journal of Law and Economics 49 (April, 1995). In their 1987 book *The Economic Structure of Tort Law*, conservative theorists William M. Landes and Richard A. Posner found that systems based on tort liability lead to lower accident rates because, they argue, if the incentive to take care is reduced by limiting the liability of a potential wrongdoer, people will be less careful, and the cumulatively significant result will be more fatal accidents. See also Gary T. Schwartz, *Reality in the Economic Analysis of Tort Law: Does Tort Law Really Deter?* 42 UCLA Law Review 377 (1994).

[38] For a typical example of a derisive view of compensation for pain and suffering, see John E. Calfee and Clifford Winston, *The Consumer Welfare Effects of Liability for Pain and Suffering: An Exploratory Analysis*, Brookings Papers: Microeconomics 1993 at 133 ("Awards for pain and suffering may be imposing a substantial deadweight cost on consumers." *Id.* at 134). For a thorough critique of the conventional wisdom, *see* Steven P. Croley and Jon D. Hanson, *The Nonpecuniary Costs of Accidents: Pain-and-Suffering Damages in Tort Law*, 108 Harvard L. Rev. 1787 (1995).

sponsibility laws of the states), or the abusiveness of the insurance company. By taking away the right of injured motorists to seek compensation for their human pain and suffering, no-fault depersonalizes the human being, treating injured people as the equivalent of damaged property.

Moreover, recent proposals reflect a profound revision of the no-fault "quid-pro-quo" as the insurance industry attempts to formulate a less expensive form of no-fault. Instead of unlimited compensation for economic losses, motorists would be required to trade their right to non-economic compensation for economic benefits that even some supporters of no-fault consider grossly inadequate.[39]

D. No-fault Places Policyholders at a Disadvantage

By depriving consumers of the leverage of adequate legal remedies, no-fault proposals inevitably place consumers at a disadvantage relative to insurance companies. The elimination of compensation for accident victims' pain and suffering removes the incentive for scrupulous lawyers to accept auto accident cases, since their fees would then have to be paid out of the victim's recovery of actual medical expenses and lost wages. Moreover, by discouraging lawyers from representing accident victims, the ban on pain and suffering compensation will indirectly limit a policyholder's ability to insist upon full payment of economic compensation such as wage loss or medical bills. Without the ready availability to plaintiffs of legal representation, insurers will have less reason to eschew abusive settlement practices, such as "low-balling."

Indeed, H.R. 2021 not only discourages lawyers from taking accident cases; it may strip policyholders of traditional state consumer protection laws that permit insurers to be sued and face heavy penalties should they fail to settle claims in good faith. Notwithstanding vague language in Section 7, Section 5 (b)(4)(B)(ii) of H.R. 2021 may abolish the right to punish an insurance company with a punitive damage award. Since insurers have a financial incentive to deny claims—they earn most of their profits from the investment of premiums—the threat of a financial penalty is often the only leverage a policyholder can wield to force an insurance company to comply with its legal obligations.

H.R. 2021's requirement that the insurance company pay claims within thirty days or pay 24% annual interest is designed to disguise the impact that freeing insurers from punitive damage awards would have in encouraging more misbehavior by insurers. But it is an illusory protection. H.R. 2021 allows an insurance company to fail to pay benefits that are in "reasonable dispute." But H.R. 2021 would allow the insurance company to determine what a "reasonable dispute" is. This gaping loophole places the policyholder in a position of great weakness vis-a-vis the insurance company.

E. No-fault Does Not Reduce Disputes and Litigation

Benefit levels, as well as threshold levels, obviously have a direct relationship to litigation in no-fault states. Jurisdictions in which the no-fault benefits are limited, depriving motorists of adequate compensation, or in which the threshold for pain and suffering claims is easily breached, are likely to experience higher levels of litigation.[40]

No-fault systems present unique inducements to litigation beyond excess-of-benefits liability claims against third parties. Disputes over whether a particular claimant's damages exceed the litigation threshold are the source of voluminous litigation in states with the less-quantifiable verbal threshold.[41] Moreover, there are reports

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[39] The industry has promoted "no frills' no-fault proposals with highly limited benefits in order to offer an alternative to insurance industry reform proposals that offer lower premiums. Dr. Robert Hunter, the former Insurance Commissioner of Texas and founder of the National Insurance Consumers Organization, is a nationally-respected advocate of no-fault systems which provide unlimited benefits. He described "no frills" no-fault legislation offering $15,000 in no-fault benefits as "a poor trade-off for consumers and a catastrophe for the seriously injured . . ." Letter from Robert Hunter, NICO, to the Honorable Bill Lockyer, Chair, California Senate Judiciary Committee, May 28, 1991, at 3-4.

[40] Of course, under some "pure" no-fault proposals, motorists would be prohibited from recourse to the courts once no-fault benefits expire, even if the claimant is left with unpaid economic losses. Note that such proposals would force the most seriously injured to seek recourse to taxpayer-subsidized programs, such as welfare.

[41] A study of auto accident litigation in Michigan determined that 22% of the reported cases (241) concerned the bodily injury threshold requirement, where the question was whether the claimant's injuries were serious enough to permit a suit against a negligent third party. George T. Sinas, *No-Fault: A Perspective From Michigan*, at 15 (June 20, 1990) (unpublished study on file with author). Referencing New York's similar "serious and permanent" standard for recovery of pain and suffering in assessing no-fault legislation in California, ... ce in-

... ntinued

of more frequent suits brought by policyholders against their own insurance companies for failure to pay no-fault benefits in good faith.[42] Finally, litigation over property damage—the single largest source of claims in most jurisdictions—will continue under no-fault, because the liability system is retained for property claims. An analysis published in the Insurance Counsel journal, a publication for insurance defense attorneys, concluded: "Whatever the advantages of no-fault, a reduction in court cases and court costs would not appear to be one of them."[43]

Of course, the proposal's arbitrary elimination of compensation for non-economic losses will eliminate "threshold" litigation. And its apparent ban on punitive damage claims in lawsuits against insurers who act in bad faith will likely discourage claims by all but the wealthiest accident victims. Nevertheless, by altering the cost-benefit analysis undertaken by insurance carriers in determining whether and for how much to settle a claim, H.R. 2021 will likely lead to more disputes, some of which will find their way to the courts. Moreover, litigation over property damage—the vast majority of car accidents involve property damage—will continue under H.R. 2021, because like most no fault systems, it retains the liability system for property claims.

IV. INSURANCE INDUSTRY REFORM IN CALIFORNIA

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

Prior to 1988, California was one of the few states in the nation that did not require insurance companies to obtain regulatory approval of rate changes.[44] Moreover, California law shielded the industry from both competition[45] and regulation.[46] Thus, neither the free market nor government supervision was permitted to moderate the impact on the economy of the insurance cycle. Proposition 103, sought to impose regulation and create a more competitive and fair marketplace for insurance in California. The following components comprise the Proposition 103 model of insurance industry reform. A complete copy of the text of Proposition 103 as enacted by California voters on November 8, 1988 appears as Appendix C.

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dustry actuaries noted that, "[t]his area of the law remains very unsettled in New York and there appears to be a reluctance on the part of the judiciary to deny claimants access to the courts... We have no reason to believe that the situation would be any different in California... we anticipate that there will be a great deal of litigation over this issue alone." Donald McGrath, Gordon Lahti, Harry Lindstrom, "The Automobile Insurance Crisis: A Different Perspective," Underwriter's Report, October 3, 1991, at 30.

[42] This is reflected in Michigan lawsuit filings. During the period 1977-89, of the 1,119 appellate opinions in Michigan addressing no-fault, 73% (826) were first party cases in which insureds were suing their own insurance company to obtain no-fault benefits. Sinas, *supra*...

A Michigan lawmaker told Maine legislators considering no fault legislation to beware of the argument that no-fault would reduce the number of lawsuits:

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

Auto Insurance Reform: Hearing before the Maine Legislature (undated testimony of Michigan Rep. Nelson W. Saunders).

[43] Risjord, *Does No-fault Reduce Litigation,* Insurance Counsel Journal, July 1986, at 389.

[44] Michigan, Illinois and Ohio, like California, were so-called "open competition" states. Jeffrey A. Eisanach, *The Role of Effective Pricing in Auto Insurance,* U.S. Federal Trade Commission, Bureau of Economics, November 1985.

[45] *See, e.g.,* former C.I.C. §1643 (prohibiting sale of insurance by banks), repealed by Proposition 103, §7.

[46] McBride-Grunsky Insurance Regulatory Act, C.I.C. §§1850-1860.3 (1947), provisions of which were repealed by Proposition 103, §7.

A. Short Term Relief: The Insurance Rate Freeze and Rollback

In order to protect consumers during the transition to the new system established by the Proposition, and to offset the rate increases during the year prior to the election, the initiative froze automobile and other property-casualty insurance rates and premiums at 80% of November 8, 1987 levels for one year.[47] The 20% rollback avoided "locking in" the excessive rates of the preceding years, during which time insurance rates rose well in excess of the inflation rate. During the period of the rate freeze and rollback (November 8, 1988 through November 8, 1989), insurers were prohibited from raising rates or premiums. However, the initiative was drafted to allow an insurer to obtain increases from the Insurance Commissioner, if the freeze and/or the rate rollback "substantially threatened" the company's solvency.[48]

The rollback provision of 103 became the focal point of the insurance industry's legal challenge to the initiative, filed two days after the election.[49] In May, 1989, the California Supreme Court unanimously upheld the rollback but ruled that the "substantially threatened with insolvency" standard might be interpreted by the Insurance Commissioner in a manner that would deny insurers their constitutional right to obtain an adequate return on their property.[50] The Court substituted a "fair rate of return" constitutional standard, leaving it to the Commissioner to determine on a company-by-company basis, through the individual rollback exemption hearings contemplated by CIC § 1861.01(b), whether the rate rollback would deprive an insurer of a fair rate of return. Virtually all of the insurance companies operating in California filed requests for a rollback exemption hearing, claiming that they would be deprived of a fair rate of return if forced to comply.[51]

The fair return standard is well-established in constitutional jurisprudence, as is the corollary principle that not every enterprise is entitled to earn a rate of return—only those which operate reasonably and efficiently.[52] It was not until after the state's first elected insurance commissioner took office in 1990 that normative standards for analyzing insurer profitability and efficiency were promulgated as regulations. These regulations contained a rollback formula, the application of which determines whether an insurer should be ordered to issue premium rebates, with interest.[53] Specifically, the "rollback" formula:

- Caps the rate of return.
- Establishes ceilings for executive salaries, and sets an overall limit on expenses equal to the industry average, rewarding insurers which operate more efficiently with a higher rate of return. Expenses in excess of that amount cannot be included in the rate base.
- Prohibits insurers from engaging in bookkeeping practices that inflate their claims losses, and limits the amount insurers can set aside as surplus and reserves.
- Forbids insurers from passing through to consumers the costs of the industry's lobbying, political contributions, institutional advertising, the unsuccessful defense of discrimination cases, bad faith damage awards and fines or penalties.

Insurers challenged the formula as confiscatory. However, in August 1994, the California Supreme Court unanimously upheld the regulations as constitutional.[54]

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[47] CIC § 1861.01.

[48] CIC § 1861.01(b).

[49] On November 10, 1988, the California Supreme court granted the requests of numerous insurance companies and trade associations to stay the initiative in its entirety. On December 7, 1988, the court vacated the stay except as to the provisions (1) requiring a rate reduction to 20 percent below 1987 rates and (2) requiring insurers to enclose in their bills an insert notifying insureds of the opportunity to join a nonprofit corporation to advocate their interests pursuant to CIC § 1861.10(c) (*see* discussion *infra*). *Calfarm v. Deukmejian*, 48 Cal. 3d 805, 814 (1989).

[50] "The risk that the rate set by the statute is confiscatory as to some insurers from its inception is high enough to require an adequate method for obtaining individualized relief." *Calfarm* at 820.

[51] Kenneth Reich, *443 Insurers Seek Rollback Exemptions*, Los Angeles Times, June 27, 1989, at A3.

[52] *See, e.g., Aetna Insurance Co. v. Hyde* 275 U.S. 440, 446-47 (1928); *Troy Hills Village v. Township Council*, 68 N.J. 604 (1975).

[53] Findings and Determinations of the Insurance Commissioner, State of California, *In the Matter of Determination of Exposure Basis, Reserve-Strengthening, Executive Compensation and Efficiency Standards for 1989 Rate Calculations*, File No. RCD-1 (August 14, 1991); Findings and Determinations of the Insurance Commissioner, State of California, *In the Matter of Determination of Rate of Return, Leverage Factors and Projected Yield for 1989 Rate Calculations*, File No. RCD-2 (August 14, 1991).

[54] *Twentieth Century Insurance Co. v. Garamendi*, 8 Cal.4th 216 (1994). The U.S. Supreme Court refused the insurance industry's final appeal. *Century-National Ins. Co. v. Quackenbush*,

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Between 1989 and 1997, insurance companies operating in California issued over $1.18 billion in premium refunds to more than seven million policyholders.[55] Among those companies that have complied with the rollback are nine of the ten largest auto insurance companies operating in California. They represent 61.4% of the marketplace.[56]

B. Regulation

Proposition 103 changed California's insurance laws from a so-called "open competition" to a "prior approval" regulatory system.[57] Insurance companies are required to submit an application for desired rate changes to the Department of Insurance. To justify the request, the application must comply with disclosure requirements and financial standards promulgated by regulations.[58] Properly administered, the prior approval system disengages the insurers' traditional "cost-plus" approach, ending their ability to unilaterally pass through to policyholders all claims costs, accompanied by overhead and profits. It substitutes a rate structure that encourages both insurers and consumers to engage in loss prevention.[59] Insurers are rewarded for research and innovative programs that lead to reduced losses and claims.[60] Consumers, in turn, are rewarded with lower premiums for their individual loss prevention efforts, such as installation of anti-theft or anti-fraud devices and maintenance of a safe driving record.

Between 1989 and 1994, most insurance rates in California remained frozen pending conclusion of the legal challenges and final compliance by insurance companies with the rollback requirement. However, a new insurance commissioner, Republican Chuck Quackenbush, took office in January 1995. Mr. Quackenbush, an avowed opponent of Proposition 103,[61] lifted the rate freeze and has since stirred controversy by refusing to implement or enforce many of 103's statutory requirements, including the "prior approval" process, despite excessive premium levels in the state.[62]

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513 U.S. 1153 (February 21, 1995) (*cert. denied*); *State Farm Mutual Automobile Insurance Co. v. Quackenbush*, 513 U.S. 1153 (February 21, 1995) (*cert. denied*).

[55] Calif. Department of Insurance, "Garamendi Orders 28 Insurance Companies to Pay $1.2 Billion in Proposition 103 Rollbacks" News Release, November 22, 1994; Calif. Department of Insurance, "Proposition 103 Rollback Settlement Status Report," Rate Specialist Bureau, June 13, 1996; Calif. Department Insurance; "Stipulation and Consent Orders of December 23, 1994," Calif. Department Insurance, various stipulation and consent Orders (1995-1997).

[56] The companies, in order of their 1996 market share, are: Farmers Insurance, Calif. State Automobile Association, Allstate Insurance Group, the Auto Club of Southern California, 20th Century Insurance Co., Mercury General Group, United States Automobile Association, Safeco Insurance Cos., California Casualty. The state's largest insurer, State Farm, challenged its rollback obligation. An Administrative Law Judge ruled that State Farm owed no rollback refund, largely on the grounds that its expense data was justified and reasonable. *In the matter of the Rate Rollback Liability of State Farm Group*, Proposed Decision, Nov. 29, 1995, at 3-7. The Insurance commissioner rejected the proposed decision. Decision and Order of the Commissioner, April 5, 1996. State Farm appealed the Commissioners decision to the Superior Court, which reversed. *State Farm Insurance Group v. Chuck Quackenbush*, San Francisco Superior Court Case No. 977832 (August 5, 1997). The Commissioner is now appealing the Superior Court's decision.

[57] A 1986 study by the U.S. General Accounting Office concluded that insurance rates were higher in states without such prior approval systems. U.S. General Accounting Office, *Auto Insurance: State Regulation Affects Cost and Availability*, August 1986.

[58] CIC § 1861.05.

[59] Under an effective regulatory regime, efficiency is rewarded with higher profits; inefficiency with a lower rate of return. The normative standards by which insurer profits, expenses, surplus, reserves, accounting practices and other behavior are to be measured are based upon the regulations developed for the rollback exemption hearings.

[60] For a discussion of the loss prevention responsibilities of insurance companies, See Ralph Nader, *Loss Prevention and the Insurance Function*, 21 Suffolk University Law Review 679 (1987).

[61] Quackenbush, then a member of the California Assembly, urged voters to defeat Proposition 103 in a campaign mailer attributed to 'Republican Leadership for Insurance Reform," but mailed to voters by Californians Against Unfair Rate Increases, a group sponsored by independent agents and insurers. Mailer on file with author.

[62] The record profit levels in California are well documented. In 1996, the average return on net worth for insurance companies selling private passenger auto insurance in California was 60% higher in California than in the United States as a whole. National Association of Insurance Commissioners, Report on Profitability by Line by State in 1996, at 36,41. Consumer advocates have asked California Commissioner Quackenbush to exercise his authority under CIC Sec. 1861.05(a) to order appropriate rate reductions. See Consumers Union, Petition For Investigation To Determine Which Private Passenger Auto Insurance Rates hi California Are Excessive And To Reduce Rates Pursuant to CCR Section 2644.1 (June 3, 1996). However, the insurance commissioner rejected this and similar requests by consumer organizations to take such enforcement action or even to promulgate the regulations needed to do so. Consumers Union, ...ition for Rulemaking Adopting Generic Determinations to Apply to Rate Applications Pursu-

C. Competition

At its best, the insurance marketplace operates imperfectly. There can never be a truly "free," i.e., perfectly competitive, market for auto insurance because (1) consumers are compelled by law to purchase insurance; (2) there are many variations on the product, making comparison shopping difficult; and (3) the underwriting process is often subjective and by definition excludes certain willing purchasers. Regulation and competition are not mutually exclusive, however. To encourage a more functional marketplace, Proposition 103 repealed a variety of statutory barriers to competition common in other jurisdictions.

Antitrust Exemption. The insurance industry won an exemption from California's antitrust laws in 1947;[63] similar exemptions remain on the books of virtually every other state and in federal law as well.[64] As a result, insurer-controlled "rating bureaus" freely distributed proposed pricing data, including projected losses, expenses, profits and overhead charges, to all insurers who wished to obtain the information—allowing tacit price collusion. Proposition 103 repealed the insurance industry's exemption from the antitrust laws and prohibited the operation of "rating" and "advisory" organizations set up by the industry to circulate pricing and policy information to insurance companies.[65]

Commission Discounting. Commissions and related selling expenditures amount to between 15 and 30 percent of each year's premiums, according to a federal study.[66] Under California's so-called "anti-rebate law," similar to statutes in effect in most other states, insurance agents and brokers were prohibited by law from reducing their own commissions in order to offer consumers a lower price.[67] The anti-rebate law rewarded the inefficiency of some agents because it shielded them from competition by agents who are willing to work harder to satisfy their customers. A study by the U.S. Department of Justice estimated savings of 6-7% annually for insurance consumers merely by eliminating "anti-rebate" laws.[68] Proposition 103 repealed the state anti-rebate law. To date, however, few California agents have reduced their commissions, largely because insurance companies and trade associations representing agents have actively discouraged such competition.[69]

Bank Sales of Insurance. 103 repealed the statutory prohibition on the sale of insurance by financial institutions.[70] By 1992, an estimated 133 banks had obtained

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ant to CCR Section 2646.3 and Administrative Procedures Act Section 11340.6 (October 1, 1996); California Department of Insurance, Analysis of Consumers Union Excess Profits Petition Private Passenger Automobile Insurance (denying the Petition) (August 15, 1996). A group of California policyholders have sued the largest insurance companies in the state demanding return of an estimated $1.6 billion in excessive premiums charged in violation of Proposition 103. *Walker, et. al. v. State Farm Insurance Group, et. al.* Civ. No. 991395, San Francisco Superior Court, December 1, 1997.

[63] McBride-Grunsky Insurance Regulatory Act, Insurance Code sections 1850-1860.3 (1947) repealed by Proposition 103, § 7.

[64] McCarran-Ferguson Act, 15 U.S.C. sections 1101 *et. seq.* (1988).

[65] C.I.C. § 1861.03. However, 103 permits insurers to exchange certain historical data, as opposed to projections, about claims. This enables insurers—particularly new or small carriers—to obtain information that will assist them in developing their own projections and prices. All such information must also be provided to the Insurance Commissioner and to the public. C.I.C. § 1861.03(b). The initiative further permits insurers to continue to participate in special joint pooling arrangements—as long as they are established by the Insurance Commissioner or by law—to make insurance more available to certain kinds of customers, such as day care centers, automobile drivers, etc. *Id.* A series of legislative modifications, at the behest of insurers, concluded in 1996 with an enactment which purported to permit insurance advisory organizations to resume distribution among insurers of data on projected losses for price-setting purposes. *See* C.I.C. § 1855.5 (Amended by Stats. 1993, c. 1219 (A.B.1086) § 1; Stats. 1996, c. 1002 (A.B.56682) § 2, eff. September 29, 1996). Under Proposition 103, § 8(b), such amendments are prohibited. *See Amwest Surety Insurance Co. v. Wilson,* 11 Cal.,4th 1243 (1995). No challenge to the amendment has yet been filed.

[66] Staff of Federal Trade Commission, Report on Life Insurance Cost Disclosure, at 86-87 (1979).

[67] *See* C.I.C. § 750.1, repealed by Proposition 103, § 7.

[68] U.S. Justice Department, *The Pricing and Marketing of Insurance: A Report of the U.S. Justice Department to the Task Group on Antitrust Immunities* 302 January, 1977).

[69] 69 In 1994, an Administrative Law Judge ruled that it did not violate the antitrust laws for an insurance company to terminate an insurance broker who engaged in such competition so long as the company's action was not the product of pressure from other brokers. *In the Matter of Prudential Insurance Company of America, et. al,* OAH Nos. L-60175, L-60174, L-60173, L-60172, L-60171, CDI Nos. UPA 0053-AP, 0054-AP, 0055-AP, 0056-AP, 0057-AP, 0058-AP, 0104-A, 0105-A.

[70] See C.I.C. § 1643, repealed by Proposition 103 § 7. California's antitrust and consumer protection laws, applicable to the business of insurance pursuant to C.I.C. § 1861.03, ensure that financial institutions do not attempt to coercively tie the sale of insurance to other financial

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permission to enter the insurance business, including several of the state's largest banks.[71] Suits by insurance agents to block this provision of Proposition 103 were unsuccessful.[72]

Expanded Group Insurance. Proposition 103 empowered consumers to more easily negotiate group insurance purchases.[73] As a result, consumers are empowered to join together to negotiate the kind of policies and coverage they want, using their bargaining power in the insurance marketplace just as large corporations do when purchasing commercial insurance policies.

Consumer Comparison Shopping Service. It is a basic tenet of economics that consumers must be well informed if the marketplace is to operate correctly. A 1987 study documented the often-insurmountable obstacles consumers confront when shopping for insurance.[74] Proposition 103 requires the California Commissioner to provide consumers with a current rate comparison survey for automobile, homeowner and other lines of insurance.[75] Consumers are to be charged a modest fee to cover the costs of this system. The California Department of Insurance has not yet implemented this provision of 103.[76]

D. Fairness

Insurance is, by definition, a discriminatory enterprise. In order to allocate risk, insurance companies group individual consumers into a larger pool composed of similar risks. To a degree often poorly understood by the insurers themselves, the business of insurance depends on the consumer's trust in the fairness of the industry's classification system.

Emphasis on Driving Safety Record. Proposition 103 prohibits the use of "territorial rating," under which insurance companies determine an individual's automobile insurance premium by calculating claims payments made within the motorist's zip code. Instead, auto insurance premiums must be based primarily upon three rating factors: a motorist's driving safety record, the number of miles he or she drives each year, and the motorist's years of driving experience, weighting those factors in that order.[77] Making the driver's own safety record the principal determinant of premiums gives motorists a strong incentive to drive safely.

The measure further requires insurers to grant a 20% Good Driver Discount to all qualifying consumers—individuals with a virtually clean driving record (one moving violation is permitted) for the preceding three years.[78] This provides a further incentive for careful driving.

A 1986 study prepared for the California Assembly by the National Insurance Consumers Organization (NICO) illustrates the discriminatory impact of the much-criticized zip code-based system of territorial rating. Of the 4.9 million cars insured in California between 1982 and 1984, 95.4% had no claims. In central Los Angeles, 93.5% of the cars avoided claims. The modest difference in the number of claims is to be expected, given population density and reliance on automobiles in Los Angeles. Nevertheless, *accident-free* Los Angeles drivers paid on the average 66% more

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products or services they provide—a frequent argument against permitting competition from banks.

[71] NICO, *A Consumer Triumph: Proposition 103 Revisited* (1992) at ii.

[72] *See e.g., Sanford v. Garamendi,* 233 Cal. App. 3d 1609 (August 28,1991).

[73] C.I.C. § 1861.12.

[74] California Public Interest Research Group, *Pick a Price, Any Price, A Report on Inconsistent Price Quoting of Automobile Insurance* (June 1987).

[75] C.I.C. § 1861.04(a).

[76] Several private firms have entered the California marketplace to provide similar information, though with limited scope and at a significant cost. *Progressive Offers California Auto Rate Comparisons,* Underwriters Report, Nov. 27, 1997, at 12; *Consumers Access to Multiple Competitive Rates Grows Through Insweb Deal With Consumers Car Club,* Auto Insurance Report, December 1, 1997, at 8.

[77] C.I.C. § 1861.02 (a). The commissioner can approve additional rating factors—but only pursuant to a formal rulemaking process, and only if they "have a substantial relationship to the risk of loss" (C.I.C. § 1861.02(a)(4)). *Consumers Union et al vs. Quackenbush,* San Francisco Superior Court Case # 982191, *Prop. 103 Enforcement Project v Quackenbush (Safeco),* San Francisco Superior Case # 982646. Such additional factors must be shown by statistical analysis to hold predictive power once the first three "mandatory" factors are applied to determine the majority of the premium. Additional factors approved by the commissioner will have relatively little impact on premiums, as the initiative requires that all optional factors combined cannot collectively outweigh the three mandatory factors in determining a motorist's premium. C.I.C. § 1861.02 (a)

[78] C.I.C. § 1861.02(b).

for property damage liability insurance than did the average accident-free driver outside Los Angeles.[79]

Judicial review of a legal challenge brought by insurers against implementation of this provision of the proposition blocked its implementation for more than three years. Insurers contended that rates must be "cost-based" under 103 and that the voters could not lawfully alter insurance classifications to substitute the "mandatory" factors for other factors which the industry argued could be shown to hold more predictive power (i.e., territory). On November 27,1990, a California Court of Appeal dismissed the challenge without deciding the merits.[80] In December 1994, the Department of Insurance published a study that rebutted the industry's subsequent contention that territorial rating was consistent with the provisions of Proposition 103.[81]

In 1997, the California Department of Insurance promulgated new regulations to implement this provision of the initiative.[82] However, an independent review of the rating plans filed by three major insurance companies determined that they were not in compliance with the requirements of the law.[83] Two lawsuits were subsequently filed to compel the insurance commissioner to properly enforce the statute.[84]

Redlining. The failure of insurers to service particular communities, principally in urban areas, has been amply documented.[85] Proposition 103's emphasis on driving record and individual driving habits, discussed *supra*, establishes a more equitable system for determining premiums which requires insurers to diminish the importance of geography. However, mandating the use of new rating factors does not address the practical reality that the availability of insurance agents and brokers is extremely circumscribed in some communities.[86] To ensure that qualified drivers can obtain insurance regardless of where they live, the measure specifies that any good driver, as defined in the initiative, has the right to purchase an auto insurance policy from the insurer of his or her choice.[87] The absence of prior insurance coverage cannot disqualify an otherwise good driver.[88] This provision of Proposition 103 is in effect; however, many insurers have reportedly refused to comply with the provision, according to statements by insurance agents and consumers.[89]

Arbitrary Cancellations and Non-Renewals. A frequent complaint among automobile insurance policyholders is that insurance companies may cancel or non-

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[79] National Insurance Consumer Organization, *Insurance in California: A 1986 Status Report for the Assembly,* October 1986, § IV, at 14-16. The NICO report's recommendations are reflected in C.I.C. § 1861.02.

[80] *Allstate Ins. Co. v. Gillespie,* As Modified on Denial of Rehearing and Decertifying Opinion, February 2,1992, reported at 1992 Cal. App. Lexis 194; 92 Cal. Daily Op. Service 675; 92 Daily Journal DAR 1035. (Filed January 22,1992). Previously published at 225 Cal. App. 3d 798 (1990)

[81] Calif. Department of Insurance, Office of Policy Research, *Impact Analysis of Weighting Auto Rating Factors to Comply With Proposition 103,* December 1994. The study found that, contrary to the industry's predictions, eliminating territory as the primary determinant of premiums would not result in substantial premium increases for good drivers. *Id.* at 4.

[82] Title 10, Chapter 5, Subchapter 4.7, Article 7, C.C.R. § 2632.1 et. seq.

[83] Virtually all insurance companies in the state were found to be misinterpreting the regulations in order to continue to base premiums on territory, in violation of Proposition 103. Kenneth Reich, *Loophole Seen Gutting New Car Insurance Plan,* Los Angeles Times, October 4, 1997, at Al. An industry trade journal noted that Insurance Commissioner Quackenbush had improperly approved the rating plans: "[T]he commissioner has been misleading the public and the media by proclaiming that under his new rules territory is no longer the dominant factor in setting auto insurance rates." *California Class Plan Ruling Should Be in Quackenbush's Hands; What Will He Do?* Auto Insurance Report, November 17, 1997 at 1, 3.

[84] *Proposition 103 Enforcement Project v. Quackenbush,* Alameda Superior Ct. Case No. 796082-2 (filed March 25, 1998); *Spanish Speaking Citizens Foundation, Inc., et. al., v. Quackenbush,* Alameda Superior Ct. Case No. 796071-6 (filed March 25, 1998);

[85] *See, e.g.: Broken Promises: The Thirty-third Insurance Commissioner's Record on Redlining and Minorities,* California Council of Urban Leagues, Latino Issues Forum, Mexican American Political Association, San Francisco Black Chamber of Commerce, Public Advocates on Behalf of Fifteen Low-income, Minority and Consumer Groups, 1990. Hearing before the Committee on Banking, Finance and Urban Affairs, Subcommittee on Consumer Credit & Insurance, U.S. House of Representatives, 103rd Congress 1st Session, February 24, 1993. (Testimony of the Honorable John Garamendi, Insurance Commissioner, State of California). National Association of Insurance Commissioners, *Urban Insurance Problems and Solutions: Interim Report,* Insurance Availability and Affordability (EX3) Task Force, December 6,1994.

[86] Khalid Al-Faris, *Selling and Servicing Levels of Private Passenger Auto Liability in Urban Cities,* Calif. Department of Insurance, Statistical Analysis Bureau, April 1993.

[87] C.I.C. § 1861.02(b)(3).

[88] *Id.*

[89] Vlae Kershner, *Agents Say Insurers Forcing Them to Skirt Prop. 103,* San Francisco Chronicle, February 5, 1990, at Al; Scott Ard, *Farmers Sued for Denying Coverage,* Alameda County Daily Review, March 3, 1990, at 1; Vlae Kershner, and David A. Sylvester, San Francisco Chronicle, *Survey Shows Biggest Insurers Sidestep 103,* February 8, 1990, at A1.

renew policies without justification—sometimes merely for the act of filing a claim. Proposition 103 prohibits such arbitrary actions unless based on three specific reasons: non-payment of premium, fraud, or the policyholder presents a substantial increase in the hazard insured against.[90] Regulations defining the "substantial hazard" exception have yet to be promulgated.

E. Public Accountability

"Capture" of the regulators by the regulated industry is common in state-based insurance systems,[91] and highly corrupting of public faith. The public accountability of those administering insurance industry reform is critical to its success. Proposition 103 contained three mechanisms to ensure such accountability.

Consumer Intervention. It is a basic tenet of democratic government that each party to a proceeding has the right to be fully represented. The adversarial process enhances openness, constructive change, and consumer acceptance.

Proposition 103 provides several avenues for consumer representation in insurance matters. First, it authorizes individual consumers to go before the Department of Insurance or the courts should insurance companies fail to comply with their responsibilities under the proposition. If the Department of Insurance fails to enforce the law or respond effectively to a consumer's complaint, consumers will not be "locked out" of the courts with no remedy,[92] as often occurs in states with lax regulators.

Second, Proposition 103 encourages non-profit consumer advocacy groups to intervene in the regulatory process to protect the interests of the public. Citizen groups which make a "substantial contribution" to a rate hearing or other matter before the Department of Insurance, or to an insurance matter which goes before a court, are entitled to receive reasonable advocacy fees and reimbursement of expenses for such costs as expert witnesses.[93] Assessments collected from insurers are used to fund this program.[94] Funded citizen intervention programs protect against unnecessary or duplicative proceedings, while providing consumers with the professional,

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[90] C.I.C. §1861.03(c). The California Supreme Court has ruled that this provision does not prevent an insurance company from terminating its pohcyholders as part of a plan to cease doing business in the state. *Travelers Indemnity Company v. Gillespie,* 50 Cal. 3d 82 (1990). Indeed, Proposition 103 contained a specific provision intended to protect California policyholders against a boycott or market withdrawal by insurance companies. Under C.I.C. §1861.11, the insurance commissioner is empowered to establish a "joint underwriting authority—in which all insurance companies selling any form of insurance in California must participate to provide coverage in the event of a shortage in any specific line of insurance.

Immediately after the passage of Proposition 103, most insurers in the state ceased selling new policies to exert pressure upon the California Supreme Court to rule favorably on the industry's request for an immediate stay of the ballot measure. The state Attorney General subsequently found the boycott to be a violation of the antitrust laws made applicable by the measure, although he declined to prosecute. E. Scott Reckard, *Insurers' Pullout Blamed on Conspiracy,* The Orange County Register, January 3, 1991 at A3. And despite repeated threats that many insurers would leave the state if Proposition 103 became law (*see* Jay Angoff, *Quit California? Don't Bet on It,* Los Angeles Times Opinion-Editorial, December 1, 1988, at B7) no major auto insurance company closed its California operations after the passage of Proposition 103. Indeed, one analysis concluded that more insurance companies had applied to do business in California since the passage of Proposition 103 (85) than withdrew (3) or had requested permission to withdraw as of July, 1990 (25). The three companies that withdrew were: Allegiance Life, Teachers Insurance and Travelers (which withdrew from eight other states simultaneously). L.P. Baldocchi, *The Post-103 Competitive Climate in California,* Underwriter's Report, July 26, 1990.

[91] *See "Sorry We Could Not Be of More Help": How the Calif. Department of Insurance Regulates a Trillion Dollar Industry,* A report to Consumers Union by Dan Noyes, Center for Investigative Reporting, May 1996, at 39. Walter L. Updegrave, *How the Insurance Industry Collects an Extra $65 Billion a Year From You By Stacking The Deck,* Money Magazine, August 1996, at 50.

[92] C.I.C. §1861.10(a). However, in *Farmers Insurance Exchange et al. v. Superior Court,* 2 Cal.4th 377 (1992), the California Supreme Court substantially limited immediate recourse to the courts. In a lawsuit brought by the state's Attorney General against an insurer under California's Unfair Competition Act (Business and Professions Code §17200, *et seq.*) for violating the anti-redlining provision of Proposition 103 (C.I.C. §1861.02(b)), the Court ruled that in matters involving regulation of rates, the courts should first defer to the administrative expertise of the regulatory agency. The court's opinion imported a primary jurisdiction requirement that did not previously reside within the Unfair Practices Act. Concerns that the courts are ill-equipped to handle the complexities of insurance rate matters plainly motivated the decision. Presumably, the proposition's explicit purpose of permitting recourse to the courts in the event that a recalcitrant insurance commissioner fails to enforce the law would not be barred by the Fanners decision in cases when recourse to the administrative agency is futile.

[93] C.I.C. §1861.1(b) was loosely modeled upon a similar consumer representation system in effect at the California Public Utilities Commission. See California Public Utilities Code (CPUC) §1801 *et seq.*

[94] C.I.C. §12979, enacted by §5 of Proposition 103.

skilled representation that insurance companies are able to obtain—at policyholder expense.[96]

Insurers typically oppose the institution of mechanisms to enhance consumer participation in regulatory proceedings as prone to result in uncontrolled, ceaseless regulatory conflict. That view is false, since even the best-funded citizen groups rarely are rarely able to contest any but the most important cases.[98] In California, there are approximately four organizations that routinely intervene in insurance proceedings.[97]

Elected Insurance Commissioner. In the majority of states, the Insurance Commissioner is a political appointee with no direct accountability to the public. Often, the appointee is a former insurance industry executive, and the appointment a form of political patronage. It is no surprise then that state regulatory insurance agencies have frequently been criticized for poor enforcement and a pro-industry bias.[98] In California, for example, independent reports repeatedly criticized the appointed insurance commissioner for inaction during the 1985-1987 insurance crisis, for failure to respond to consumer complaints and for incompetent enforcement of the Insurance Code.[99]

Proposition 103 required that the Insurance Commissioner be elected, commencing in November 1990.[100] Currently, twelve states elect their insurance commissioner.[101] The theoretical advantages of an elected commissioner are consequential, particularly to the implementation of insurance industry reforms. An elected commissioner is accountable to the public, rather than to other elected officials, whose own accountability to the public on specific issues may be less direct. Since only the voters may pass judgment on the commissioner's performance, the commissioner has the independence—and incentive—necessary to act in the public interest. Because voters will evaluate the insurance commissioner by the fairness of the rates and practices of insurers, a commissioner who fails to satisfy the public should find it difficult to win re-election.

As a practical matter, however, the ability of insurance companies—a powerful constituency within the political economy—to elect sympathetic candidates has been demonstrated in several instances,[102] including the second election of insurance commissioner in California in 1994.[103]

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[96] An additional device to guarantee effective consumer representation was struck from the measure by the California Supreme Court. *See* CIC § 1861.10(c). Insurance consumers were to be given the opportunity to establish and join a democratically-created and controlled advocacy organization. A staff of advocates, funded by voluntary contributions and grants, would represent consumers on insurance matters before the Insurance Commissioner, the courts, and the state legislature. In order to enable the advocacy organization to obtain the support of consumers, insurers were to be required to enclose special notices within their premium bills, informing their customers of the opportunity to participate in the program. (Insurers would be reimbursed by the organization for any additional expenses caused by insertion of the notice). However, the California Supreme Court excised this provision of Proposition 103, ruling that § 1861.10(c) violated Article II, § 12 of the California Constitution, which prohibits an initiative from "naming or identifying" a private corporation. *Calfarm, supra* at 832. A subsequent effort in the California legislature to create such an advocacy group was blocked by insurance industry lobbyists.

[98] It is the absence of professional representation which can be troublesome for insurers: a vacuum is created that is often filled by individual citizens, with little or no resources and little training. These individuals have a more difficult time participating in proceedings effectively, and the proceedings themselves are forced to move more slowly in order to accommodate the individuals.

[97] Cal. Dept. of Ins. World-Wide Web site (titled, Intervenor Program) July 1997.

[98] National Association of Ins. Commissioners, *1995 Insurance Department Resources Report,* at 2, Table 1 (1996). *See High Turnover in Regulators Ranks,* PIA/CIIG Study, Insurance Journal, May 14, 1990 at 12, which reported that 37% of Insurance Commissioners were employed in the insurance industry before taking office.

[99] Dan Noyes, *"Sorry we could not be of more help": How the California Department Of Insurance Regulates a Trillion Dollar Industry* (A report to Consumers Union by Dan Noyes, Center for Investigative Reporting) May 1996, at 39; Auditor General of California, *The Department of Insurance Needs to Further Improve and Increase Its Regulatory Efforts* (June 1987); Robert Shireman, *Bark But No Bite: Toothless Regulation by the Department of Insurance Has Left California Consumers Unprotected,* Consumers Union, July 1987.

[100] C.I.C. § 12900, enacted by Proposition 103, § 4.

[101] National Association of Insurance Commissioners, *1995 Insurance Department Resources Report* at 2, Table 1 (1996).

[102] L.H. Otis, *Delaware Funding for Regulator Questioned,* National Underwriter, Nov. 11, 1996, at 1; Susan Briggs, *U.S. Drops Indictment of Mississippi Commissioner,* Best Week, August 29, 1994, at 3.

[103] Republican Assembly Member Chuck Quackenbush defeated the Democratic candidate by 49% to 43%. California Secretary of State, Statement of Vote, November 8, 1994, General Election, 1994. Insurance companies and agents donated $2.5 million to his campaign, approxi-

Continued

Critics argue that election of the commissioner "politicizes" the office and may attract officials who view the position as a "stepping-stone" to higher office. That is certainly correct, to the same extent that every other office filled by popular vote is subject to the same politicization. And while a commissioner's desire to be reelected or to proceed to higher office would seem to work to the advantage of voters in their role as policyholders, to the degree that insurance companies are more concerned about electing a supportive candidate than is the general public, the more likely it will be that insurers will successfully dominate the electoral process.

Statutory Remedies. Prior to Proposition 103, California's consumer protection, civil rights and other statutes were inapplicable to the insurance industry by express statutory exemption.[104] The initiative repealed the exemption, making available to the consumers a host of state law remedies for improper conduct.[105]

F. The Impact of Proposition 103 on Premiums

Unlike no-fault, Proposition 103 makes no change in the amount of compensation paid to auto accident claimants, nor does it directly alter the system by which such claims are made or paid. Instead, "insurance industry reform" alters the insurance marketplace by regulating the rate-setting process as well as certain underwriting and marketing practices, and eliminating barriers to competition. Data drawn from NAIC reports[106] show that this approach to insurance reform has succeeded in restraining premium increases and has provided California consumers with substantial savings on their auto insurance.

Average auto liability premiums dropped 0.1% in California between 1989 and 1995. In the years immediately prior to Proposition 103, auto insurance premiums in California sustained double-digit increases. Preelection rate increases by insurance companies in anticipation of Proposition 103's passage, and post-election increases taken while Proposition 103 was stayed pending judicial review by the California Supreme Court, pushed the average liability premium in California to $519.39 by 1989. According to the NAIC data, California's average auto liability insurance premium in 1995 was $518.75—0.1% less than the 1989 figure. See Tables 9 and 10.

Auto premiums fell in California while premiums throughout the rest of the nation increased 32.2%. Another measure of the impact of Proposition 103 is a comparison of the growth rate in average liability premiums in other states. Liability premiums for the rest of the country grew 32.2% between 1989 and 1995.

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mately 70% of his total campaign receipts, according to campaign disclosure statements on file at Office of the Secretary of State of California. Mr. Quackenbush never made public appearances; his campaign emphasized a law enforcement platform. Richard Rambeck, *What Criteria Do Voters Use In Electing Commissioners?* Insurance Week, November 11, 1996, at 30. Commissioner Quackenbush has fueled controversy and continuing criticism from consumer advocates (including the author) for favoring insurance industry positions. *See, e.g.,* James P. Sweeney, *Foe Claims Quackenbush Strongly Favors Insurers,* San Diego Union-Tribune, February 8, 1995 at A3; Thomas S. Mulligan, *Quackenbush, Consumer Group Trade Jabs,* Los Angeles Times, February 9, 1995, at D2; Ann Bancroft, Associated Press, *Insurance Commissioner Cost Public $221 Million, Group Says,* (Los Angeles) Daily News, February 9, 1995, at News-7; Russ Nichols, *Quackenbush: Bought, Paid For,* (Los Angeles) Daily Commerce, March 31, 1995, at 1; *Quackenbush Ducks,* editorial, Sacramento Bee, July 11, 1995, at B6; The Insurers' Commissioner, editorial, San Francisco Chronicle, May 24, 1996, at A26; *Insurers Are Finding a Friend in Quackenbush,* editorial, Los Angeles Times, August 2, 1996, at B8; Nick Budnick, *If It Quacks... When Big Insurance Talks, Chuck Quackenbush Listens,* Sacramento News & Review, September 12, 1996, at 18; Mark Gladstone, *Quackenbush Accused of Delaying Probe of Donor,* Los Angeles Times, September 26, 1996, at A3; *Quackenbush Vs. The Press,* editorial, Sacramento Bee, January 22, 1997, at B6; *Insurance Commissioner Should Avoid Conflicts,* editorial, San Francisco Chronicle, March 7, 1997, at A26; Carolyn T. Geer and Ashlea Ebling, *A Quack In The China Shop,* Forbes, October 20, 1997, at 89.

[104] *See e.g.,* McBride-Grunsky Act, Cal. Ins. Code §§ 1850 to 1863.3, portions repealed by Proposition 103, § 7.

[105] C.I.C. § 1861.03(a).

[106] One caveat regarding the 1995 NAIC data should be noted. Shortly after the publication of the 1995 NAIC report in January, 1997, consumer advocates determined that some 1995 California premium data had been omitted from the report and notified the NAIC. Though unaware of the problem, NAIC officials subsequently confirmed this discovery and stated that California Department of Insurance had failed to provide the NAIC with complete data. The NAIC has stated that it will attempt to correct the omission in future reports. Therefore, the 1995 data presented here should be considered preliminary.

Table 9. Comparison of Average Liability Premiums, 1989-1995

	1989	1990	1991	1992	1993	1994	1995
California	$519.39	$501.34	$522.95	$510.71	$508.05	$496.82	$518.75
Rest of Nation	$317.32	$338.55	$358.82	$381.69	$402.65	$411.40	$419.55

Table 10. Comparison of Growth in Average Liability Premiums, 1989-1995

	% Change 1989-90	% Change 1990-91	% Change 1991-92	% Change 1992-93	% Change 1993-94	% Change 1994-95	% Change 1994-95
California	-3.5%	4.3%	-2.3%	-0.5%	-2.4%	4.6%	-0.1%
Rest of Nation	6.7%	6.0%	6.4%	5.5%	2.2%	2.0%	32.2%

California's average liability premium, though still high, dropped significantly after the passage and implementation of Proposition 103. With its urban populations and extraordinary reliance on the automobile, California's average liability premium is still high compared to the rest of the nation. However, since the passage of Proposition 103, California's rank relative to the nation has dropped. In 1989, California had the 2nd highest average auto liability premium in the nation. By 1992, the state had dropped to 8th highest. In 1995, it was 11th.

The rate of growth of the average auto insurance premium in California has slowed. In 1988, California had the seventh fastest rate of annual growth in auto insurance liability premiums in the nation. By 1994, California was 47th. Between 1988 and 1994, California experienced the slowest rate of auto premium growth of any state. California had one of the six *slowest* rates of auto insurance premium growth in the nation each year between 1990 and 1994.

Proposition 103 saved California motorists an estimated $14.7 billion between 1989 and 1995. In 1991, former Insurance Commissioner John Garamendi exercised his authority under Proposition 103 to order a freeze on all rate increases requested by insurance companies that had refused to pay their Proposition 103 rollback. Those that fulfilled their rollback obligation were permitted rate increases when justified based on informal application of the Proposition 103 regulatory formula developed by the Insurance Department.[107] Had these regulatory actions not occurred, California motorists would have paid an additional $14.7 billion in premiums, or $1,171 per policyholder.[108] This figure does not include the premium refunds already paid to automobile insurance policyholders.

New regulatory approach leads to premium increases in 1995. The preliminary NAIC data appear to reflect the impact of the laissez-faire philosophy of Insurance Commissioner Quackenbush, who took office in January of 1995. During his first year in office, the average auto liability premium rose 4.6% over the previous year. This marked the first increase in four years, the largest since the passage of Proposition 103 in 1988 and more than double the average increase for the rest of the nation between 1994 and 1995. Between 1990 and 1994, California had one of the six slowest rates of auto liability insurance premium growth in the nation. By

[107] Because the rate freeze continued through most of Commissioner Garamendi's entire term as insurers pursued their legal challenge to his regulations—the California Supreme Court upheld the regulations five months before he left office (*Twentieth Century Insurance Co. v. Garamendi, supra*)—he did not promulgate provisions of the regulatory formula needed to govern rate change requests under C.I.C. §1861.05.

[108] The estimate is based on the methodology utilized by NICO. *See* National Insurance Consumers Organization, *A Consumer Triumph: Proposition 103 Revisited*, at 18. NICO utilized "combined average premium" data from the NAIC.

The insurance industry has claimed that the economic recession, not Proposition 103, was responsible for holding premiums down in California during Commissioner Garamendi's tenure. Since the recession affected the entire nation, it cannot explain why the average liability premium in California remained stable during a period when it grew by 32% for the rest of the nation. Insurers have argued that increased unemployment in California and fewer motor vehicles on the road are responsible. However, unemployment statistics show that of the ten states with the highest unemployment rates in the nation between 1990 and 1993, nine had an average increase in their premiums of 27.6% during that period. California is the tenth state. U.S. Dept. of Labor, Bureau of Labor Statistics; U.S. Dept. of Commerce, Statistical Abstract of the U.S. 1992, 1994. Similarly, there were more vehicles on the road in California in 1993 than in previous years, and the total mileage driven in California rose between 1990 and 1993. U.S. Federal Highway Administration; National Association of Insurance Commissioners, *State Average Expenditures and Premiums for Personal Automobile Insurance in 1995*, January 1997 (and prior years' reports).

1994, California ranked 47th. In 1995, however, California experienced the 10th highest annual rate of growth in the nation.

Auto insurance profits in California remain excessive. Despite a lengthy freeze on rate increases and over $1 billion in premium refunds, the average profit of California auto insurance companies in 1995 was over 60% higher than the national average.[109] Confronted with 103's stringent rate regulation and rollback requirements, which ended the cost "pass-through" system, insurers have indeed tightened their belts as predicted: cutting agent commissions, reducing expenses, fighting fraud and promoting loss prevention.[110] The excessive profits insurance companies are earning in California prove that further reductions in existing rates are justified.

V. THE POLITICS OF AUTO INSURANCE REFORM

Over the last decade, auto insurance has joined the ranks of other pocketbook issues, such as taxes and utility rates, which generate enormous attention from politicians, the press and the public.

For the auto insurance industry, which wrote $119.1 billion in premiums in 1995, much is at stake in the outcome of the debate. The policyholders who pay those premiums have an equal interest. Elected officials often attempt to balance their obligation to their constituents against the need to accommodate the insurance industry's powerful influence within the political economy. However, public dissatisfaction with insurance companies, as reflected in the industry's consistently low ratings in opinion polls,[111] make it a vulnerable target for politicians. In 1997, for example, a little known state legislator came within four points of unseating the incumbent governor of New Jersey by blaming her for the high auto insurance rates produced by the state's no-fault system. He called for its repeal and enactment of insurance industry reforms based on California's Proposition 103 model.[112]

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[109] National Association of Insurance Commissioners, *Report on Profitability by Line by State in 1995*, November 1996.

[110] One of the areas in which the impact of Proposition 103 has been most obvious is in the efforts by insurance companies to fight fraud. Two years after Proposition 103 passed, the Los Angeles District Attorney noted that, "until coming under pressure to lower rates under Proposition 103, [insurance] carriers simply settled claims and passed the cost to consumers in the form of higher premiums. 'That has begun to change,' he said. 'Insurance companies are getting serious about fraud.'" Lois Tinmick, *51 to Face Charges in Auto Insurance Fraud Roundup*, Los Angeles Times, October 18, 1990, at B4. Heightened scrutiny of claims by insurers is at least partly responsible for the 48% reduction between 1989 and 1994 in lawsuits for personal injury auto accident filed in California Superior Courts. *1996 Annual Report*, Judicial Council of California, at 109. Industry observers have noted the industry's cost-cutting mentality and attributed it to insurance industry reform. *See, e.g.*, Richard Yingling, *Rebuilding Crumbling Loyalties*, Best's Review, September 1990, at 57,59. *Auto Insurers Dominate List of Top Combined-Ratio Results*, Best Week, February 7, 1994 at P/C1, P/C2: "Low expense ratios are a common factor among many of auto insurers that posted underwriting profits. They have avoided resource-hungry products, outsourced functions or eliminated the middle man from their operations." The Impact of Proposition 103 on the behavior of the insurance industry has extended beyond California. As the U.S. economy entered a recession in the early 1990s—accompanied by a drop in investment income to which the industry would normally respond with premium increases—industry officials warned each other to avoid the destabilizing premium gyrations of the mid-1980s. As one insurance executive explained, "The last soft market was driven purely by the need for cash to invest...We all know we can't do the dumb things we did last time...We will not see a repeat of 1985-86." Mark A. Hofmann and Christine Woolsey, *Marketplace Not What It Used To Be: Insurers*, Business Insurance, July 13, 1992, at 55. Another executive has observed: "I don't think you'll see a 1985-1986 repeat. There are too many regulatory restraints put in place to preclude it. A lot of regulations addressed our own stupidity. We made the bed and now we have to lie in it." Mark A. Hofmann and Christine Woolsey, *Insurers Say Expectation of Price Turn Pushed Back*, Business Insurance, January 10, 1994, at 1, 14. And a senior official with the Insurance Services Office, an industry trade group, warned: "As an industry, nothing will disrupt our relations with customers faster—not to mention regulators and public policy makers—than an abrupt recovery from our current underwriting cycle: Remember the fallout from the last recovery: California's Proposition 103 and other price-suppression laws, threats to the industry on the antitrust front, and virulent consumer hostility..." *Not Like 1985: ISO Official Predicts Next Upturn in Cycle to be Gradual*, Insurance Week, October 19,1992, at 15.

[111] In a recent poll of California voters' confidence in thirty-four institutional entities, insurance companies scored the lowest. Six times as many people reported they had "not much," rather than "a lot" of confidence in insurers. The Field Institute, Release # 1853. October 1, 1997.

[112] *Texas Commissioner Bomer Fires First Shot in National Rate Cut War*, Auto Insurance Report, March 16, 1998, at 1-2. And in California's 1998 gubernatorial campaign, Democratic primary candidate Al Checci called for a 10% rate rollback based on the excessive profits achieved by California auto insurers. *Id.*

The insurance industry, acutely aware of its impaired credibility, is not without its own strategy. The $259.7 billion property-casualty industry, of which auto insurance is a significant part, has generated and effectively exploited public antagonism towards lawyers and the tort system in the past. Proponents of no-fault frequently cast the issue as a referendum on the plaintiff's lawyers who represent auto accident victims, almost always on a contingency fee basis.[113] Thus, the insurance industry has sought to place auto insurance reform within the parameters of the larger debate it has instigated for more than two decades over the tort system, a context in which plaintiff's lawyers make effective targets.[114] Indeed, many of the institutions and academics who have promoted no-fault auto insurance legislation, such as the Manhattan Institute and Professor Jeffrey O'Connell, receive substantial support from insurance companies,[115] and have previously promoted proposals to restrict tort law rights in product liability and medical malpractice cases.[116] Since the issue of sponsorship is itself critical in the insurance debate, insurers have worked hard to develop the appearance of consumer support for no-fault.[117]

The politics of insurance reform are well illustrated in the current effort by no-fault supporters to enact the federal "consumer choice" no-fault legislation. Indeed, it is apparent that the politics of "choice" no-fault legislation transcend even the issue of insurance reform. In a Washington, D.C., seminar sponsored by the Heritage Foundation in 1996, no-fault proponents explicitly portrayed the "choice" legislation as a means of achieving highly partisan goals. No-fault advocate Michael Horowitz stated: "One needs to focus on the purely political side of the money that [the

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[113] For example, the proponents of the pure no-fault ballot initiative defeated by California voters in 1996 based their entire campaign on an anti-lawyer theme. "[The initiative]... will bring unscrupulous personal injury lawyers and runaway lawsuits under control. These lawsuits cost consumers too much money, hurt our economy and cost all of us jobs." Argument in Favor of Proposition 200, California Ballot Pamphlet, March 26, 1996 at P96; Hallye Jordan, "Limits Sought for Fees, Lawsuits: Lawyer-Bashing Advocates Hope to Convince Voters," San Jose Mercury News, March 21, 1996, at 1A;

[114] The Field Poll placed the legal profession in second to last place, just ahead of insurance companies.

[115] For example, the New York-based Manhattan Institute has published numerous proposals to restrict the right of consumers to seek judicial recourse under state tort laws. It is one of a number of non-profit organizations which, through the sponsorship of academicians, has sought to portray its work as scholarly and non-partisan. Senior fellow Michael Horowitz was an early leading advocate of "choice" no-fault (Michael Horowitz, *Let Drivers Tailor Auto Insurance*... New York Times Op-Ed, March 21,1993, at F11). The Institute is supported by large corporations which actively promote "tort reform," including such insurance firms as State Farm, Aetna, Cigna, Metropolitan Life, Safeco, and Traveler's Insurance. Manhattan Institute, judicial Studies Program Mission Statement and Overview, New York, N.Y., November, 1992. A fundraising solicitation by the Institute was unusually explicit in stating the benefits to corporate donors of its advocacy of tort "reform": "We feel that any funds made available to the Judicial Studies Program will yield a tremendous return at this point—perhaps the highest 'return on investment' available in the philanthropic field today." William H. Hammett, President of Manhattan Institute, Corporate Solicitation Letter accompanying *Judicial Studies Program Mission Statement and Overview*, New York, N.Y., November, 1992.

Campaign disclosure reports reveal that University of Virginia Professor Jeffrey O'Connell was paid at least $67,000 by the insurance industry in 1988 to tour California in opposition to Proposition 103 and in support of Proposition 104, the insurance industry-sponsored "no-fault" initiative. Campaign disclosure statement, Citizens for No-Fault, Sponsored by California Insurers, Schedule E (723/88-9/30/88); (10/1/88-10/22/88).

[116] For example, Professor O'Connell has urged the application of "no-fault' to medical negligence. *O'Connell Devises New No-Fault Plan*, The National Underwriter, August 24, 1979, at 4. Manhattan Institute staff have advocated statutory limits on the size of the contingency fee injured plaintiffs may pay a lawyer to represent them (Peter Passell, *Contingency Fees in Injury Cases Under Attack by Legal Scholars*, New York Times, February 11, 1994 at 1) and blamed the nation's health care crisis on lawsuits (Jeffrey O'Connell and Michael Horowitz, *The Lawyer Will See You Now: Health Reform's Tort Crisis*, The Washington Post, June 13, 1993 at C3). Similarly, financial consultant Andrew Tobias, a supporter of no-fault legislation, authored a paper which argued that the legal system, rather than the insurance system, was responsible for massive increases in the cost of medical malpractice insurance. *Treating Malpractice: Report of the Twentieth Century Fund Task Force on Medical Malpractice Insurance*, Priority Press Publications (1986).

[117] After the passage of Proposition 103, the insurance industry's California political consultant wrote a confidential memorandum urging the industry to find ways to co-opt grass-roots consumer and minority organizations in order to successfully promote no-fault. This would be necessary, he argued, because, "[w]ithout consumer credibility, reform concepts are easily discredited as special interest pocket-lining by the Industry... The Insurance Industry desperately needs the credibility of third parties to endorse and advance efforts to control insurance costs in California." Clinton Reilly Campaigns, *Agenda 1989: The Lessons of the 1988 Insurance Campaign* at 3.

"choice" no-fault legislation] takes away from the tort bar."[118] Another participant, Grover Norquist, the President of Americans for Tax Reform, made the same point: because trial lawyers make substantial campaign contributions to Democratic candidates, and no-fault would reduce lawyers' income, passage of no-fault would enhance the political prospects of the Republican Party. "Trial lawyers are [a] bigger funder of the Democratic Party than the labor unions..."[119] Norquist said. "[O]n the level of what's important to do today for political reasons and for fights two years from now, five years from now, ten years from now, if this legislation is passed, the people we argue with and fight with next year and five years from now [will be] shorter and less powerful than they are today...[T]hat makes...future fights possible."[120] Horowitz agreed that passage of no fault would, "really make a difference in the [1996 congressional] election in terms of real seats in the House, real seats in the Senate...a real payoff for what the Republican revolution is all about..."[121]

CONCLUSION

No fault auto insurance systems have been a failure. No fault systems have an historical experience of driving up rates because good drivers are required to pay for bad drivers, all drivers are covered regardless of fault so that double the claims are paid, fraudulent claims perpetuate, drivers must litigate property damage claims, and insurance companies have reneged on promises to voluntarily lower premiums. According to the latest data from the National Association of Insurance Commissioners, the most effective way to reduce auto insurance rates is to repeal no fault systems and implement vigorous regulation and anti-monopoly protections.

H.R. 2021 is an attempt by insurance companies who promised no fault would work two decades ago to elevate their failed experiment to a draconian level: the abolition of pain and suffering compensation for even the most seriously injured auto accident victims. Yet H.R. 2021 guarantees no premium reduction, precludes bad faith claims against insurers by eliminating punitive damages, and creates an administrative insurance system of red tape that is dramatically tilted against the consumer.

Because of no fault's documented flaws—its high cost being one of the most relevant—American motorists are opposed to no fault. No state has adopted a no fault system since 1976.[122] Since 1989, four states have repealed their mandatory no fault laws.[123] Notwithstanding millions of dollars in expenditures by the insurance industry, its campaigns to pass no fault in state after state have been defeated. Indeed, in states which currently have no fault systems, the insurance industry must wage a nearly constant defensive battle to prevent no fault's repeal.

Whether any form of no-fault could achieve savings sufficient to offset the higher cost of compensating parties regardless of fault has yet to be determined;[124] no state has adopted a "pure" no-fault law, and the voters of one state have overwhelmingly rejected it. Indeed, the results of the few plebiscites on no-fault suggest that barring access to the tort system as a means of reducing the price of automobile insurance is not acceptable to consumers. As no-fault advocates Keeton and O'Connell acknowledged in their initial discussion of no-fault three decades ago, "Proposals to eliminate completely the common law action for negligence arising out of automobile

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[118] Transcription of recording of Heritage Foundation conference panel on tort reform, Washington, D.C., March 19,1996, at 9.

[119] *Id.* at 5.

[120] *Id.* at 8.

[121] *Id.* at 17. Norquist also pointed out the strategic significance of no-fault's alleged cost savings: "[I]t paints everybody on the other side as the hostage to special interests, the trial lawyers—not a particularly popular special interests—at the expense of the general interest, at the expense of the average American." *Id.* at 7.

[122] As of 1994, ten states had mandatory no fault laws. Another eleven states and the District of Columbia had non-mandatory, or "optional," no fault systems. In these states, tort suits and compensation are not restricted, and motorists may choose to "add-on" no fault coverages, or motorists may choose whether to be covered by no fault or by tort.

[123] Connecticut repealed its mandatory no fault law effective Jan. 1, 1994; Georgia repealed its mandatory no fault law effective Oct., 1, 1991; New Jersey repealed its mandatory no fault law in 1990; Pennsylvania repealed its mandatory no fault law effective July 1990.

[124] In their recent publications, Professor O'Connell and most other no-fault proponents rest their claims concerning no-fault's purported cost savings on a series of computerized projections made by the RAND Corporation. *See, e.g.,* Jeffrey O'Connell, Stephen Carroll, Michael Horowitz and Allan Abrahamse, *Consumer Choice in the Auto Insurance Market,* 52 Maryland Law Review 1016 (1993). As noted previously, the RAND study is flawed and its conclusions never comport with the actual experience under no fault as documented by the NAIC data.

accidents are perhaps doomed to founder as unable to muster the necessary widespread political support." Basic Protection for the Traffic Victim (1965) at 164.

The United States Congress should not preempt the laws of the fifty states to impose this system upon American motorists. That think tanks such as the Hudson Institute and the Manhattan Institute, academics such as University of Virginia Professor Jeffrey O'Connell as well as the University of Wisconsin Auto Accident Compensation Project, and consultants such as Andrew Tobias would support such a duplicitous scheme strips any credibility from these insurance industry partisans.

The best reform model to relieve motorists of the burden of paying excessive insurance premiums is California, where Proposition 103 has reaped an unprecedented $15 billion in savings for motorists. State regulation of insurance, if administered properly, will lower premiums. Reform of the insurance industry's operations and practices, including eliminating barriers to competition, do not rely on restrictions on coverage or gimmicks to deliver real price savings: they would force auto insurance companies to compete with each other in a marketplace in which consumers are fully informed of their options.

APPENDIX A—PROPOSITION 200 ON THE MARCH 1996 CALIFORNIA BALLOT

In 1994, a consortium of utility, high-tech and financial services firms announced the formation of a lobbying committee, the Alliance to Revitalize California, to sponsor a so-called "pure" no fault initiative for the March 1996 ballot as part of a package of three initiatives to broadly limit access to the courts and the application of the state's tort laws. Proposition 200 would have:

- established a pure no-fault system;
- abolished fault-based tort liability for economic losses (including losses exceeding the no-fault coverage) unless the motorist who caused the accident was engaged in criminal conduct or the shipment of hazardous waste;
- abolished compensation for non-economic damages in all cases;
- required that taxpayer-funded public assistance programs and other forms of private insurance coverage bear the costs of auto accident victims before auto insurers are responsible to pay claims;
- offered a total of $50,000 in benefits;
- promised substantially lower auto insurance premiums, without providing any statutory rate reduction requirement;
- eliminated tort lawsuits against insurers who failed to pay no-fault benefits in good faith.

The chief differences between the federal "choice" legislation and 200 are that Proposition 200 abolished tort liability for economic damages as well as for non-economic damages and did not purport to offer a "choice."

Like H.R. 2021, Proposition 200 was based on a proposal drafted by Prof. Jeffrey O'Connell and Michael Horowitz, two recognized leaders of the national corporate campaign to restrict state tort laws, and publicized by the Manhattan Institute.

O'Connell is considered the "father of no fault," a proposal for unlimited auto insurance benefits which he first discussed in a legal publication with Robert Keeton in 1965. Californians became acquainted with O'Connell in 1988, when he became one of the insurance industry's leading spokespeople against insurance reform Proposition 103 and advocate of Proposition 104, the insurance industry-sponsored "no fault" initiative. Campaign disclosure reports later revealed that O'Connell had been paid at least $67,000 from the insurance industry for his California moonlighting against Prop 103.[1]

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

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

The Manhattan Institute is a think tank[2] which purports to be concerned about the protection of consumers against avaricious lawyers,[3] but it is funded by a roll call of some of the largest corporations in the world, led by insurance companies: State Farm Insurance, Aetna, Chase Manhattan Bank, CitiCorp, Bristol-Myers Squibb, Exxon, Pfizer, Phillip Morris, Procter & Gamble, Prudential, RJR Nabisco, Cigna, Dow Chemical, General Electric, Union Carbide, Metropolitan Life, Safeco, and Traveler's. Among the four corporate donors listed at the $50,000 and above level by the Manhattan Institute two are insurers, State Farm Insurance Company and Aetna.[4]

The Institute has worked hard to adopt a patina of academic respectability, but its purpose is laid out in a blunt November 1992 fundraising letter to the Institute's corporate and insurance industry sponsors.[5] The fundraising letter previewed the pure no fault proposal which became Proposition 200 and is now H.R. 2021.[6]

The Manhattan Institute publicly unveiled its no-fault proposal in a March 21, 1993, New York Times op-ed by Michael Horowitz criticizing a "pay at the pump no fault system" that corporate consultant and financial writer Andrew Tobias had promoted in a self-published book and in the California Legislature.[7] "Bravo, Andy!" Horowitz exclaimed, for the portion of Tobias' proposal that would "aboli[sh] all pain-and-suffering claims... But Horowitz expressed his funders' disinterest in a pay-at-the-pump insurance delivery system that would have taken insurance out of the hands of the insurance industry: "Having seen the dreary effects of a judicialized system, Mr. Tobias would substitute a politicized and bureaucratized one."[8] Horowitz then recommended his own 1992 "plan, co-drafted with O'Connell."

Tobias's 1993 proposal to establish a "pay at the pump no fault" system, in which motorists would purchase insurance through a gas tax, ran into considerable opposition in the California Legislature, largely because the insurance industry strongly opposed the "pay at the pump" aspect of the plan, which would have virtually eliminated insurance agents, marketing and other expenses of the insurance system. To win support from insurers, Tobias approved amendments which eliminated the "pay at the pump" part of the plan—the core of his proposal—leaving only a typical "no fault" law, which insurers had always sought from the Legislature. This rapid capitulation was the first indication that Tobias's professed interest in consumers was vulnerable to political expediency.[9] Tobias's "no fault" proposal was nevertheless defeated in a subsequent committee hearing. He then proposed a similar initiative for the November, 1994 ballot, under the banner of "Common Sense Legal Reform" (a popular name for a plank in the corporate tort deform platform) but later withdrew it after its debut elicited widespread criticism.

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

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

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

[5] Attached in Appendix.

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

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

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

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

With the universal collapse across the nation of no fault, the insurance industry and its allies, O'Connell, Horowitz and Tobias, were prepared to go to greater lengths to resuscitate no fault, suggesting even more cumbersome and complex alternatives.[10] The "pure" no fault proposal in which the right to sue was eliminated completely, along with pain and suffering, would have been unthinkable by O'Connell's standards when he first proposed no fault. It was the antithesis of the humane program of "socialized auto insurance" originally articulated. But pure no fault became acceptable when it grew clear that traditional no fault was an experiment that would soon be relegated to the dust bins of history as state after state repealed their no fault laws (as noted above, since 1979, five states have repealed their no fault laws, and no state has adopted a no fault system since 1976). The Insurers-O'Connell-Horowitz-Tobias plan was at the core of Prop. 200.

Their proposal focused not on unlimited benefits but, in the aftermath of California Proposition 103, on lower premiums. Their no-fault plan promised the insurance industry could "save" consumers more than $30 billion nationally by "replac[ing] 'third party' with 'first party' insurance," and letting consumers "opt out of... pain-and-suffering" compensation.[11] This was the genesis of Proposition 200 and H.R. 2021, which eliminate pain and suffering compensation and which the Proposition 200 proponents trumpeted across California as a consumerist idea of their own making—Tobias's pay-at-the pump without the pump.[12]

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

To give the California effort a veneer of legitimacy and independence from the insurance industry, Tobias and his colleagues recruited Silicon Valley executives, entrepreneurs and high-tech corporations by offering to place on the ballot two additional propositions of particular interest to them: Proposition 201, which would have required swindled investors to post a bond paying for swindlers' legal expenses before recovering their losses; and Proposition 202, which would have cut the fees of consumer's contingency fee attorneys (but not, of course, those of corporate defense attorneys). The strategy was to use the massive financial resources of these business groups to obviate the need to rely on insurance industry money, which would have instantly condemned the measure to defeat by California voters. (Campaign disclosure reports revealed that many of the major donors who ultimately gave a total of $19 million to the Alliance to Revitalize California campaign had engaged in allegedly illegal conduct in the past, for which Propositions 201 and 202 would buy them legal immunity). Conversely, Proposition 200, promising lower premiums, was designed to be the "populist" measure, a Trojan horse which would overshadow, and thus grease voter approval of, the other two tort "reform" propositions.

Astroturf consumer advocates. Business support alone was insufficient to convince voters that the three initiatives were pro-consumer. This Michael Horowitz recognized in his 1993 New York Times op-ed when he wrote of an "exciting... possibility of a broad alliance between market-oriented and consumer groups."

Thus, a second tactic was to portray the three propositions as "pro-consumer" by portraying their sponsors as consumer advocates.[13] This was accomplished by hiring consultants, fund-raisers and other campaign operatives who once worked with "Voter Revolt," the organization established to sponsor Proposition 103.[14] In a confidential November 15, 1995 campaign memo, the Chairman of Proposition 200's campaign noted the need for legitimacy in the eyes of the public: "When voters perceive the battle to be between insurance companies on the one hand and a coalition

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

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

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

[13] Andrew Tobias claimed the appellation by virtue of an award he had once received from the Consumer Federation of America.

[14] Rosenfield left the organization in 1993.

of consumer groups and lawyers on the other, they are overwhelming inclined to side with the lawyers... However when consumers are added to both sides of the equation the lawyers realize no benefit... This observation underscores the critical importance of Voter Revolt being put forward as an equal partner in the fight for no fault." (Memo Attached.)

Once the state's toughest critic of insurance companies and big business, the "Voter Revolt" name was put at the forefront of efforts for pure no-fault legislation, The "Voter Revolt" name has also been invoked in Congress on behalf of pure no fault legislation. Testifying before the House Subcommittee on Courts and Intellectual Property of the House Judiciary Committee on February 10, 1995, Michael Horowitz invoked support by "Voter Revolt" for H.R. 10, claiming it was *"the Nader-affiliated consumer group which sponsored California Proposition 103 mandating sharp auto-mobile insurance rate reduction"* (his emphasis).[15]

Campaign disclosure reports filed with the Secretary of State show how the merchandising of the Voter Revolt name was a fraud designed to fool the voters and enrich a number of individuals:

While the proponents of the measures claim be acting in the name of Voter Revolt, these individuals were never actually employed nor paid by Voter Revolt for their work on that campaign. For example, Michael Johnson, an employee of Andrew Tobias and a spokesperson for the no fault initiative, claimed to be the "Policy Director" of Voter Revolt. In fact, Johnson was never paid by Voter Revolt, but rather by the Alliance to Revitalize California. Johnson, who continues to represent himself as a staff person of Voter Revolt, apparently still works for Silicon Valley sponsors of the ballot measures. In a recent deposition, Johnson identified himself as a "political consultant" employed by an offshoot of the Alliance to Revitalize California.[16]

During 1995 and 1996, William Zimmerman, partner in a Santa Monica-based political consulting firm, Zimmerman and Markman, claimed to be Voter Revolt's "Political Director." According to a recent deposition in a lawsuit related to the three ballot measures, Zimmerman admitted that he had not been an employee of "Voter Revolt" in 1995 and 1996 after all. (He described himself as "an unpaid advisor to the organization.") He received $515,402.15 for public relations and media production services from the Alliance to Revitalize California.

People hired to collect signatures and campaign door to door for the three propositions identified themselves as grassroots "Voter Revolt" workers. But campaign reports show that during the election period when the Alliance spent in excess of $19 million on the initiatives in the name of Voter Revolt, Voter Revolt itself had virtually no staff or resources. During the entire time period from January 1, 1996 to March 31, 1996, Voter Revolt reported receiving $84,583 and spending $116,747. From April 1 to June 30, 1996 Voter Revolt reported receiving $7,166 and spending $12,536.

In fact, these "grassroots activists" were professional fund-raisers hired by "Progressive Campaigns" a private, for-profit organization that specializes in campaign signature gathering and political canvassing. Progressive Campaigns received $5,344,495.30 in fees from the Alliance to conduct its operations in the name of Voter Revolt. The Voter Revolt name was used by Progressive Campaigns to both sway voters and solicit contributions from unsuspecting members of the public. They were paid up to $1 a signature to qualify the measures for the ballot, using the name "Voter Revolt." However, these signature gatherers were never employed by Voter Revolt. Progressive Campaigns paid the signature collectors as independent contractors. As a group of them later wrote in a letter to a national magazine in response to an article by Tobias extolling the "grassroots base" for Proposition 200:

> "We must point out that the 'consumer group Voter Revolt'... is not even real. It is an old name that Nader actually coined a while back which is being used as a front for the for-profit 'Progressive Campaigns, Inc.' We went out to the public as Voter Revolt, but our paychecks said Progressive Campaigns."

The insurance industry funds Prop. 200—after the election. Post-election disclosure reports confirm what many suspected would occur: insurance companies stepped in *after the election* to make substantial contributions to the Alliance, which

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[15] Nader subsequently wrote Representative Carlos Moorhead, Chairman of the Committee, commenting, "Voter Revolt has been taken over by turncoats who now provide their services for anti-consumer initiatives. They are NOT affiliated with me or any of our organizations."

[16] During the campaign, Johnson frequently described himself as a "former Nader Raider," insisting that he had worked for Nader in Washington, D.C. That, too, was a distortion at best. Records from Nader's office—The Center for the Study of Responsive Law—show that Johnson had been rejected by Nader's office after applying for a job. He later obtained employment as a researcher at one of the numerous citizen groups in Washington that Nader had founded.

was heavily in debt after the campaign was over. Many of the state's largest insurance companies made over $700,000 in donations to the Alliance by way of Taxpayers Against Frivolous Lawsuits, a separate campaign committee established by insurers and other business organizations to fight yet another round of ballot measures on the November, 1996 ballot.

Insurance Company Donations to "Taxpayers Against Frivolous Lawsuits"

NAME OF CONTRIBUTOR	REPORTING PERIOD	AMOUNT
State Farm Mutual Auto Insurance Company	4/1/96-6/30/96	$50,000.00
American Insurance Corporation	4/1/96-6/30/96	$350,000.00
Association of California Life Insurance Companies	4/1/96-6/30/96	$5,000.00
Farmer's Insurance Group of Companies	4/1/96-6/30/96	$50,000.00
American Council of Life Insurance	7/1/96-9/30/96	$100,000.00
Philadelphia Insurance Company	7/1/96-9/30/96	$1,000.00
Paradigm Health Corporation	7/1/96-9/30/96	$7,500.00
Transamerica Corporation	7/1/96-9/30/96	$25,000.00
California Casualty	7/1/96-9/30/96	$10,000.00
Association of California Life Insurance Companies	10/1/96-10/19/96	$2,000.00
Association of California Insurance Companies Issues	10/1/96-10/19/96	$10,000.00
California Indemnity Exchange	10/1/96-10/19/96	$10,000.00
Chubb & Son, Incorporated	10/1/96-10/19/96	$50,000.00
Metropolitan Life	10/1/96-10/19/96	$20,000.00
Wayne Lowell—VP Pacificare	10/19/96-12/31/96	$100.00
CNA Insurance Company	10/1/96-10/19/96	$20,000.00
United American Healthcare	10/1/96-10/19/96	$800.00
Total Insurance Money		$711,400.00

Donations from "Taxpayers Against Frivolous Lawsuits" to The Alliance

DATE	AMOUNT
10/10/96	$350,000.00
10/17/96	$350,000.00
10/20/1996-12/31/96	$260,352.90
TOTAL	$960,352.90

And finally, campaign reports filed in January of 1997 reveal that Voter Revolt itself later received funds from the insurance industry through the same conduit. Taxpayers Against Frivolous Lawsuits paid Voter Revolt $205,345.

This audacious effort to establish grassroots legitimacy—sometimes referred to as an "Astroturf" strategy—failed. Proposition 200 was met with unanimous and strong opposition by consumer groups. More than 75 public interest groups opposed the initiative, along with the powerful Consumer Attorneys of California, and *no* citizen group supported it. Even some-time supporters of traditional no fault weighed in to oppose the draconian abolition of pain and suffering compensation for even the most seriously injured accident victims (which is identical to H.R. 2021). Robert Hunter, a nationally-recognized consumer advocate on insurance matters and former Texas Insurance Commissioner, opposed Proposition 200. Hunter stated," Proposition 200, with its puny benefits and total abolition of legal rights, would harm California consumers seriously. Proposition 200 is bad no-fault that strips away important rights to motorists and passengers."

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

On March 26, 1996, the California voters issued a stinging rebuke of no-fault for the second time in eight years. A conservative Californians electorate defeated a bal-

lot measure to establish a pure no-fault auto-insurance by nearly a 2 to 1 margin: No 65%, Yes 35%.[17]

APPENDIX B—THE RAND REPORT

The California-based RAND Corporation has issued a series of widely distributed reports on no fault auto insurance. Press releases accompanying the reports invariably suggest that no fault proposals, including those similar to H.R. 2021, would dramatically lower insurance "costs" in many states.

The RAND reports have been widely touted by no fault supporters to bolster their argument that no fault will dramatically lower premiums. However; the studies utilized highly questionable and sometimes severely flawed assumptions; the resulting conclusions are inaccurate and often misrepresented.[1] Moreover, the "savings" described by RAND are in the form of lower costs to insurers, not lower premiums for policyholders—a point omitted from the publicity generated by RAND and the insurance industry.

Data and Methodology. In undertaking their 1991 analysis, RAND's researchers had two serious problems: First, RAND had no access to independent data. All of its data was obtained from insurance industry sources. The integrity and credibility of the data are questionable. Second, the data obtained—directly from the insurance industry—was incomplete. RAND was forced to make numerous assumptions and extrapolations, some of which are erroneous or unjustified.

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

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

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

Moreover, the industry data contains estimates of medical and other bills which may be submitted by the claimant *in the future.* These estimates, however, are *made by insurance adjusters, not the claimants.* Insurers have a variety of financial and tax incentives to inflate such estimates wholly apart from attempting to influence the outcome of a study. Thus, the data is inherently unreliable and depends on estimates by individuals who may have little knowledge of or expertise in guessing what a particular policyholder may claim in the future.

Use of Industry "Consumer Panel" survey. Since the closed-claim database did not include data on people who filed no claims, RAND used industry polling data from households where a person was injured but did not file a claim. But the industry itself has noted that such data may not be demographically representative or reliable.[2]

Use of "Special Tabulations" Made by the Industry for RAND. The Insurance Services Office, an industry association that disseminates pricing and other

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

[1] RAND has previously acknowledged that over 50% of the RAND Institute for Civil Justice's funding is derived from the insurance industry. In addition, the insurance industry is heavily represented on the ICJ Board of Overseers: board members include representatives from State Farm (two), Kemper, Aetna, GEICO, Travelers, Allstate, SAFECO, USAA, CNA, the Alliance of American Insurers (two), John Hancock, and the Property-Casualty Insurance Council. Of the numerous law firms and associations represented on the board, only one is identified as a plaintiff law firm. Industry sponsorship raises concerns that may explain RAND's choice of presentation of the data to suggest that no fault will lower insurance rates or otherwise benefit consumers. Insurer funding may also explain why RAND has never studied the need for insurance rate regulation, the discriminatory redlining and territorial rating practices of insurers, the waste and inefficiency in the industry, the compensation of its executives, the need for private suits to force insurers to settle claims and the investment practices of the industry.

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

data to most insurers pursuant to the industry's federal antitrust exemption, provided RAND with a special computer run. The reliability of this data is unknown.

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

Indeed, referring to the amendment of no fault in Massachusetts in 1988, an industry expert noted that the "actual addition costs [of] raising the PIP limit were roughly double what the commissioner assumed... What law makers failed to foresee were the behavioral changes of participants in the system which the auto reform precipitated."[3]

The RAND materials do not appear to acknowledge even the basic reality that under no fault, more claimants are paid—the motorist who caused the accident, in addition to the innocent motorist.

Another erroneous assumption with potentially great significance is that no fault does not reduce the accident deterrent effect of the tort system. There is literature indicating it does, though RAND dismisses it summarily.[4]

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

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

Early RAND reports referred to savings in "total injury coverage costs." These are costs incurred by insurance companies. For example, RAND's definition of "total injury coverage costs" included the insurers' own legal fees and claim processing costs.[5] The "savings" reported by RAND would go to *insurance companies*, not policyholders.

The RAND report did not include property damage costs in its study. Property damage costs constitute about half of the typical auto insurance premium, as the RAND study acknowledged.[6] Therefore, the "savings" for insurers suggested by the news reports are, at the least, inflated by 50%.

Compensation. The RAND reports rely on historical data, as opposed to projections, in reviewing compensation under no fault. The reports confirm that victims receive less compensation under no fault:

According to the 1991 RAND report, on the average victims receive more net compensation (compensation left after legal fees and related expenses) *under the tort system* ($3,645) than under no fault ($3,182).[7] Under traditional tort systems, 62% of victims receive additional compensation above their medical bills and partial wage loss; under no fault, only 26% receive the additional compensation.[8]

Most of the "savings" projected by RAND come from simply restricting the amount of compensation paid to victims. Referring to so-called low-coverage, "no frills" no fault plans proposed by the insurance industry in several states, RAND's authors admitted:

> "No fault plans that slash costs tend to reduce the compensation less seriously injured people receive for non economic loss, such as pain and suffering. And they don't substantially improve the traditional system's treatment of the more seriously injured, who rarely recover even their economic losses in wages, medical payments and out-of-pocket expenses."[9]
>
> "All no fault plans reduce transaction costs. However, with the exception of plans that ban claims for non economic loss, the net reduction in total costs provided by reduced transaction costs is only about 10 percent; *the rest of the savings must come from reduced compensation.*"[10] [Emphasis supplied]

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

Referring to drivers involved in accidents who are "...*at fault* or if the other driver was at fault but uninsured," the study says: "they will tend to benefit from no

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[3] National Underwriter, December 23, 1991, p.4.
[4] Carroll, et. al., "No Fault Approaches to Compensating People Injured in Automobile Accidents," RAND Institute for Civil justice, R-4019/ICJ, December 1991. p.15.
[5] RAND Report, p. 9.
[6] Id., p.2.
[7] Id., p. 10.
[8] Id., p. 11.
[9] RAND Institute for Civil Justice, Press Release (National), p.2.
[10] RAND Report, p. 17.

fault because they can *expect to collect a larger fraction of their economic loss.*" [Emphasis supplied].[11]

But "if the *other driver was both insured and at fault,* the claimant's compensation will be lower under no fault than under the traditional system, *because no fault limits compensation to economic loss.*" [Emphasis supplied].[12]

In summary, the initial RAND report confirmed that "injured people with more modest economic losses—who constitute the vast majority of those injured in auto accidents—lose because they receive no compensation for non-economic loss."[13]

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

- Roughly *the same percentage* of people (45%) are paid within three months of the claim under either the tort or no fault systems.[14]
- Under no fault, about 20% of claimants still wait an average of three to six months; under tort, about 40% wait three to six months.[15]
- The average claimant under no fault will still have to wait more than three months (116 days) to receive less compensation; under the tort system claimants wait twice as long (181 days) on the average, but receive more funds.[16]
- The insurers' transaction costs are about the same percentage of the total "injury coverage costs" under either system—12% for no fault vs. 14% for tort systems.[17] *No fault will do nothing to reduce the bloated nature of insurance industry overhead and bureaucracy.*

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

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

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

APPENDIX C—COMPLETE TEXT OF PROPOSITION 103 AS ENACTED BY CALIFORNIA VOTERS ON NOVEMBER 8, 1988.

INSURANCE RATE REDUCTION AND REFORM ACT

Section 1. Findings and Declaration.

The People of California find and declare as follows:

Enormous increases in the cost of insurance have made it both unaffordable and unavailable to millions of Californians.

The existing laws inadequately protect consumers and allow insurance companies to charge excessive, unjustified and arbitrary rates.

Therefore, the People of California declare that insurance reform is necessary. First, property-casualty insurance rates shall be immediately rolled back to what

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[11] Id.
[12] Id.
[13] Id.
[14] Id., p.13.
[15] Id.
[16] Id., p.12.
[17] Id., p.10.

they were on November 8, 1987, and reduced no less than an additional 20%. Second, automobile insurance rates shall be determined primarily by a driver's safety record and mileage driven. Third, insurance rates shall be maintained at fair levels by requiring insurers to justify all future increases. Finally, the state Insurance Commissioner shall be elected. Insurance companies shall pay a fee to cover the costs of administering these new laws so that this reform will cost taxpayers nothing.

Section 2: Purpose.

The purpose of this chapter is to protect consumers from arbitrary insurance rates and practices, to encourage a competitive insurance marketplace, to provide for an accountable Insurance Commissioner, and to ensure that insurance is fair, available, and affordable for all Californians.

Section 3: Reduction and Control of Insurance Rates.

Article 10, commencing with Section 1861.01 is added to Chapter 9 of Part 2 of Division 1 of the Insurance Code to read:

Insurance Rate Rollback

1861.01(a) For any coverage for a policy for automobile and any other form of insurance subject to this chapter issued or renewed on or after November 8, 1988, every insurer shall reduce its charges to levels which are at least 20% less than the charges for the same coverage which were in effect on November 8, 1987.

(b) Between November 8, 1988, and November 8, 1989, rates and premiums reduced pursuant to subdivision (a) may be only increased if the commissioner finds, after a hearing, that an insurer is substantially threatened with insolvency.

(c) Commencing November 8, 1989, insurance rates subject to this chapter must be approved by the commissioner prior to their use.

(d) For those who apply for an automobile insurance policy for the first time on or after November 8, 1988, the rate shall be 20% less than the rate which was in effect on November 81 1987, for similarly situated risks.

(e) Any separate affiliate of an insurer, established on or after November 8, 1987, shall be subject to the provisions of this section and shall reduce its charges to levels which are at least 20% less than the insurer's charges in effect on that date.

Automobile Rates & Good Driver Discount Plan

1861.02. (a) Rates and premiums for an automobile insurance policy, as described in subdivision (a) of Section 660, shall be determined by application of the following factors in decreasing order of importance: (1) The insured's driving safety record. (2) The number of miles he or she drives annually. (3) The number of years of driving experience the insured has had. (4) Such other factors as the commissioner may adopt by regulation that have a substantial relationship to the risk of loss. The regulations shall set forth the respective weight to be given each factor in determining automobile rates and premiums. Notwithstanding any other provision of law, the use of any criterion without such approval shall constitute unfair discrimination.

(b)(1) Every person who (A) has been licensed to drive a motor vehicle for the previous three years and (B) has had, during that period, not more than one conviction for a moving violation which has not eventually been dismissed shall be qualified to purchase a Good Driver Discount policy from the insurer of his or her choice. An insurer shall not refuse to offer and sell a Good Driver Discount policy to any person who meets the standards of this subdivision. (2) The rate charged for a Good Driver Discount policy shall comply with subdivision (a) and shall be at least 20% below the rate the insured would otherwise have been charged for the same coverage. Rates for Good Driver Discount policies shall be approved pursuant to this article.

(c) The absence of prior automobile insurance coverage, in and of itself, shall not be a criterion for determining eligibility for a Good Driver Discount policy, or generally for automobile rates, premiums, or insurability.

(d) This section shall become operative on November 8, 1989. The commissioner shall adopt regulations implementing this section and insurers may submit applications pursuant to this article which comply with such regulations prior to that date, provided that no such application shall be approved prior to that date.

Prohibition on Unfair Insurance Practices

1861.03 (a) The business of insurance shall be subject to the laws of California applicable to any other business, including, but not limited to, the Unruh Civil Rights Act (Civil Code Sections 51 through 53), and the antitrust and unfair business practices laws (Parts 2 and 3, commencing with section 16600 of Division 7, of the Business and Professions Code).

(b) Nothing in this section shall be construed to prohibit (1) any agreement to collect, compile and disseminate historical data on paid claims or reserves for reported claims, provided such data is contemporaneously transmitted to the commissioner, or (2) participation in any joint arrangement established by statute or the commissioner to assure availability of insurance.

(c) Notwithstanding any other provision of law, a notice of cancellation or nonrenewal of a policy for automobile insurance shall be effective only if it is based on one or more of the following reasons: (1) non-payment of premium; (2) fraud or material misrepresentation affecting the policy or insured; (3) a substantial increase in the hazard insured against.

Full Disclosure of Insurance Information

1861.04. (a) Upon request, and for a reasonable fee to cover costs, the commissioner shall provide consumers with a comparison of the rate in effect for each personal line of insurance for every insurer.

Approval of Insurance Rates

1861.05. (a) No rate shall be approved or remain in effect which is excessive, inadequate, unfairly discriminatory or otherwise in violation of this chapter. In considering whether a rate is excessive, inadequate or unfairly discriminatory, no consideration shall be given to the degree of competition and the commissioner shall consider whether the rate mathematically reflects the insurance company's investment income.

(b) Every insurer which desires to change any rate shall file a complete rate application with the commissioner. A complete rate application shall include all data referred to in Sections 1857.7, 1857.9, 1857.15, and 1864 and such other information as the commissioner may require. The applicant shall have the burden of proving that the requested rate change is justified and meets the requirements of this article.

(c) The commissioner shall notify the public of any application by an insurer for a rate change. The application shall be deemed approved sixty days after public notice unless (1) a consumer or his or her representative requests a hearing within forty-five days of public notice and the commissioner grants the hearing, or determines not to grant the hearing and issues written findings in support of that decision, or (2) the commissioner on his or her own motion determines to hold a hearing, or (3) the proposed rate adjustment exceeds 7% of the then applicable rate for personal lines or 15% for commercial lines, in which case the commissioner must hold a hearing upon a timely request.

1861.06. Public notice required by this article shall be made through distribution to the news media and to any member of the public who requests placement on a mailing list for that purpose.

1861.07. All information provided to the commissioner pursuant to this article shall be available for public inspection, and the provisions of Section 6254(d) of the Government Code and Section 1857.9 of the Insurance Code shall not apply thereto.

1861.08. Hearings shall be conducted pursuant to Sections 11500 through 11528 of the Government Code, except that: (a) hearings shall be conducted by administrative law judges for purposes of Sections 11512 and 11517, chosen under Section 11502 or appointed by the commissioner; (b) hearings are commenced by a filing of a Notice in lieu of Sections 11503 and 11504; (c) the commissioner shall adopt, amend or reject a decision only under Section 11517 (c) and (e) and solely on the basis of the record; (d) Section 11513.5 shall apply to the commissioner; (e) discovery shall be liberally construed and disputes determined by the administrative law judge.

1861.09. judicial review shall be in accordance with Section 1858.6. For purposes of judicial review, a decision to hold a hearing is not a final order or decision; however, a decision not to hold a hearing is final.

Consumer Participation

1861.10. (a) Any person may initiate or intervene in any proceeding permitted or established pursuant to this chapter, challenge any action of the commissioner under this article, and enforce any provision of this article.

(b) The commissioner or a court shall award reasonable advocacy and witness fees and expenses to any person who demonstrates that (1) the person represents the interests of consumers, and, (2) that he or she has made a substantial contribution to the adoption of any order, regulation or decision by the commissioner or a court. Where such advocacy occurs in response to a rate application, the award shall be paid by the applicant.

(c)(1) The commissioner shall require every insurer to enclose notices in every policy or renewal premium bill informing policyholders of the opportunity to join an

independent, non-profit corporation which shall advocate the interests of insurance consumers in any forum. This organization shall be established by an interim board of public members designated by the commissioner and operated by individuals who are democratically elected from its membership. The corporation shall proportionately reimburse insurers for any additional costs incurred by insertion of the enclosure, except no postage shall be charged for any enclosure weighing less than ⅓ of an ounce. (2) The commissioner shall by regulation determine the content of the enclosures and other procedures necessary for implementation of this provision. The legislature shall make no appropriation for this subdivision.

Emergency Authority

1861.11. In the event that the commissioner finds that (a) insurers have substantially withdrawn from any insurance market covered by this article, including insurance described by Section 660, and (b) a market assistance plan would not be sufficient to make insurance available, the commissioner shall establish a joint underwriting authority in the manner set forth by Section 11891, without the prior creation of a market assistance plan.

Group Insurance Plans

1861.12. Any insurer may issue any insurance coverage on a group plan, without restriction as to the purpose of the group, occupation or type of group. Group insurance rates shall not be considered to be unfairly discriminatory, if they are averaged broadly among persons insured under the group plan.

Application

1861.13. This article shall apply to all insurance on risks or on operations in this state, except those listed in Section 1851.

Enforcement & Penalties

1861.14. Violations of this article shall be subject to the penalties set forth in Section 1859.1. In addition to the other penalties provided in this chapter, the commissioner may suspend or revoke, in whole or in part, the certificate of authority of any insurer which fails to comply with the provisions of this article.

Section 4. Elected Commissioner

Section 12900 is added to the Insurance Code to read:

(a) The commissioner shall be elected by the People in the same time, place and manner and for the same term as the Governor.

Section 5. Insurance Company Filing Fees

Section 12979 is added to the Insurance Code to read:

Notwithstanding the provisions of Section 12978, the commissioner shall establish a schedule of filing fees to be paid by insurers to cover any administrative or operational costs arising from the provisions of Article 10 (commencing with Section 1861.01) of Chapter 9 of Part 2 of Division 1.

Section 6. Transitional Adjustment of Gross Premiums Tax

Section 12202.1 is added to the Revenue & Taxation Code to read:

Notwithstanding the rate specified by Section 12202, the gross premiums tax rate paid by insurers for any premiums collected between November 8, 1988 and January 1, 1991 shall be adjusted by the Board of Equalization in January of each year so that the gross premium tax revenues collected for each prior calendar year shall be sufficient to compensate for changes in such revenues, if any, including changes in anticipated revenues, arising from this act. In calculating the necessary adjustment, the Board of Equalization shall consider the growth in premiums in the most recent three year period, and the impact of general economic factors including, but not limited to, the inflation and interest rates.

Section 7. Repeal of Existing Law

Sections 1643, 1850, 1850.1, 1850.2, 1850.3, 1852, 1853, 1853.6, 1853.7, 1857.5, 12900, Article 3 (commencing with Section 1854) of Chapter 9 of Part 2 of Division 1, and Article 5 (commencing with Section 750) of Chapter 1 of Part 2 of Division 1, of the Insurance Code are repealed.

Section 8. Technical Matters

(a) This act shall be liberally construed and applied in order to fully promote its underlying purposes.

(b) The provisions of this act shall not be amended by the Legislature except to further its purposes by a statute passed in each house by roll call vote entered in

the journal, two-thirds of the membership concurring, or by a statute that becomes effective only when approved by the electorate.

(c) If any provision of this act or the application thereof to any person or circumstances is held invalid, that invalidity shall not affect other provisions or applications of the act which can be given effect without the invalid provision or application, and to this end the provisions of this act are severable.

Mr. GILLMOR. We will move to Mr. Gladstone.

STATEMENT OF MICHAEL H. GLADSTONE

Mr. GLADSTONE. Thank you, Mr. Chairman. My name is Michael Gladstone. I am an attorney with the law firm Mays & Valentine in Richmond, Virginia, where I practice in the areas of personal injury and product liability litigation. I am the chair of the legislative committee of the Virginia Association of Defense Attorneys and a member of the Defense Research Institute, on whose behalf I am here today. DRI is a 21,000-member association of attorneys who represent primarily defendants in civil lawsuits. We greatly appreciate your allowing us to appear today and address the issue of auto insurance costs at this hearing.

There is no question that in many jurisdictions auto insurance costs are too high. DRI has always taken the position that many States' auto accident reparation systems can and should be reformed. DRI stresses that the basic principles of the existing liability system, however, are sound, and that the system can be improved within the current framework without resorting to untested changes.

The most frequently advanced reason, and we have heard about it today, for reforming the accident reparation system is the added cost to consumers' insurance bills attributable to fraudulent or inflated claims. As lawyers whose primary task is to identify and defend against non-meritorious claims, DRI members are uniquely and, I might add, painfully sensitive to this problem.

We have heard about the RAND Institute study that suggests that some 34 percent of the medical costs and injury claims are excessive and how that is multiplied by the concept of multiple of damages in settlement of claims. I must tell you that from the standpoint of DRI, that estimate is consistent with the reaction of seasoned practitioners. Nobody argues the need for adjustments in reform. We submit, however, that the reform should be targeted directly at alleviating the causes of excessive claims, not of preventing the payment of appropriate, meritorious claims.

While it is true a pure no-fault program like Auto Choice would create a disincentive for the type of fraudulent complaints that we have heard complained about today, most of the savings nevertheless come from eliminating noneconomic damage claims in all cases, regardless whether the claims are frivolous or inflated or meritorious.

DRI has a few ideas that we would like to suggest for reducing auto insurance costs which preserve the jury system, an important concept, and we stress this of fault-based responsibility.

It suggests that you look at taking action that would eliminate the collateral source rule. This rule prevents jurors from hearing evidence of compensation plaintiffs receive from health insurance, wage continuation programs or other collateral sources. The result is double and sometimes multiple recoveries for many plaintiffs,

and double taxation for the rest of us who pay taxes to provide the government benefits and also pay higher premiums to fund extra multiple recoveries.

You may consider encouraging no pay and no play, which is just a short way of saying if you don't participate in a financial responsibility scheme, then you don't get to recover noneconomic damages if you are injured and then attempt to sue. This has been enacted in California, and, according to our information and according to the insurance commissioner there, has reduced costs to consumers by about a quarter of a billion dollars.

We would encourage you to scrutinize what can be done to adjust the concept of contingency fee representations. The practical limitation or removal of the financial incentive to deceive and puff the basis for injury claims would substantially address the complaint repeated today that 28 cents out of every insurance premium dollar goes to the "trial lawyers," close quote.

Repeal or take action that would encourage repeal of seat belt gag rules. Seat belt gag rules say that a plaintiff's failure to comply with the seat belt law cannot be used against him, even if that nonuse increases the injuries that he is claiming damages for. This anomaly clearly rewards the lawbreaker and punishes the consumer. This is an excellent example of the effectiveness of the plaintiff's bar to relieve their clients from the normal consequences of behavior applicable to everyone else.

Your ability to influence issues in these areas should not be underestimated, and we would submit that the better way to approach the issue of high auto insurance costs is to attack directly the things that make it easy for those who are of a mind to deceive and to quit inflating claims. Thank you.

[The prepared statement of Michael H. Gladstone follows:]

PREPARED STATEMENT OF MICHAEL H. GLADSTONE, DEFENSE RESEARCH INSTITUTE

Good Morning, Mr. Chairman. My name is Michael H. Gladstone. I am an attorney with Mays & Valentine in Richmond, Virginia, where I practice in the areas of personal injury and product liability litigation. I am the legislative committee chair of the Virginia Association of Defense Attorneys and a member of Defense Research Institute. DRI is a 21,000-member association of lawyers who represent defendants in civil lawsuits. Thank you for allowing us to address the issue of auto insurance costs at this hearing.

There is no question that, in many jurisdictions, automobile insurance costs are too high. We have always taken the position that states' auto accident reparation systems can and should be reformed, but that the basic principles of the liability reparation system are sound and the system can be improved within its own framework, without resorting to untested changes.

I'd like to take just a few moments to discuss why we think modifying traditional tort law is preferable to the Auto Choice proposal, and then offer some concrete suggestions as to how auto insurance costs can be reduced without radically altering the civil justice system.

Advantages of the Traditional Tort Law System

Ideally, reform of auto accident reparations should remain true to four principles: the retention of liability based upon fault; preservation of the civil jury system; availability of non-economic damages to the severely injured; and state, rather than federal, solutions to local problems.

Liability based upon fault. Liability based upon fault means that people and corporations are held responsible for their actions. In recent years, in such areas as welfare reform, criminal justice, education, and athletics, members of Congress have called for more assumption of personal responsibility. We believe that personal responsibility must also be the hallmark of civil liability reform.

"No-fault" systems of liability, are, by definition, a derogation from the principle of responsibility. A driver who is held accountable for the consequences of his negligence has an additional incentive to take precautions for his safety and the safety of others. A driver should not receive the same benefits for an injury he causes that he would receive as an innocent victim.

Preservation of the civil jury trial. Defense lawyers believe in retaining the civil jury system. While there have been cases in which juries are reckless and out of control in awarding damages, our members have found that most jurors are responsible, apply common sense, and weed out non-meritorious claims. Jury awards can be excessive when jurors are not given sufficient legal guidance. It is the role of judges and legislatures to make good substantive law for jurors to apply. There is no inherent flaw in the institution of the jury.

Indeed, juries have a value to our society that goes beyond their actual role in fact-finding. In an age when many Americans can't be bothered to vote or be active in civic affairs, the jury system still requires us to make a contribution to our community. It may be an inconvenience to be called for jury duty, but it's also an opportunity to assemble with fellow citizens from different walks of life and settle disputes in a centuries-old tradition. The civil jury is part of our civil society.

Non-economic damages. We believe that, in all but the least serious cases, non-economic damages should be recoverable. The "pure no-fault" scheme embodied in the federal "Auto Choice" legislation would pre-empt the recovery of general damages even in cases involving catastrophic injury. It is a huge leap from eliminating non-economic damages for whiplash or soft-tissue injuries, as several states have done, to eliminating them for spinal and head injury cases.

We are concerned that Auto Choice would treat quadriplegia much the same way as a routine whiplash injury. Our members frequently take the position in court that damages in small auto cases have been exaggerated, but we can't deny that an individual who has been permanently paralyzed or disfigured deserves some compensation for pain and suffering. Savings from auto accident liability reform should come from reducing payments in nuisance cases, not in serious cases.

Federal vs. state legislation. We advocate the use of state experiments in alternative auto accident reparation systems, rather than federal legislation. Each state's needs are different, and state legislatures are well-equipped to evaluate local problems. We support federal legislation in the area of product liability. But auto liability is not quite analogous to product liability, where products in a nationwide stream of commerce are subject to a patchwork of laws. Most driving is done intrastate, most accidents involve residents of the same state, and insurance has always been regulated on the state level.

A clear view of how well public policies work is obscured when the law in every state is uniform. It was by studying the effects of different state laws that researchers discovered the flaws in "dollar threshold" no-fault plans, which led to the development of the "Auto Choice" proposal. In that study, researchers found that "verbal threshold" no-fault could also save money.[1] Adoption of the untested "Auto Choice" on the federal level would likely preclude further experimentation with other alternatives in our state "laboratories of democracy." Instead, you could do as Yale Law Professor Peter Schuck suggests, and let your counterparts in one of America's state capitals volunteer their state as a guinea pig before taking federal action.[2]

Reforms to the System

The most frequently advanced reason for reforming the auto accident reparations system is the added cost to consumers' insurance bills attributable to fraudulent or inflated claims. As lawyers whose primary task is to identify and defend against non-meritorious claims, DRI members are uniquely sensitive to this problem. Stephen Carroll of the RAND Institute for Civil Justice has estimated that some 34 percent of the medical costs in injury claims are excessive, wasting some $4 billion per year in medical resources and causing about $12 billion in payments of unwarranted claims. He pinpoints soft-tissue injuries as the leading culprit.

Given this situation, the need for reform is clear. It is also clear that reforms must be targeted at alleviating the causes of excessive claims, not at preventing the payment of *appropriate* claims. A "pure no-fault" program like Auto Choice would create a disincentive for the type of fraudulent claims seen in the tort system, but most of the savings it would generate in terms of claims paid would come from eliminating non-economic damages in all cases, regardless of whether the claims are inflated.

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[1] Stephen Carroll et al, *The Costs of Excess Medical Claims for Automobile Personal Injuries*, RAND Institute for Civil Justice (1995).

[2] Peter H. Schuck, "No Fault, No Foul," *The New Republic*, May 4, 1998.

Here are ten better ideas for reducing auto insurance costs that preserve the jury system:

1. *Eliminate the collateral source rule.* This rule prevents jurors from hearing evidence of compensation a plaintiff receives from health insurance, wage continuation programs, or other sources. The rule developed in the common law during an era when few employers offered health insurance coverage or sick pay and before government programs like Social Security Disability Insurance had been enacted. Today, however, nearly American is eligible for such collateral source payments.

   In most cases, health insurers will file a subrogation lien entitling them to reimbursement for payments from the tortfeasor. But far too frequently, in routine auto cases, health insurers neglect to file their liens. Seldom, if ever, does an employer file a lien for the plaintiff's "sick days." And federal disability benefits and state rehabilitation benefits are not subject to subrogation at all. The result is double recoveries for many plaintiffs, and "double taxation" for the rest of us, who pay taxes to provide government benefits while paying higher premiums to fund extra recoveries.

   The collateral source rule thus offers a bonus to plaintiffs in most cases, which not only pads damages in those claims but also encourages the filing of claims that would otherwise be too small to bother with. Because auto accident claims are generally settled at an amount three times the plaintiff's economic damages, abolishing the collateral source rule can reduce payments in individual cases by as much as one third. Payments could be reduced even further if jurors were informed that personal injury damages are not taxable.
2. *"No Pay/No Play" for auto accident plaintiffs:* Disqualify uninsured drivers from collecting non-economic damages. This eliminates "free riders" from the tort system—those who sue to collect damages they incur, but don't take responsibility for paying damages they cause. This has been enacted in California and, according to the Insurance Commissioner there, has reduced costs to consumers by one quarter of a billion dollars.[3]
3. *Apply the "Not a Drop Rule" to auto accident plaintiffs.* Laws in some states provide that evidence of alcohol use by a party is not admissible unless it can be shown that the party was intoxicated. The rationale for this rule has been that juries would be unduly prejudiced by testimony that a driver had a drink or two that did not affect his ability to drive. Generally, we'd agree with this rationale as it applies to the rules of evidence. But a state could, as a matter of policy, require that recoveries by drinking drivers be reduced, perhaps by mandating that use of any alcohol by plaintiffs within a short time prior to an accident would disqualify them from collecting some or all of their non-economic damages. Needless to say, this would not only reduce insurance costs but also help deter drunk driving.
4. *Require attorney contingency fee disclosure.* Defense lawyers must negotiate their fees with sophisticated customers, and our bills are subject to audits. Plaintiffs' attorneys, on the other hand, deal with unsophisticated consumers and generally charge one third of any recovery. If you required contingency fee attorneys to disclose how many hours they worked on a case and calculate an hourly breakdown of their fees upon settlement, consumers would no doubt demand cuts in fees that amounted to over a few hundred dollars per hour.[4] I don't know whether this would lower auto insurance costs, but it would answer the complaint made by Messrs O'Connell and Horowitz that plaintiffs' lawyers collect too much of auto compensation.
5. *Repeal "Seat Belt Gag Rules."* The seat belt gag rule is an exception to the "negligence per se" doctrine which plaintiffs' bar lobbyists have gotten inserted in many states' mandatory seat belt laws. The common law doctrine of "negligence per se" holds that a jury should consider a party's violation of a statute in determining whether he was negligent. The seat belt gag rule says that a plaintiff's failure to comply with the seat belt law cannot be used against him, even if that non-use increased the damages he suffered. This anomaly rewards the lawbreaker and punishes the consumer.
6. *Create "Medical Injury Profiles."* A proposal endorsed by our California chapter and introduced in the California Senate by Senator Bill Lockyer would create medical injury profiles for non-serious injuries. These guidelines, formulated with input from medical professionals, could be introduced into evidence by defendants to contest the reasonableness or necessity of medical treatment claimed by an in-

[3] J.C. Howard, "Calif. Auto Profits in High Gear," *National Underwriter*, April 20, 1998.
[4] See, e.g., SB 383, Illinois General Assembly, Introduced February 5, 1997 (Sen. Dillard).

jured party.[5] This would directly address the issue of medical overutilization identified by the RAND study. It would deter plaintiffs' lawyers from sending clients to medical bill mills to ratchet up damage claims.

At this point I would note that my suggestions thus far have applied to state laws. But as you know, two of the areas I've touched on, alcohol use and seat belt use, involve state laws that have been the subject of federal legislation. Congress has mandated that states pass seat belt laws or else lose highway grant money.[6] You are now considering similar legislation with regard to .08 blood alcohol content. If you feel that auto insurance rates are an appropriate subject of federal legislation, you could consider mandating some of the changes I've just outlined.

I now want to pass along several suggestions from the insurance industry as to other policies that would reduce auto insurance costs.[7] These are not tort reform proposals, but involve policy areas that have an impact on premiums.

1. Tightening drivers license requirements for young and older drivers. States can restrict drivers under the age of 18 to probationary licenses, that do not allow multiple passengers in a vehicle or use of a vehicle during late night hours. States can also require reexamination of drivers whose deteriorating skills or medical conditions make them hazards to others.
2. Strengthening penalties for auto theft to incapacitate professional car thieves. We have enacted mandatory minimum sentences for drug dealers. Why not mandatory sentences for car thieves? They increase costs to the American public even more directly than drug dealers do.
3. Impounding vehicles of recidivist drunk drivers. Merely revoking drivers licenses of repeat drunk drivers is not enough, because if they have a car, they will tend to use it. If you take away their cars, they can't drive. Let them move into the city and walk to the tavern.
4. Finally, evaluating legislation in terms of how it will impact on automobile usage. Insurance costs are related to urbanization and urban sprawl. The next time you consider a bill to build new highways or to help locate new businesses in a remote suburban or rural area, think of how that decision might affect automobile usage. Choosing assistance to mass transit over new highways, and encouraging businesses to locate in downtown areas, will help keep down auto insurance costs.

We applaud the focus that Joint Economic Committee has drawn to the fact that high auto insurance rates impact most severely on low-income drivers. We want auto insurance to be more affordable to the working poor as well—after all, it's only when people buy insurance that our members can be paid to defend them. We believe that the approach to auto insurance cost containment that I've outlined today would provide meaningful savings while retaining the civil justice system we cherish. Thank you.

Mr. GILLMOR. Thank you very much.

We will now move to Professor O'Connell.

STATEMENT OF JEFFREY O'CONNELL

Mr. O'CONNELL. Thank you, Mr. Chairman. I am Jeffrey O'Connell, and I am a law professor at the University of Virginia. And as was stated earlier, I have been involved in trying to enact automobile insurance reform for some years.

Let me address Mr. Rosenfield's point. He indicates that the basic problem with the inner city is that insurance companies won't sell to the poor, and there is some of that. But let me describe an exchange between representatives in the minority groups in Los Angeles with Mr. Rosenfield's partner, Ralph Nader.

There had been proposed in California a plan not dissimilar to what in many ways is being proposed by this bill. It would have allowed people to give up their claim for pain and suffering in return for lower premiums. And Nader, in meeting with members of minority and consumer groups, including Mario Obledo, national

[5] See, e.g., SB 49, California Legislature, Introduced December 20, 1994 (Sen. Lockyer).
[6] 23 U.S.C. 153.
[7] These suggestions are from the National Association of Independent Insurers publication *Containing Auto Insurance Costs* (1992). DRI does not take any position on these issues; they are repeated here for informational purposes.

chairman of the Rainbow Coalition, and John Gamboa, who is executive director of the Latino Issues Forum, and George Dean, who is president of the California Council of Urban Leagues, and Harry Snyder, who is the West Coast director of Consumers Union, Nader said this: "By giving up their rights to file lawsuits and seek pain and suffering compensation, people insured under this no-fault proposal would become victims of a two-class auto insurance system under which rich policyholders would have more ability to recover damages from accidents than the poor."

I am not sure that is true. I am a reasonably affluent fellow, and I would be glad to give up my claim for pain and suffering if I thought I could reduce my premiums and get out of this gang of four that was so graphically illustrated by the first two speakers, of which Mr. Rosenfield utters not a word.

Nader said, "Why should they give up their pain and suffering awards? The trouble with minority groups is that they have accepted the principle that if they were poor, they'd have to get compensated for just medical benefits and wage losses, not pain and suffering."

But Obledo, who is, as I have said, one of the national chairmen of the Coalition, said this: He said, Nader doesn't understand that 5 or 6 million Californians cannot afford auto insurance. Some of these points, he said, are meritorious of Nader, but we are in a situation here that we had to come up with a plan that provides insurance for low costs.

And Edith Adams, who was counsel of the Latino Issues Forum, said, we understand Nader is a man of principle, but about 6 million people are going to be sacrificed for the principle. If he were in our boat, he would probably do the same thing we are doing; that is, proposing this kind of no frills policy.

If you understood the dilemma of the poor, you are dealing with an auto insurance system which requires people to pay not only for medical expense and wage loss, but for pain and suffering. These are people who have no health insurance. They have no fire insurance. They have no disability insurance. They have no property insurance of any kind, and State after State says to them, you will buy this Cadillac of auto insurance that will pay not only for medical expenses and wage loss, which are not covered in any other contingency, but you will cover for pain and suffering, leading to all of the kinds of fraud and quasi-fraud that we have heard of.

And the poor said, we want out of this game. And they are right. I want out of it, too.

What does Mr. Rosenfield suggest? He wants us at the Federal level apparently to do nothing.

The question was asked why should the Federal Government do anything about this? This problem was unerringly identified by a very famous study in 1932, the Columbia Report. That is 66 years ago. That is two-thirds of a century, which has seen dramatic changes in every aspect of human life. And the States have been unable to solve this problem. This is clearly an issue of joint jurisdiction. The Federal Government clearly has jurisdiction over interstate commerce, and the time has come for the Federal Government to intervene in a very mild way, relatively speaking, to say if the States want to keep their common law of torts, they can, but

people should be given an option if the States will agree that the option the Federal Government offers should be continued.

Let me just finish by saying a lot of issues that legislators face are tough. I remember Mike Dukakis saying it would be great to be a legislator if you didn't have to vote. It is hard to vote.

You hear this cacophony of opinions from Rosenfield and me, and you have to decide who is right. You don't have to decide who is right here. You don't have to decide that the RAND Corporation is right or Rosenfield is right. All you have to decide is the tort system, as it operates so good, that everybody should be continued to be mandated to have it, or should they be offered an alternative. If Rosenfield is right, then people won't buy it, just as they don't buy other insurance programs that are expensive and unworthy. But people have been trapped in our lawyer-dominated system much too long.

[The prepared statement of Jeffrey O'Connell follows:]

PREPARED STATEMENT OF JEFFREY O'CONNELL, PROFESSOR OF LAW, UNIVERSITY OF VIRGINIA

THE PRESENT SITUATION

It was the often-acknowledged—and even arguably horrendous—inadequacy of traditional tort liability as applied to personal injury suffered in automobile accidents that led to the enactment of no-fault insurance laws in many states. 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 form 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. As the summary of the RAND study noted, disputes about auto insurance continue to excite debate. Critics of the tort system insist that its costs are too high and that its payments are "inefficient, inequitable, and slow" in compensating injured people. But critics of no-fault laws rebut that the systems that replaced fault-based payments with PIP (Personal Injury Protection) payments 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.

True reform should involve a fair trade, *e.g.* making it easier for claimants to be paid promptly but paying them less, as under workers' compensation laws, thereby lowering fortuity, delay and transaction costs.

In this respect, pertinent is a federal bill sponsored by Senator Mitch McConnell (R. KY) and based on ideas advanced by myself and coauthors. (The bill has a rather novel approach to federalism and tort reform which will be discussed at the end.)

As to the bill's pertinence to auto insurance, threshold no-fault plans completely bar entry into the tort system for pain and suffering unless the injured person is at least relatively seriously hurt. That "seriousness" level is sometimes set by verbal descriptions and sometimes by a dollar level of medical expenses which has to be surpassed. "Add-on" no fault plans, on the other hand, allow any person to bring a trot suit for pain and suffering, with the only restriction that one would have to subtract one's no-fault benefits from any tort award. No-fault plans can require a claimant to deduct from one's no-fault benefits amounts one receives from other sources to pay one's medical expenses or lost wages, *i.e.*, one's collateral sources.

It turns out, though, that allowing no-fault benefits plus access to tort suits not only under add-on plans but under threshold plans is very expensive.

The original hope was that no-fault laws would provide compensation to many more accident victims than are paid under traditional tort liability systems, and with faster payments and far lower lawyers' and adjusters' fees, along with not paying for pain and suffering. Thus no-fault insurers could pay more people for less money. But the original no-fault concept has been "undermined" because the system is being used more and more frequently to incur enough health-care costs to allow motorists both to collect no-fault benefits and to trigger a built-in right to sue based on fault about the statutory threshold.

THE PROPOSED CHOICE SYSTEM

Choice reform could give motorists the option of foregoing claims for noneconomic loss, without requiring them to do so. Motorists thus could be given the alternative of purchasing PIP coverage, payable without reference to fault at the compulsory insurance level currently required for liability for bodily injury. Persons electing such PIP coverage could neither sue nor be sued for pain and suffering if involved in accidents with either those who had elected PIP or otherwise. Such PIP motorists would only be allowed to claim in tort against other motorists, whether covered by PEP or otherwise, for economic loss in excess of their PIP coverage. (But, if an injury was caused by a tortfeasor's alcohol or drug abuse, there would be no restriction on the right to sue in tort.) 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 noneconomic loss (under coverage termed "tort maintenance coverage"), just as they do today under uninsured motorists coverage. Claims for economic loss in excess of one's own tort maintenance coverage would be allowed against PIP insureds. In accidents between two tort liability insureds, the current common law tort system would apply without change.

Note that in a state that already has no-fault insurance, the plan would be implemented such that the state's no-fault law could be retained except that, pursuant to the foregoing description, rights to claim for noneconomic loss above the threshold could be waived, with corollary reliance on tort maintenance coverage by those who stay in the tort system.

ADVANTAGES TO THE LESS AFFLUENT

A Fall 1994 editorial in an African American Philadelphia newspaper read as follows:

> If you just listened to the candidates [jockeying] for election in November, you would easily think that the only *issue* of importance is crime because all the candidates talk about is who will be the "toughest" on criminals.
>
> There is one issue that impacts more Philadelphians than all of the crimes committed in any given month and that is the (criminal) auto insurance rates Philadelphians are FORCED to pay simply because they live within the city.
>
> Because state law mandates that all motor vehicle owners must have insurance to drive those vehicles and because many Philadelphians are required to pay auto insurance rates far in excess of the value of the vehicles they drive, many Philadelphians are committing a crime because they are driving without the legally required auto insurance.
>
> Curiously, none of these tough on crime candidates is addressing the issue of... auto insurance rates which [have] turned thousands of otherwise law abiding Philadelphians into criminals. Many city residents see a better option in becoming petty criminals than impoverishing themselves by paying the highest auto insurance rates in the nation.
>
> Candidates need to get real and use their clout to assist reforming auto insurance laws which force decent citizens to become criminals.

This situation exists to a substantial degree in every American community, large and small. Currently, less affluent motorists (if they insure at all) can pay over 30% of their annual household income on auto insurance, impeding their buying such necessities as food or shelter. A recent study of low-income insured motorists in Maricopa County, Arizona, found that 44% were forced at some point to postpone buying food in order to pay their auto insurance premium.

Furthermore, the poor may also pay substantially more in absolute terms because so many of them live in urban areas where typical personal auto insurance premiums are much higher than in suburban and rural areas. In 1994, the average annual premium charged by one California insurer for minimum liability coverage in Los Angeles was $81 1; the same coverage in Northridge came to only $578. For Wisconsin the 1994 average was $367 in Milwaukee, but $213 in Waukesha.

Note also that under the tort system an insurance company, in rating its own insureds, only considers whether they are likely to be involved in an accident, not what they would be paid once an accident occurs. A liability insurance company, in setting premiums, knows it will not pay its own insured but rather the unknown persons its insureds may tortiously injure in a future accident. The poor therefore pay very high premiums even though by definition they surely incur less wage loss (and probably less medical expenses) compared to others. It is as though one was charged for fire insurance based only on the likelihood of fire but not on the value of one's house. Under auto insurance, then, at a given level of coverage, the poor must pay into the insurance pool the same as the rich even though they will extract

much less from the pool. Keep in mind, too, that the poor are less likely to pursue a tort claim. According to legal sociologist H. Lawrence Ross:

> [Tlort law in action may . . . be termed inequitable. It is responsible to a wide variety of influences that are not defined as legitimate by common standards of equity. The interviews and observations I conducted convinced me that the negotiated settlement rewards the sophisticated claimant and penalizes the inexperienced, the naive, the simple, and the indifferent. Translating these terms into social statuses, I believe that the settlement produces relatively more for the affluent, the educated, the white, and the city-dweller. It penalizes the poor, the uneducated, [the African American and the rural dweller] . . .

Tort law's adversarial basis also disadvantages lower income drivers in another sense: such drivers are often without resources to temporarily tide themselves over after an accident and are thus often compelled under tort law to accept low settlements because of their need for immediate payment. When the poor are involved in suit, however, there is reason to believe that they are especially vulnerable to the schemes of illicit lawyers, doctors, and chiropractors to pad claims and even stage accidents.

Thus, community leaders of minority and low-income groups are likely to favor this proposal. In 1989, when a proposal was made to allow such groups to buy a low-benefit firstparty auto insurance policy, eliminating payment for pain and suffering, the Los Angeles Times described the situation as follows:

> For the first time since he intervened in California's "war of initiatives" over auto insurance [in 1988], consumer advocate Ralph Nader is having his views questioned by some of the consumer, minority and low-income groups that are most committed to lowering insurance prices.
>
> At an unannounced meeting with Nader in Sacramento . . . representatives of a coalition of these groups who are backing a proposal for a no-frills . . . insurance policy to be sold across the state for $760 to $200 challenged his opposition to [such] insurance.
>
> People who described the meeting said it was a polite but spirited exchange during which Nader and [his ally] Harvey Rosenfield . . . were criticized for aligning themselves with the California Trial Lawyers Assn. . . .
>
> Those present at the meeting from the minority and consumer side—including Mario Obledo, national chairman of the Rainbow Coalition, John Garnboa, executive director of the Latino Issues Forum, George Dean, president of the California Council of Urban Leagues, and Harry Snyder, West Coast director of the Consumer [sic] Union—declared that they saw no [other] way of making auto insurance affordable to the poor . . .
>
> Nader responded that by giving up rights to file lawsuits and seek pain and suffering compensation, people insured under the no-fault proposal would become victims of a "two-class auto insurance system" under which rich policy holders would have more ability to recover damages from accidents than the poor.
>
> "Why should we give up pain and suffering awards?" Nader asked in a subsequent interview. "The trouble with the minority groups is that . . . [t]hey accepted the principle that if they were poor, they'd have to get compensated for just medical benefits and wage losses, not pain and suffering . . ."
>
> Dean of the Urban League told The Times . . . "we estimate there are 5 million drivers who can't afford and don't have insurance now . . . I remember saying to Ralph myself that I know he has been a hero for the consumer in many instances, but I think he is wrong on tins particular issue," said Dean. "We're trying to come up with something affordable that will allow the people who are our constituency—the low-income people in this state—to drive legally and not break the state's mandatory insurance law. That's our bottom line."
>
> Obledo said he had told Nader that 5 or 6 million Californians cannot afford auto insurance. "Some of his points . . . are meritorious," he said of Nader, "but we're in a situation here that we had to come up with a plan that provides insurance for the lowest cost."
>
> Edith Adams, counsel to the Latino Issues Forum, said . . . "We understand [Nader's] a man of principle, but in this case about 6 million people are going to be sacrificed for the principle. If he were in our boat, he would probably do the same thing we're doing (proposing a no-frills policy)."
>
> The Consumer [sic] Union's Snyder said he felt the meeting had succeeded in making Nader and Rosenfield "realize that is they are going to kill a low-income solution, they have to come up with one that's at least as good." So far, he said, "Nader's theology makes each accident a meal ticket for the trial lawyer."

Other important segments of the consumer movement have broken with Nader and the trial bar in calling for systematic reform of the auto tort system, based on what they see as tort laws *anti*-consumer character. A report by the National Insurance Consumer Organization, an organization closely associated with Ralph Nader that generally defends the tort system, breaks with Nader in describing the pain and suffering component of automobile tort law as a "dream of a huge reward... [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..."

Mr. GILLMOR. Thank you very much.

Let me begin.

I will comment on Mr. Rosenfield's comment, which wasn't strictly within this bill, the proposal for government regulation of the profits of insurance companies. Based on the fact that they have excess profits, how do you define excess? Do you do it—if we are going to be real about this, do you do it on a rate of return, a percent of sales, or is it just a political statement?

Mr. ROSENFIELD. No. In California under the first elected commissioner, there is a very extensive formula established to determine an appropriate rate of return and excluding certain expenses that were excessive or unjustified, such as lobbying costs and so on. So it is done every day around this country, and it can certainly be done to the insurance companies.

Mr. GILLMOR. If you are going to do it, it is a competitive business. You can buy insurance from any number of people. I would presume the rate of return on the insurance industry is substantially below, for example, rate of return by Coca-Cola, Microsoft. I mean, would it be—my question is what percent rate of return do you consider excessive, and should we also be regulating the profits of those companies and industries with higher rates of return?

Mr. ROSENFIELD. Mr. Chairman, when the State mandates that people buy insurance as a condition of using their motor vehicles, and as in California where the law was changed a couple of years ago to punish with massive fines and forfeiture those people who are unable to afford insurance, then the State has an obligation and a right to order the insurance companies to make a reasonable profit——

Mr. GILLMOR. What is reasonable? You still haven't give me a number.

Mr. ROSENFIELD. How about 12 to 14 percent rate of return?

Mr. GILLMOR. Do you consider that excessive?

Mr. ROSENFIELD. No. Again it depends what the formula is, but if you do it correctly, as we have advocated, that would be in the ballpark. But the assumption is that there is competition in this industry. In the same publication that talks about the excessive reserves, it says, "In a market where so many are making so much, the laws of economics will eventually have to take over. We continue to make that assumption despite a great deal of evidence to the contrary."

This is not a competitive market. One of the things that the Congress could do is repeal the McCarran-Ferguson exemption from the antitrust laws. Then we would see a little more competition.

Mr. GILLMOR. If we are concerned about those factors which are major parts of the cost problems, and we are concerned about excessive rates of return, and concerned, for example, with attorneys,

if you want to go into the court system, as a practical matter you are mandated to get an attorney.

If you look at that pie chart over there and you see the biggest piece goes for attorneys, how could we justify regulating insurance company profits, which are a much smaller part of that, and not regulate attorneys' fees in these cases?

Mr. ROSENFIELD. First of all, I want to repeat in a slower fashion the point that I made in my testimony, which is that 103 has led to a 49 percent decline in auto accident lawsuits without saying a word about attorneys, and it ended the cost plus pass-through mechanism which encourages insurance companies to pay claims.

By limiting how much they could charge and their profits, we have given them an incentive to fight fraud that they have never had before. That statistic, I think you can—one of proposals that we have made, for small auto accident cases you create a small claims system which you would not need an attorney for. There are ways around the excessive involvement of the attorneys in small accidents without no-fault arbitrarily limiting compensation and discouraging attorneys from taking legitimate cases.

Mr. O'CONNELL. If you will look at the Yellow Pages in the District of Columbia or Los Angeles or New York or Philadelphia or Richmond, you go through and look at the auto insurance companies' advertisements, and you will see countless advertisements that say, bring us your policy and we will tell you whether we can reduce that and charge you less.

This is an area where there is a lot of competition, believe me, because those ads indicate it. If you will go to the Yellow Pages and look at the lawyer's advertisements, you will never see any lawyer alluding to what they will charge. They never tell you that they are going to charge you a third. You will never see a lawyer saying, I will charge you less than my competitors will charge you. So your point is a very powerful one.

When you look at that chart, who is competing more, the insurance companies who say, bring us your policy and we will tell you whether we can subtract from it, or the lawyers who won't even tell you what they will charge?

Mr. GILLMOR. My time is expired. Let me go to the gentleman from Michigan, Mr. Stupak.

Mr. STUPAK. When you talk about the 28 percent for lawyers, that includes defense lawyers?

Mr. O'CONNELL. It does indeed.

Mr. STUPAK. Thank you.

Mr. Gladstone, under this bill, noneconomic damages are not recoverable, correct?

Mr. GLADSTONE. They are not recoverable if you opt into the first level of coverage. You can pay a higher premium, as I understand it, and put yourself in a position——

Mr. STUPAK. But if the purpose is to give coverage at a reasonable rate, the proponents of this bill would go to the first level, correct?

Mr. GLADSTONE. Presumably.

Mr. STUPAK. If a child is killed in an auto accident by a negligent driver, he doesn't have any economic losses. Maybe you will get some burial expenses and some medical expenses. Unless the child

dies instantly, then you just get burial expenses. Doesn't that child have some value?

Mr. GLADSTONE. The child has value to the extent that the State involved has a wrongful scheme, which most do by statute, and this does raise a very interesting question. A problematic aspect of——

Mr. STUPAK. Your insurance policy is not going to cover under level one?

Mr. GLADSTONE. In this particular bill it would be interesting to see how any coverage would flow. There would appear to be no recovery in this particular bill.

Mr. STUPAK. So no pay, no play; is that what you meant? Since kids don't pay into this, they don't get to play?

Mr. GLADSTONE. No, but children of the sort you are speaking of would not be drivers. My remark dealt with drivers themselves who were attempting to recover and had failed to participate in a financial responsibility.

Mr. STUPAK. Most people who ride in a car are not drivers. Passengers are probably underaged people or do not have a car of their own.

Mr. GLADSTONE. And that raises another dilemma with this bill. I agree.

Mr. STUPAK. Mr. O'Connell, I was reading some articles, and one is The Injury Industry, and back in 1971 you said this, and I want know if you have changed your mind or what has happened.

You said, "Since a significant number of automobile accidents involve innocent victim and blameworthy driver, equity requires an award of general damages, including compensation for pain and suffering, as well as reimbursement for out-of-pocket loss. This argument gains force as the severity of injuries increases. It has special force in relation to cases of permanent disfigurement involving severe injury, but relatively low out-of-pocket loss. Many victims, for example, sustain minimal out-of-pocket losses, but very severe psychiatric losses. Example, an amputee with a desk job, or the grossly disfigured person whose earnings are not affected by disfigurement, for these victims and for society generally the bargain of eliminating the possibility of general damages in higher amounts in return for certainty of payment in lesser amounts may be unacceptable." Have you changed your mind?

Mr. O'CONNELL. No, I haven't changed my mind in this sense. That should be ideally what we should have, but what I have learned, and Michigan is a good example, and New York is another good example, trying to do both is not affordable by more and more people.

It would be wonderful if we could have everybody being paid their economic loss up to a certain point and then for all of the serious people to get their pain and suffering.

Let me give you the New York figures. $50,000 is required for no-fault coverage. One can sue under a very high verbal threshold, as in Michigan, if one suffers death or substantial bodily impairment. It turns out in New York two-thirds of the bodily injury policy goes to cover the claims above the threshold. Only one-third goes for the $50,000, which have very generous benefits in no-fault, so that although one would like to be able to provide both, it is turning out that it is hugely expensive to do so and intolerably ex-

pensive for more and more people in the middle and lower income groups.

Mr. STUPAK. You don't disagree that people are entitled to non-economic damages?

Mr. O'CONNELL. I don't disagree if they are entitled to it and if they can afford it and society can afford it, but we are looking at a society where over 40 million people don't have any health insurance in this country.

Mr. STUPAK. So a person without means doesn't suffer as much as a person with means?

Mr. O'CONNELL. He suffers as much, but he doesn't have any health insurance, and I am saying as between requiring him to buy pain and suffering coverage for a serious accident and having money to pay for health insurance, I am not sure requirement for pain and suffering for an auto accident is the best use of his or the public's dollars.

Mr. STUPAK. On insurance policies there is a coordination of benefits between health insurance and the medical expense that you have with your auto claim. Now, if you don't have health insurance, it is going to fall on your no-fault or auto insurance claim?

Mr. O'CONNELL. Yes. And I am saying people are desperately trying to pay for health insurance in the first place, and I am very skeptical of a system that comes along and says, you don't have to buy health insurance at all, but we are going to require you to buy pain and suffering coverage when you are in a serious auto accident. I don't think that makes a lot of sense as public policy, sir.

Mr. GILLMOR. The gentleman's time has expired.

Mr. KINZLER. May I respond?

Mr. GILLMOR. Yes.

Mr. KINZLER. This is a reality in most tort States. The average liability coverage is roughly $60,000. So if I hit you, and I have $60,000 of coverage, and you have a serious permanent injury, a lifelong injury, you can recover $60,000, assuming you were completely free from fault.

One-third is automatically going to go to your attorney, and you know that because that is a profession that you were a part of. That one-third goes whether you do 2 hours of work as a trial lawyer or 50 hours of work. That means you have $40,000 to compensate you in a very serious injury. $40,000 over here shows why people with serious injuries don't recover half of their economic damages, never mind for pain and suffering.

This bill does not prevent a person with a serious injury who chooses the personal protection insurance coverage from buying first party no-fault benefits for pain and suffering. Those benefits would still be cheaper because now you don't have lawyers involved. They would be cheaper and available in every single accident.

The person in a single-car accident who hits a tree and has a lifelong injury is perfectly innocent and has not a dime of recovery.

The person who is driving as a parent, whose child is sitting in a baby seat in the back, the baby spits out the pacifier. The person fumbles to pick up the pacifier, and while they are doing that crosses a yellow line. They are at fault, legally at fault. If the mother and the child are maimed, they have not one penny of recovery.

Under this system they could buy first party benefits for pain and suffering, and in every one of those cases they would be covered. That is not true in the tort system today.

Mr. STUPAK. According to Mr. O'Connell, it is based upon their economic means to do it.

Mr. KINZLER. If you have personal protection insurance which is going to drop your premium for bodily injury by almost by 50 percent, and you added this back on, it would still be dramatically cheaper, and you have that coverage in every situation.

Mr. GILLMOR. The gentleman from Oklahoma, Mr. Largent.

Mr. LARGENT. Thank you, Mr. Chairman.

Mr. Kinzler, can you address the question which has been raised by people about the insurance premiums not going down in States that have passed no-fault laws?

Mr. KINZLER. Yes. This is a very interesting situation. There are 13 State no-fault laws today. Three are choice, but there is a no-fault option in those States.

In New Jersey and Pennsylvania, which are choice systems, the no-fault option is between 30 and 40 percent cheaper than the fault option.

Mr. Rosenfield talks about the high cost. The statistics are funny. The single least expense of the lowest cost State in the country in terms of auto premiums today is North Dakota. It is a no-fault State. Not a lot of people and not a lot of accidents, but maybe that has something to do with it.

Michigan, which is Mr. Stupak's State, for all of its unlimited medical benefits, $60,000 for work loss and the right to sue for serious injury for pain and suffering, is 19th in the country, which is relatively low for an urbanized area, but the major reason for States that have had failures in terms of costs is very simple.

Those States, 8 of the 13 States, have what are called dollar thresholds. In Massachusetts if you have $2,000 of economic injury, you can also sue for pain and suffering. Well, it is interesting what happens. Massachusetts used to have a threshold that was $500. In the year after they raised the threshold from $500 to $2,000, the average number of visits to a doctor's office went from 13 to 31.

What you have are basically flawed systems that retain pain and suffering in a situation where you have an incentive to sue. What has happened now is the people, the trial bar which has encouraged these weak thresholds, is now turning around to tell you, "They don't work." This is like the person who murders both parents and goes to court and pleads for leniency because he is an orphan.

Why this bill would work is very simple. It takes out the pain and suffering dollars so you have no—there is no threshold to shoot for. There is no fraud. Even in Michigan, as good a no-fault law as it is, there is still some wiggle room and a few extra doctors' bills, and you can sue. That is why it works.

Mr. LARGENT. Is there a movement nationwide in States to go to this Auto Choice at a State level?

Mr. KINZLER. There are been bills introduced in Louisiana, in New Jersey. But beyond that, two or three other States have considered it, but they have not done so, no.

Mr. LARGENT. Mr. Rosenfield, do you agree there is a problem with the current tort system that we have that kind of produces these types of scenarios and the abuse and fraud that is taking place?

Mr. ROSENFIELD. Thank you for asking me that question.

I think the numbers are so wild. One person said 99 percent of the claims in California are fraudulent. If you believe the insurance industry advocates of no-fault, essentially everybody in the country is doing what this guy at the other end of the table did, organize fraud rings.

Are there too many lawsuits? If so, let's focus precisely on that problem, and one of the ways is to give the insurance companies an incentive to fight fraud, to do things that we have done in California, such as stop runners and cappers, limit lawyer advertising without infringing on their First Amendment rights, so you don't have that sort of encouragement mentality.

There is a problem of some kind there. The way to solve it is not by throwing out all legitimate suits and all legitimate claims for pain and suffering and getting rid of lawyers. That is not the solution.

If I may, I want to correct the record of one thing that Mr. O'Connell said. Those groups he mentioned who claim or purported to represent low-income organizations do not speak for the mainstream low-income people in the State of California.

SCOC, SCLC, NAACP, these are the big groups, and they have all opposed no-fault. I don't want the record to reflect that there is significant minority support for no-fault in California.

Mr. LARGENT. I will pass that comment on to Reverend Jesse Jackson.

If I can just ask one other question, if I can remember what it is.

It was about your issue of establishing excessive rates, and you have validated that by saying it is State-mandated. Would you also say that we should establish a law that says you can't have excessive rates of return on food?

Mr. ROSENFIELD. My answer to that is this: If food were required by law to be purchased, then we would have laws that prevent it from being priced excessively.

Mr. LARGENT. There are some things that even Washington understands that you don't have to mandate a law on, and food is one of them.

Mr. ROSENFIELD. I do health care, but I guess Washington is not really interested in that. Health care would be a good one. Make sure that everybody——

Mr. LARGENT. What about food?

Mr. ROSENFIELD. No, I think health care. That is something that millions of people are afflicted, don't have health care insurance, and it would obviate the need to discuss no-fault. No-fault is universal health care for auto accident victims. If you want to talk about mandating something, I think Congress could step up to the plate and mandate health care benefits for everybody.

Mr. LARGENT. I thought since you flew 3,500 miles, you might not want to avoid the question, but since you are going to, I yield back my time.

Mr. ROSENFIELD. I thought I answered the question.

Mr. GILLMOR. The gentlelady from California, Ms. DeGette.

Ms. DEGETTE. Mr. Blizzard, I found your work fascinating in prosecuting these complex crime rings that stage fraudulent auto collisions, and I want you to know that all of us are concerned about fraud. These individuals were subsequently convicted of a crime?

Mr. BLIZZARD. Yes.

Ms. DEGETTE. This kind of a fraud is a felony, I would assume?

Mr. BLIZZARD. Yes, ma'am.

Ms. DEGETTE. My question is these criminals under this bill could still opt to purchase the kind of insurance policy that the criminals in your crime ring were operating under when they staged these auto collisions, correct?

Mr. BLIZZARD. Yes, ma'am, they could.

Ms. DEGETTE. Now, I have a question for the professor and others who might want to answer it, and that is my understanding of this legislation is there is an underlying assumption that if people could choose the option of what this process—no-fault insurance with no noneconomic damages, which, as I said before, no State has, but this is the proposal, the assumption is that the policies would be cheaper; is that right?

Mr. O'CONNELL. Yes.

Ms. DEGETTE. My question is, where in this bill does it say that the insurance companies would have to offer cheaper policies to the consumers?

Mr. O'CONNELL. The bill doesn't say that, because unlike Mr. Rosenfield, we don't presume to know much better than the market how these things can function.

Ms. DEGETTE. Well, I mean, what you are talking about and you yourself say, you know, since the 1930's—well, forever, in this country, we have been relying on the tort system, and I was happy to hear defense lawyers actually agree with the plaintiffs' lawyers about the tort system. So what you are proposing is a fundamental realignment of the tort system for a group of people who decide to give up their right to noneconomic damages in exchange for lower rates. And what I am concerned about here is I have seen no evidence that would mandate insurance companies to offer lower rates for these policies.

Mr. O'CONNELL. Well, the bill does say the bill will not take effect if the insurance commissioner in a given State doesn't find that rates were below——

Ms. DEGETTE. But they have 90 days to determine that, right?

Mr. O'CONNELL. That is right.

Ms. DEGETTE. Now how are they going to know that if we have never done it before and we have no evidence?

Mr. O'CONNELL. Because you can have hearings as to what will be the effect on rates. You have the RAND studies and others. And keep this in mind: If, in fact, these policies are not cheaper, people will not buy them.

Ms. DEGETTE. And let me ask you this: The RAND study, now there have been subsequent analyses, and as you know, it varies as much as 48 percent, whether or not we are going to save money on this, right?

Mr. O'CONNELL. There can be variations within States.

Ms. DEGETTE. But we don't really know if there will be a savings. But let's say a State insurance commissioner says, okay, within 90 days we think this could be cheaper, what the heck, it seems intuitive, so they allow them to offer it, okay?

Mr. O'CONNELL. Yes.

Ms. DEGETTE. Now, let's say the insurance companies are going to want people to buy these, I don't know what you call them, these policies, these no-fault policies. There is going to be a financial incentive for insurance companies to sell these.

Mr. O'CONNELL. You don't find the insurance industry in here proposing this bill. There are many insurance companies who are opposed to it precisely because their cash-flow will be very much lower.

Ms. DEGETTE. I will tell you why; because they won't have to go out and hire Mr. Gladstone and his buddies to represent them in these lengthy lawsuits, and the damages they are going to have to pay out are going to be greatly limited because there won't be any noneconomic damages, right?

Mr. O'CONNELL. That is right, but their cash-flow is lower also.

Ms. DEGETTE. So what is to prevent the insurance companies from offering lower-income people just a slightly lower rate, but with many fewer protections?

Mr. O'CONNELL. Well, the answer to that is the market. That is, if, in fact, insurance companies, and there are, as the Chairman said, thousands of them, if this plan doesn't offer them, some of them, the option of coming in with substantially lower costs, then the plan will fail. You have indicated that some insurance companies are interested in this bill; some are, some aren't. But if it passes, the companies that are interested in it and believe in it will offer policies that fairly reflect their risk.

Ms. DEGETTE. May I ask unanimous consent for 1 extra minute, Mr. Chairman?

Mr. GILLMOR. Without objection.

Ms. DEGETTE. I am taking Mr. Markey's time in his absence.

Mr. GILLMOR. It is easier to take his time in his absence.

Ms. DEGETTE. I know, that is why I waited for the opportunity of his absence.

I wanted to ask Mr. Kinzler, you talk about how devastating the involvement of attorneys is in this system. My question is, particularly in complex cases with very high damages, what is to say the insurance companies would have paid those victims any money in the absence of involvement of a lawyer?

Mr. KINZLER. For example, we are talking about economic damages at the moment. Do you want to start with that?

Ms. DEGETTE. Either way, I mean, under the current tort system.

Mr. KINZLER. We can talk about noneconomic damages, but that only happens if you happen to be hit by Bill Gates in a serious injury case. That data is unrefuted data. For all the challenges you see to the RAND study, the same profile goes back to the 1930's, goes back to the 1971 26-volume Department of Transportation study, so let's talk about your question. Your question relates to

the question of payment of damages. Now, what is the responsibility to pay them, how do we know the insurers will pay them?

Ms. DEGETTE. Without the involvement of lawyers.

Mr. KINZLER. Well, first of all, if you have a serious injury that doesn't occur in a car, and you have health insurance, you go to your health insurance company. You have almost no rights in terms of suing your health insurance company unless it is a really abuse of the system and goes on a long time.

Ms. DEGETTE. Sir, I don't have much time, even though it is Mr. Markey's time.

Mr. KINZLER. What I am suggesting is in this system, if your insurance company does not pay you within 30 days, unlike health insurance, you have a right to sue them with an attorney. If you recover, you get a reasonable attorney's fee, and you get 24 percent annual interest. That is a bigger penalty to health insurance, which routinely pays.

Ms. DEGETTE. Well, never mind.

May I ask permission to submit questions, follow-up questions in writing?

Mr. GILLMOR. Yes, that would be fine.

The distinguished gentleman from New York, the ranking member, Mr. Manton.

Mr. MANTON. Thank you, Mr. Chairman.

My question will be to Mr. Kinzler.

Mr. Kinzler, this type of no-fault system is somewhat unfamiliar to me, so I would like to present the scenario and have you explain the outcome under the proposed legislation.

The fact pattern is as follows: If a blind elderly person, who does not drive and has no auto insurance, is a passenger in a vehicle driven by a resident relative who has chosen no-fault coverage, and this elderly person is injured in an accident while being driven by said relative, does that person have the right to go to court and recover damages?

Mr. KINZLER. Let me make sure I follow this fact pattern. You have a blind resident relative, a resident relative of the driver?

Mr. MANTON. Yes.

Mr. KINZLER. All right. Okay.

Mr. MANTON. Let's call the driver the niece.

Mr. KINZLER. So the driver—well, the resident relative—the way the bill works is the resident relative is covered by the policy, by the insured individual. So if you have—let's see if we can work back in this and make sure we get exactly what you want here.

If I am the father of the child or the father of an elderly mother living at home, my choice binds that resident relative if they are involved in an accident unless the resident relative chooses the other system. The resident relative would have that right.

So let me make sure I understand what we are talking about here. You are talking about a resident relative of the person——

Mr. MANTON. Is the passenger, the elderly person, bound by the contract of the niece?

Mr. KINZLER. Well, no, because unless she was the resident—the niece was the owner, the policyholder?

Mr. MANTON. Correct.

Mr. KINZLER. The niece is the policyholder. This elderly woman is a resident relative in the sense that she is dependent upon the individual? I am just trying to get the fact pattern right. And now this person has chosen the PPI option; is that correct?

Mr. MANTON. Yes.

Mr. KINZLER. And they are hit by another driver.

Yes, all resident relatives, period, are bound by the choice unless they——

Mr. MANTON. Is that constitutional, that one can be bound by the contract of another, with some other third party?

Mr. KINZLER. For dependents, I believe so. I don't see any reason that wouldn't be.

Mr. MANTON. Mr. Gladstone, do you have any thoughts on that?

Mr. GLADSTONE. The bill, as I understand it, doesn't define members of the household for purposes of being bound by choice for a household as necessarily being a dependent of any sort, as I recall.

I think the broader point to be made is the practical dilemma is of one household member choosing for the whole group and the propriety of one person selecting for a household when others may disagree with that. That is just a minor practical problem with the bill, but you have hit the nail on the head.

Mr. KINZLER. If I may, if there is a disagreement, that individual has a right to choose a different system, so the resident relative can choose the opposite system under either situation.

Mr. MANTON. Mr. Rosenfield, you seem to disagree with Mr. Kinzler on that point.

Mr. ROSENFIELD. Well, you said it was a blind person who is the passenger, so they will not have purchased auto insurance.

Mr. MANTON. They don't drive, they are blind.

Mr. ROSENFIELD. I mean, I agree that we would have to go to the Library of Congress and get an opinion on this.

Mr. O'CONNELL. It isn't that unusual for the head of the household to bind people as to the kind of insurance that they buy. You and I buy health insurance. If we don't buy health insurance, our dependents don't have any. If we don't buy fire insurance, members of our family may be without housing. It is not totally unusual to have the head of the household bind people by his or her choice about insurance.

Mr. GLADSTONE. We are talking about two completely different issues. One would cutoff a right of recovery that otherwise would exist, rather than simply choosing in the marketplace from varying sorts of health insurance plans. They are two different things.

Mr. O'CONNELL. But on the other hand, keep in mind, this person now has the beneficiary not only—the beneficiary of receiving her economic loss when she is in an accident, irrespective of fault. It isn't a trade that is without benefit. The head of the household has prudently said, I think it is better that members of my household be assured of their payment for economic loss, rather than have a chance at maybe having a tort claim. That is not an irrational choice for the head of the family to make, especially if an adult in the family can choose otherwise.

Mr. MANTON. I think my time has expired. Thank you, Mr. Chairman.

Mr. OXLEY. Actually, your time has expired.

Gentlemen, thank you all for your testimony. I apologize for having had a meeting off the Hill. But we appreciate your testimony for the record.

I ask unanimous consent that Members wishing to enter their opening statement to be made part of the record may do so, and that we keep the record open for any written questions we may want to request of the panel.

With that, this subcommittee stands adjourned.

[Whereupon, at 1:13 p.m., the subcommittee was adjourned.]

[Additional material submitted for the record follows:]

PREPARED STATEMENT OF HON. DANIEL PATRICK MOYNIHAN, A U.S. SENATOR FROM THE STATE OF NEW YORK

I commend the Subcommittee for holding this hearing today on auto insurance reform legislation. At the outset, I simply would remark that this issue has been with us for 30-odd years, so I do not think it could be said that we are impulsive in bringing it before you today. I assume, correctly I'm sure, that the Subcommittee members are all familiar with the details of the legislation. In particular, you will hear from Jeffrey O'Connell, the Samuel McCoy Professor of Law at the University of Virginia, who has been involved with this subject throughout his career and taught me the subject a very long while ago. I wish to provide some of the background and a particular perspective.

The automobile probably has generated more externalities, as economists and authors Alan K. Campbell and Jesse Burkhead remarked, than any other device or incident in human history. And one of them is the issue of insurance, litigation, and compensation in the aftermath of what are called "accidents" but are nothing of the kind and are the source of so much misunderstanding.

When a certain number of "accidents" occur (I think that in 1894, if memory serves, there were two automobiles in St. Louis, Missouri, and they managed to collide—at least, it has been thought thus ever since), they become statistically predictable collisions—foreseeable events—in a complex transportation system such as the one we have built.

This began to be a subject of epidemiology in the 1940s, and by the 1950s, we had the hang of it. We knew what we were dealing with and how to approach it.

The first thing that we did—I think it fair to say it was done in New York under the Harriman administration, of which I was a member—was to introduce the concept of passenger safety into highway and vehicle design. Safety initiatives were undertaken, first at the State level. Then, in 1966, Congress passed *two* bills, the National Traffic and Motor Vehicle Safety Act and the Highway Safety Act, to establish pervasive Federal regulation. At the time, the last thing in the world an automobile manufacturer would suggest was that its product was a car in which one could safely have an accident! Perhaps *other* motorists, driving *other* companies' cars, had accidents...It took quite a bit of learning—social learning—but eventually it happened: safety features such as padded steering wheels and dashboards, seat belts, and airbags became integral design considerations. Now it is routine; we take such features for granted. It wasn't always thus. Social learning.

And then the issue of insurance and litigation and so forth arose. In 1967, if I could say, which would be 31 years ago, I wrote an article for the New York *Times* Magazine, which simply said, "Next, a new auto insurance policy." By "next," I meant a natural evolution, building on the epidemiological knowledge we had developed regarding the incidence of collisions and the trauma they caused to drivers, passengers, and pedestrians. And I had a good line here, I think: "Automobile accident litigation has become a twentieth-century equivalent of Dickens's Court of Chancery, eating up the pittance of widows and orphans, a vale from which few return with their respect for justice undiminished."

The are several fundamental problems with the current system of auto insurance, as I explained back then. First, determining fault, necessary in a tort system, is no easy task in most instances. Typically, there are few witnesses. And the witnesses certainly aren't "expert." The collisions are too fast, too disorienting. And adjudicating a case typically occurs long after the collision. Memories fade.

More important, as I remarked at the time, is that "no one involved (in the insurance system) has any incentive to moderation or reasonableness. The victim has every reason to exaggerate his losses. It is some other person's insurance company that must pay. The company has every reason to resist. It is somebody else's cus-

tomer who is making the claim." This leads to excessive litigation, costly legal fees, and inefficient, inequitable compensation.

A 1992 survey of the nation's most populous counties by the U.S. Department of Justice found that tort cases make up about one-half of all civil cases filed in state courts. Auto collision-related lawsuits account for 60 percent of these tort cases—more than all other types of tort lawsuits combined. Such lawsuits are time consuming: 31 percent of automobile tort cases take over one year to process. They are clogging our courts, displacing other types of civil litigation far more important to society.

And for all the time, money, and effort these lawsuits consume, they do not compensate victims adequately. On average, victims with losses between $25,000 and $100,000 recover just over half (56 percent) of their losses, and those persons with losses over $100,000 receive just nine cents on the dollar in compensation.

"Auto Choice," as our legislation is known, will curtail excessive litigation by changing insurance coverage to a first-party system—at the driver's option. Individuals will insure *themselves* against economic damages regardless of fault. They can, if they wish, insure for non-economic losses, too. They simply pay a higher premium. In the event they sustain damages in a collision, under Auto Choice, they bypass litigation altogether, and they receive just and adequate compensation in a timely fashion.

I earnestly hope that Congress will enact this important legislation this year. It will benefit all American motorists. My House and Senate colleagues who have cosponsored the legislation will detail the impressive savings that will accrue to drivers who switch to first-party "auto choice" policies. These savings are bigger than any tax cut Congress is likely to enact, and they won't affect our ability to balance the budget. But even more important, I think, is the fact that "auto choice" will take some of the strain off our overburdened judiciary. I don't know if we can calculate the value of such a benefit.

PREPARED STATEMENT OF HON. EARL POMEROY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NORTH DAKOTA

Chairman Oxley, Representative Manton, members of the Subcommittee, I appreciate this opportunity to testify in opposition to the Auto Choice Reform Act, a bill to impose a federal no-fault auto insurance law on all 50 states. As the only former insurance commissioner in Congress, I believe that the federal preemption of state authority proposed in H.R. 2021 is unnecessary and contrary to the interests of consumers.

Mr. Chairman, I would like to state at the outset that I have no objection to the concept of no-fault auto insurance. In fact, my home state of North Dakota is one of 16 states that have no-fault insurance laws. My objection is to legislation that would override the auto insurance laws of all 50 states—including no-fault laws—to impose a federally prescribed no-fault law as H.R. 2021 does.

Why is it important to preserve state authority over insurance? To answer the question, it is helpful to recall why Congress delegated the authority to the states in the first place. Since insurance is a commodity of interstate commerce, under the Constitution, the federal government has jurisdiction. However, more than 50 years ago, Congress decided to delegate the authority to regulate insurance to the states when it enacted McCarran-Ferguson. The rationale was that the conditions that impact the insurance market vary widely from state to state and that the states are in a better position than the federal government to tailor insurance laws and regulations to suit the needs of its residents.

Perhaps no line of insurance is more subject to local variation than auto insurance. No one would argue that driving in rural North Dakota is the same as driving the New Jersey turnpike. North Dakota has an extremely low population density, more road miles per capita than any other state, a very low rate of auto theft, relatively low health costs, and a traditional reluctance to resolve disputes through litigation. New Jersey, on the other hand, has the highest population density in the country, high traffic congestion, and a high cost of living. Should the federal government impose the same auto insurance law on states with such widely varying market conditions? I would argue emphatically no—that auto insurance is the shining example for why insurance is best left to the states rather than a target for federal preemption.

The idea of federal no-fault insurance has been around for more than 30 years. Ironically, the early advocates of federal no-fault legislation were mostly liberal Democrats. The critics were mostly Republicans and conservative Democrats who were concerned about usurping the authority of states. Today, the cast of characters

has changed 180 degrees as Majority Leader Armey, one of the most conservative members of Congress, leads the charge to federalize auto insurance law. Regardless of whether federal no-fault is sponsored by a liberal or a conservative, what was bad policy 30 years ago is bad policy today.

The advocates of federal no-fault insurance bear a heavy burden of proof. In my judgment, a federal preemption of state law such as the one proposed by H.R. 2021 could only be justified to address a serious national crisis in which the state legislatures have proven themselves incapable to respond. The issue of auto insurance law meets neither test.

The statistics on auto insurance seem to indicate that there is a serious problem in a handful of states but that the national market is more or less stable. In New Jersey, New York, and DC the average annual premiums exceed well over $1,000. However, according to the National Association of Insurance Commissioners, the average auto insurance premium nationwide was $774 in 1996—an increase of 11 percent from 1992 ($712) which is about equal to the rate of inflation. I am aware that insurance companies recently announced reductions in auto insurance premiums. In North Dakota, we enjoy the lowest auto insurance premiums in the country at $506 per vehicle per year.

Second, there is nothing standing in the way of state legislatures adopting no-fault laws. Not surprisingly, the bill's sponsors represent states with high auto insurance premiums and are frustrated with the inaction of their state legislatures. Such frustration is understandable but is hardly a valid reason to preempt the laws of all 50 states, including those laws that have produced efficient auto insurance markets. As an alternative, I suggest that the sponsors of the bill call their governors and state legislatures to advance their auto insurance reform proposals.

It is ironic that exactly one week after the House passed H.R. 10—a bill which reaffirms the authority of states to regulate insurance—the Commerce Committee would hold a hearing on legislation to significantly preempt state insurance authority. For the same reasons that this Committee battled to protect state insurance authority in H.R. 10, I would urge the members to reject H.R. 2021. Although not perfect, state regulation of insurance affords the best protection for consumers and is far superior to any federal alternative.

PREPARED STATEMENT OF RUDOLPH W. GIULIANI, MAYOR, CITY OF NEW YORK

Mr. Chairman and Members of the Subcommittee. On behalf of the citizens of the City of New York, I am pleased to submit this statement in support of federal auto-choice legislation.

Over the past ten years, automobile insurance premiums in New York State have increased by 44%, according to the National Association of Insurance Commissioners. That is almost double the increase incurred by the rest of the country. Many cities including Los Angeles, Philadelphia, Washington, D.C. and New York have been hit particularly hard. The cause of these increased premiums is due, in large part, to the nationwide explosion in tort litigation. Insurance companies raise premiums to cover the cost of huge personal injury awards—most notably for inflated or excessive "pain and suffering." As long as tort attorneys maintain the incentive to litigate these excessive claims, insurance companies will have the incentive to raise premiums. The average motorist is left paying a higher premium, which the recent Joint Economic Committee study on auto-choice entitled "Auto Choice: Impact on Cities and the Poor" has appropriately termed a "tort tax." There is something awry about a low or middle-income motorist struggling to pay enormous premiums to an insurance company which, in turn, passes on the money to a claimant, often for an inflated claim, who then passes on much of the wealth to a personal injury attorney.

The ramifications of the current system are far-reaching for the average motorist. New York City has been witness to a noticeable improvement in the quality of life of its residents. More disturbing though to the overall health and continuity of the City is the disparity between the City rate and the suburb rate. Even nearby suburbs pay considerably less. For example, according to the Joint Economic Committee study, a male, 20 year old Brooklyn driver pays $2,270 per year while a male, 20 year old Yonkers driver pays only $1,363 per year. Cities in upstate New York also pay relatively little compared to the New York City rate. Brooklyn drivers pay five times as much as Rochester drivers. Clearly, this discriminatory tort tax is levied with particular harshness against New York City.

Whether low-income or middle-income, city resident or suburban resident, help is needed to shield people across the country from unjustified insurance rates and to provide much needed relief to motorists. Therefore, I support the House bill (H.R.

2021), sponsored by Majority Leader Armey and others, to provide legal reform to motor vehicle tort systems because it would directly benefit the City of New York and other municipalities and their taxpayers.

The so called "auto-choice" bill would allow people to opt out of paying for pain-and-suffering coverage. Essentially, the bill gives people the right to choose from two types of coverage. Under the motor vehicle personal protection insurance option, insured parties are entitled to receive their net economic losses from their own insurance carriers without regard to fault. Non-economic loss such as pain-and-suffering, inconvenience and emotional distress would not be recoverable. thereby lowering premiums and speoding up claim processing. The insured would retain the right to sue another driver, based in fault, for economic, but not noneconomic, damages exceeding the plaintiff's coverage. Additionally, if the personal protection insured motorist is involved in an accident with an uninsured motorist, the insured motorist is compensated from his own carrier without regard to fault, and may also claim against the uninsured party based on fault.

Alternatively, a motorist can choose to insure also for non-economic damages through tradition tort liability coverage. In this case, drivers have the same rights under state tort law to be covered for non-economic damages as they do now under state law, in that they would have to prove fault or negligence, but injured party claims would be paid by their own insurance companies. According to this plan, as with the personal protection insurance plan, any negligently injured motorist whose economic damages exceeded his coverage could sue the negligent driver for all such damages remaining. Both choices would allow full recovery for economic and non-economic damages from intentional wrongdoers or inebriated drivers.

This bill will begin to remedy the problem of runaway tort litigation awards that hamstring our cities. Less than sixteen years ago, New York City's total payout in personal injury actions was approximately $28 million. Last year, the City paid over $288 million in personal injury actions. Over $40 million went to pay for claims involving vehicle accidents. The true beneficiaries of the current system are lawyers, not litigants. Under current contingency fee laws and practices, attorneys stand to gain 33% to 40% from plaintiff awards. Adding on expert witness fees and other similar expenses leaves the plaintiff with barely half the amount awarded. The present system appears to encourage lawyers and litigants to fill the courts with inflated or groundless claims of pain and suffering with the hope of obtaining an underserved windfall. These damages are often based on sympathy and a desire to punish the defendant, rather than objective criteria. It is these windfalls that contribute to the enormous premiums paid by honest, law-abiding taxpayers. Even more disturbing is the number of groundless claims filed with insurance companies.

Of course, in many personal injury cases, the City is sued as a deep pocket defendant. What many people fail to consider is that when the City pays, taxpayers pay. Under the current system taxpayers pay far more than they should because, often, jury awards are grossly disproportionate to the injury suffered. Or worse, the City has to pay out a claim larger than the City's share of the fault.

The economic consequences of these tort claims and inflated automobile insurance premiums are enormous. Residents, as taxpayers, lose money that could otherwise be spent on essential services. Residents, as individuals, lose money otherwise available as disposable income. Residents, as consumers, lose money because the cost of goods and services increases as businesses have to pay higher insurance premiums. Finally, and perhaps most disturbingly, residents question our judicial system as a result of courts clogged with tort litigation.

The critical need for auto-insurance reform stems in large part from the people's appropriate frustration with large jury awards, and the ever-increasing insurance premiums they pay, largely as a result of those awards. The Joint Economic Committee study projects that the bill will save the American people $35 billion in all.

H.R. 2021, begins to restore equity and fairness to a troubled system. I should be clear in stating that people who deserve recovery should get that recovery. This bill allows these people to do so, without the expense and time inherent in protracting litigation stemming from the hopes of an underserved, unearned "reward for being injured." Under a sensible tort system, litigants should be compensated, not rewarded, for being injured. Moreover, the bill allows for a quicker and more efficient processing of claims, without the financial and emotional expense of protracted litigation. This is particularly true for motorists who choose the personal protection plan, as they are not required to prove fault to recover economic loss from their own insurance carrier.

This bill would help to contain the tort litigation explosion by dramatically decreasing the pain-and-suffering incentives which are so destructive of the present system. Courts would be able to more efficiently handle cases brought by people with genuinely meritorious claims.

The benefits of this bill are significant. According to the Joint Economic Committee study, if all insured motorists choose the personal protection plan, the average premium would drop by $184. In New York, the average premium would drop by $385. All this can occur while at the same time we can achieve affordable, fair and equitable insurance coverage. Lower income drivers and urban drivers will see a dramatic decrease in their insurance rates. According to the Joint Economic Committee study, lower income drivers can expect to save 36% in premiums. Nationwide, drivers will see a reduction of over 22%.

Auto-choice represents a major step forward in the direction of comprehensive auto-insurance and tort reform. This legislation delivers a long-awaited "tort tax cut." With the increased savings expected to be generated by this legislation, individuals could better afford to meet their expenses, and municipalities could better afford desperately needed programs. These historic reforms are a matter of national and local concern. The City of New York urges you to give people the chance to make decisions about how to protect themselves. We urge favorable consideration of the bold reforms addressed in this bill.

CITY AND COUNTY OF DENVER
May 14, 1998

The Honorable RICHARD ARMEY
House Majority Leader
301 Cannon House Office Building
Washington, D.C. 20515

DEAR CONGRESSMAN ARMEY: As Mayor of Denver and Chair of the Advisory Board for the United States Conference of Mayors, I want to express my enthusiastic; and active support of the Auto Choice Reform Act of 1997.

This legislation would achieve several valuable purposes. First, it would give our nation's drivers the option to reduce their auto insurance premiums by as much as 40 percent. Second it would provide in many cases for fuller and faster compensation to victims of serious auto injuries. Third, it would substantially minimize one of the most regressive, burdensome, and unfair costs imposed on our nation's urban poor—auto insurance premiums. And fourth, it would reduce the growing problem of uninsured motorists by increasing the affordability of auto insurance.

I strongly believe that government can forge broad alliances across ideological, economic, and ethnic barriers by fashioning public policy on the twin foundations of efficiency and fairness. The Auto Choice Reform Act is a wonderful example of this principle. The remarkable savings achieved by this legislation are derived by tackling the gross inefficiencies of fraud and abuse and excessive litigation, and by expanding consumer choice.

This last point is worth emphasizing. This legislation gives drivers a CHOICE, NOT A MANDATE. In particular, drivers would have the option to remain with their current coverage, which requires consumers to pay a significant portion of their premium for the unlikely, expensive and often protracted avenue of suing for noneconomic damages (e.g., pain and suffering).

Or drivers can choose an alternative that allows them to quickly recover economic losses such as medical bills and lost wages, and still retain the right to sue for those noneconomic damages that were inflicted intentionally or as a result of drugs or alcohol. If they choose this second alternative, they would be compensated promptly by their own insurance plan rather than undergoing the costly and time-consuming process of determining fault.

In addition to recovering economic losses more quickly, this legislation enables injured drivers to recover economic losses more completely. According to the RAND Institute for Civil Justice, auto accident victims with costly injuries (economic losses between $25,000 and $100,000) recover on average only about half of their losses. Victims with very costly injuries (in excess of $100,000) recover on average just 9 percent of their losses.

In contrast, drivers who opt for the alternative option authorized by Auto Choice would be automatically compensated for all of their economic losses. Only if economic losses exceeded the limits imposed by a driver's insurance policy would the driver have to seek recovery for the excess amount under applicable state negligence laws.

This legislation also gives states a choice instead of a mandate. States may opt out of the Auto Choice Reform Act by statutory enactment or if the state insurance commissioner determines that the legislation would not reduce bodily injury premiums by at least 30%.

The expected savings from this legislation are enormous. Nationally, according to the congressional Joint Economic Committee study, the savings would equal $35 billion a year. In Colorado, drivers would save an estimated 50% in personal injury premiums, constituting 26% of their total auto insurance premium. For the urban poor, who unfairly and unacceptably pay higher premiums notwithstanding their more limited resources, the savings would be even more substantial. A low-income driver in Colorado would expect to see a 40% reduction in overall premium savings. The average savings for a Colorado driver would be $230, 12th highest in the nation. The total savings in auto insurance premiums in Colorado would be $639 million.

I commend you for this bipartisan, thoughtful auto insurance reform legislation that replaces waste and fraud and inefficiency with consumer choice and faster and fuller compensation for injuries.

Yours truly,

WELLINGTON E. WEBB
Mayor

ISBN 0-16-057137-5