THE INSURANCE CRISIS: AN INDUSTRY PERSPECTIVE*

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Many people approach insurance issues from different perspectives. Most people agree on a majority of the numbers, and I would certainly agree that one of the great things missing in the discussion of insurance is a common database from which we can work. If there is a way that we can move that along the system, it would be a great accomplishment because I believe we all have common goals.

This symposium has been billed as an opportunity to discuss a crisis in insurance. I believe the word "crisis" is too strong. This so-called crisis is not a one industry phenomenon. It is actually a societal crisis that affects many industries.[1] Therefore, it is necessary to examine the problem in the larger context of the system of which the insurance mechanism is just a part. Simply put, policies and attitudes about societal risks and compensation to victims and who should pay for those injuries are not keeping up with the changes in our judicial system.[2] The problem is how

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[1] *See, e.g.*, Lindsay, *Businesses Change Ways in Fear of Lawsuits*, N.Y. Times, Nov. 18, 1985; Jaffe, *ABA Wants Tort System Streamlined*, The Star-Ledger (Newark, N.J.), Jan. 12, 1987; *New Drug Withdrawn; Mfgr. Fears Lawsuits*, THE REFORMER, Feb. 1987, at 3 [hereinafter THE REFORMER]; GENERAL ACCOUNTING OFFICE, MEDICAL MALPRACTICE: NO AGREEMENT ON THE PROBLEMS OR SOLUTIONS, GAO Report No. GAO/HRD-86-50, at 3, 22-39 (Feb. 1986) [hereinafter MEDICAL MALPRACTICE].

[2] *See generally* MEDICAL MALPRACTICE, *supra* note 1, at 13-14; U.S. DEPT. OF JUSTICE, REPORT OF THE TORT POLICY WORKING GROUP ON THE CAUSES, EXTENT AND POLICY IMPLICATIONS OF THE CURRENT CRISIS IN INSURANCE AVAILABILITY AND AFFORDABILITY 30-35, 51 (Feb. 1986) [hereinafter Report of the Tort Policy Working Group].

to reconcile society's ideas with the systems, including insurance, that are designed to carry out those policies.

It is important to recognize that society as a whole, including the insurance industry, cares deeply about those people injured or killed every day. Everyone wants to see that those individuals are adequately and justly compensated. But what is adequate? And in all fairness who should pay for this compensation?

The insurance industry critics have an answer: the insurance companies should pay.[3] This is a simple idea, but is it equitable. To imply that insurance companies can pay for all societal losses is analogous to asking the dealer to pay for the player's losses in a poker game.

In the liability insurance field, the insurance carriers serve as transfer payment agents.[4] Basically, they help people share risks.[5] The carriers collect insurance premiums at one end and pay out claims to victims at the other.[6] There may be a lot of "gobble-de-gook" in between, but there is no magic. There is no "they." To paraphrase Pogo: we have seen the enemy and "they" is "us."

Besides through insurance premiums, how does society pay to spread the risks? Society pays through higher municipal taxes,[7] and higher fees for medical services,[8] including paying many times more than is necessary for certain types of vaccinations for children.[9] Society's costs for recreation are also in-

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[3] *See* Church, *Sorry, Your Policy Is Canceled*, TIME, Mar. 24, 1986, at 17, 19 [hereinafter *Sorry, Your Policy Is Canceled*].

[4] *See* R. MEHR & E. CAMMACK, PRINCIPLES OF INSURANCE 12-14 (1976) [hereinafter PRINCIPLES OF INSURANCE].

[5] *See id.* at 3-5; S. HUEBNER, K. BLACK, JR. & R. CLINE, PROPERTY AND LIABILITY INSURANCE 3-12 (1968) [hereinafter PROPERTY AND LIABILITY INSURANCE]; A. MOWBRAY & R. BLANCHARD, INSURANCE 3-13 (1955) [hereinafter INSURANCE].

[6] INSURANCE, *supra* note 5, at 41-48.

[7] *See generally Sorry, Your Policy Is Canceled*, *supra* note 3, at 16-19.

[8] *See id.* at 19, 25.

[9] *See generally id.* at 18; *see also* REPORT OF THE TORT POLICY WORKING GROUP, *supra* note 2, at 45, 47, 52; 1 STATE OF NEW YORK ADVISORY COMMISSION ON LIABILITY INSURANCE: INSURING OUR FUTURE 37-38 (Apr. 1986) [hereinafter INSURING OUR FUTURE]; MEDICAL MALPRACTICE, *supra* note 1, at 10. Obviously, all those increased costs are paid for by the consumers. The fifteen billion dollars identified by the GAO report as the cost of defensive medicine is a staggering figure alone. *See* MEDICAL MALPRACTICE, *supra* note 1, at 10. The increased cost for DPT vaccine is quoted variously as between two and twenty times the cost of the vaccine itself; the excessive amounts go to defend litigation. This is not to say that the vaccine is

creased.[10] The list goes on endlessly.[11]

How did this situation arise? The judicial system is operating in a way it was never intended to operate, as far as the societal cost-benefit equation is concerned. The complexity of societal and judicial ideas about fault has increased in recent history.[12] In earlier years, when someone was at fault, that person paid.[13] When a child hit his little sister, it was his fault and he was punished. If your sidewalk was in disrepair and someone was injured because of your failure to maintain your property, you had to

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perfectly safe; it is not and cannot be made perfectly safe. Medical experts are unanimous in their agreement that the benefit far outweighs the harm. According to Eugene Shapiro, Assistant Professor of Pediatrics and Epidemiology at the Yale School of Medicine, "a severe adverse neurological reaction to the [DPT] shot occurs between 1 in 100,000 and 1 in 300,000 doses. The risks of death and severe complications from pertussis or a whooping cough, [the "P" in DPT] is 'considerably higher than that'. . . ." *Retarded Boy's Parents Sue Vaccine Maker*, J. COM. (June 15, 1987). The real question this kind of situation presents is who should pay, and should the matter be in the tort, or fault-based, system at all. Where there is broad social benefit in an activity, perhaps society should develop a compensation system to respond to losses that that activity causes, and handle the matter outside of the judicial system.

10 *Sorry, Your Policy Is Canceled*, *supra* note 3, at 19, 20, 24.

11 One of the most frightening aspects of the increased cost we pay is the loss of new products and services and a lack of enthusiasm to develop and market new ideas. Obviously this cost is impossible to measure empirically, and one is left, as all too often has occurred in the liability debate, with anecdotal evidence of the loss. For example, a drug that relieved the uncontrollable blinking or muscle spasms due to a neurological disorder was temporarily unavailable because of a fear of lawsuits resulting from the drug's use. *See* THE REFORMER, *supra*, note 1, at 3. *The New York Times* reported a "chilling effect" on efforts to obtain venture capital to support new business. Broad, *Does the Fear of Litigation Dampen the Drive to Innovate?*, N.Y. Times, May 12, 1987. This type of fear has even extended to universities that sell patent licenses. Howard M. Bremer, patent counsel for the University of Wisconsin at Madison, expressed the fear that if a "small business" purchased a patent from a university and was ultimately sued because of a product it developed and marketed, plaintiffs would be tempted to attack the relatively "deep pockets" of the vendor university. *Id.* Mr. Bremer felt this was particularly problematic because small businesses generally outperform large enterprises in product innovation. *Id.* According to Bremer: "There's some sincere questioning of whether we should license to small businesses at all." *Id.*

12 *See generally* Report of the Tort Policy Working Group, *supra* note 2, at 30-33. "Beginning in the early to mid-1960's it became fashionable to reject the twin pillars upon which tort law historically had been constructed—deterrence and compensation—in favor of seemingly more enlightened theories based largely on concepts of societal insurance and risk spreading." *Id.* at 30.

13 *See* W. KEETON, D. DOBBS, R. KEETON & D. OWEN, PROSSER AND KEETON ON THE LAW OF TORTS 21-31, 608-15 (1984) [hereinafter THE LAW OF TORTS].

pay.[14] However, there were limited accepted norms as to what punishment fit the crime.[15] For the most part, an injured party was compensated in direct proportion to the loss sustained, and those found negligent or responsible for the injury or loss were assessed in direct proportion to the degree of responsibility.[16]

As our society became more complex, the notions of risk and fault have been twisted around. The young man who hit his little sister, now says that his older sister, whose allowance is two times greater, made his arm move. Now, he claims that she is at fault. In addition, he is exhausted from doing his homework, which is his mother's fault for sending him to a tough school. Because his mother has inexhaustible resources, she has deep pockets. With the help of an attorney, who is an expert on the joint and several liability doctrine, the young man is acquitted, his older sister pays for the black eye, and his mother is ordered to take them all to the country for the weekend for relief of pain and suffering.

Society is leaning more and more toward a system of maximum compensation with less and less fault.[17] The judiciary has

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[14] *See id.* at 417-18, 425-28, 608-609; Stewart v. 104 Wallace St., Inc., 87 N.J. 146, 432 A.2d 881 (1981) (an owner of commercial property was held liable for injuries sustained as a result of the deteriorated condition of the sidewalk abutting the property).

[15] THE LAW OF TORTS, *supra* note 13, at 25-26, 608-15 (1984).

[16] *Id.* at 345-55, 608-15.

[17] *See* Report of the Tort Policy Working Group, *supra* note 2, at 31. The New York Commission's report describes the evolution of tort law during the twentieth century, through the 1950's as follows: "during this period courts tended to impose on the plaintiffs in tort cases quite stringent burdens of proof of injury and the causation thereof, and to narrow the duties of care assigned to defendants." INSURING OUR FUTURE, *supra* note 9, at 122. After describing the specific rules flowing from this philosophy, the Commission noted that:

> Although these and similar principles undergirded the tort law through most of American history, they are almost entirely without force today. During the past three decades sweeping changes have been introduced into the law of torts, changes whose significance is only beginning to be realized. Whether these changes are considered generally positive or negative is a matter of individual judgment and not a little controversy. But there can be no question that something very close to a revolution has occurred in prevailing tort principle.
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> Examples of the change abound. The doctrines of sovereign immunity and charitable immunity are defunct almost everywhere. The rule of contributory negligence has been abandoned in favor of the rule of comparative fault in most jurisdictions, and is in tattered circumstances where it is still formally the law. The duties of care imposed on defendants have expanded greatly, and the burdens of proof on plaintiff [sic]

altered the balance between the degree of loss and the degree of reparations received, and the balance between the degree of harm and the degree of responsibility for undoing that harm.[18]

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have been much reduced. Thus, the manufacturer's defense of no "privity" with the buyer of its products has been abolished, and the doctrine of strict liability for product-caused injuries has been generally accepted, which rule does not require the plaintiff to establish that the manufacturer was negligent but only that the product was defective. And, new doctrines emerge yearly, such as the theories of "enterprise" or "market share" liability, under which the plaintiff need not show that the product of a particular defendant caused the injury, but is permitted to sue all manufacturers of that type of generic product and shift the burden of proof to the defendant to establish that its product did not cause the injury. In some jurisdictions, failure to meet this burden means that liability is apportioned among such defendants according to market share.

These changes in the law reflect significant changes in social attitudes. The earlier emphasis on protecting activity and imposing liability only to deter especially hazardous behavior has been replaced with a primary concern for full compensation of injuries and that businesses and governments take fully into account the possible consequences of their conduct before taking action. Injuries which in an earlier era where [sic] deemed unhappy but unavoidable accidents of life are now treated as occasions for a finding of tort liability and a resulting duty to compensate. And, a more sophisticated and sensitive society has insisted that injuries that are difficult to gauge—pain, anguish, stress, loss of companionship—be compensated as fully as the physical and economic injuries that are subject to objective measurement. One major effect of this trend has been an expansion of average jury awards, not in the great mass of cases, but largely in the more serious cases where astronomical sums have become nearly commonplace.

Id. at 123-24.

18 As the New York Commission correctly points out, this movement toward a compensation system has shifted the burden of compensating injuries to those perceived to be "more effective avoiders and spreaders of risk than. . .individual consumers," for example business and government. INSURING OUR FUTURE, *supra* note 9, at 124.

This trend has been evaluated statistically for Cook County, Illinois by the Rand Corporation Institute for Civil Justice (ICJ). A. CHIN & M. PETERSON, DEEP POCKETS, EMPTY POCKETS: WHO WINS IN COOK COUNTY JURY TRIALS (1985). In cases where the plaintiff was not severely injured, the ICJ's findings revealed that corporate defendants typically paid about 30 percent more than individual defendants paid for similar injuries. *Id.* at vii. Government defendants fared even worse in those types of cases, paying 15 percent more than corporations and 50 percent over the individual defendants. *Id.* This phenomenon emerged with even greater clarity when the plaintiffs were severely injured. Corporate defendants paid three times more than government defendants and 4.4 times more than individual defendants. *Id.* In addition, juries seemed to be influenced by the existence of a corporate defendant when a plaintiff was severely injured: "corporate defendants were more likely than other defendants to be found liable." *Id.*

For example, a Florida woman was awarded $75,000 when she injured her back while she and her boyfriend were driving cars at Disney World's Grand Prix Raceway. A Florida court found Disney World one percent at fault, and the injured woman fourteen percent. Her boyfriend was found to be eighty-five percent at fault. Disney World was ordered to pay the entire $75,000 award.[19] While the example may be extreme, it is true nonetheless. Extensions of that type of interpretation of civil justice are what concerns students of tort reform today.[20] The goal should be to determine a policy which most closely represents society's desires as to how much gets paid, when, and by whom.

The mechanism of insurance helps people share risks.[21] If risk sharing were the only consideration, the industry could predict risks by determining what premiums must be exacted to meet claim payments.[22] Obviously, when the civil justice system requires that the injured must be compensated at a much higher level, the costs must rise accordingly. Moreover, when the civil justice system has many elements of a lottery which complicate predictability, prices also increase.[23]

Tort reform is only part of the solution to the so-called insurance crisis. Such reform would assure fair compensation to injured parties by those who are responsible. Such reform would also promote compassionate and fair treatment of all parties to a lawsuit. Even the American Bar Association suggests that the time has come for at least some form of tort reform.[24]

The main objectives of tort reform should be directed at two

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19 Walt Disney World Co. v. Wood, No. 68-647, Sup. Ct. Fla., Slip Op. (Nov. 5, 1987), *appealed from* 489 So.2d 61 (Fla. 4th Cir. 1986).

20 *See generally Sorry, Your Policy Is Canceled*, *supra* note 3, at 25-26.

21 *See* PROPERTY AND LIABILITY INSURANCE, *supra* note 5, at 4; INSURANCE, *supra* note 5, at 3-13; PRINCIPLES OF INSURANCE, *supra* note 4, at 31-32; E. FISHER & P. SWISHER, PRINCIPLES OF INSURANCE LAW xxi (1986).

22 *See generally* PRINCIPLES OF INSURANCE, *supra* note 4, at 11-14.

23 Unpredictability is an anathema to insurers who seek to quantify risk, and then spread this risk. What cannot be predicted cannot be quantified or spread, and the insurer's ability to rely on the law of large numbers as an equitable risk-spreading mechanism is eroded. In the words of Edward J. Noha, Chairman and CEO of CNA Financial Corporation: "And where there is a lack of predictability, the insurance mechanism cannot function." Mills, *Insurance and the Justice System*, J. COM. (Apr. 6, 1987)

24 Shipp, *A.B.A. Urges Modest Limits on Lawsuits Over Injuries*, N.Y. Times, Feb. 18, 1987, at A14.

specific areas. First, inappropriate windfall settlements must be stopped. That is, ending the unlimited discretion which civil juries have in awarding damages for claims of pain and suffering, mental anguish, and other non-economic loss.[25] These awards are in addition to the awards for economic losses sustained by the injured parties. Statutory caps on those non-economic awards are a means to an end, with that end being more predictability and less cost to the consuming public. If there are other means to achieve that end, they should be used. The capping proposals under consideration rarely discuss capping economic losses, and focus instead on limiting the intangible non-economic injuries that are subject to juries' unfettered discretion.[26]

Second, the concept of joint and several liability should be modified. Co-defendants should not be required to pay damages in excess of their proportionate share.[27] In addition, punitive damages should be modified.[28] If someone's conduct is fla-

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[25] The Tort Policy Working Group made a similar recommendation pointing out that:

> Non-economic damages such as pain and suffering, mental anguish and punitive damages are inherently open-ended. They are entirely subjective, and often defy quantification. For example, in many instances it simply is not possible, no matter how much money is awarded, to compensate someone fully for the pain and anguish of the loss of a loved one or from a serious injury. Moreover, because such damages are essentially subjective, awards for similar injuries can vary immensely from case to case, leading to highly inequitable, lottery-like results. Accordingly, such damages are particularly suitable for a specific limitation.
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> The open-ended nature of such damages makes them a particular problem from the standpoint of achieving predictability. Unlike economic damages (medical expenses, lost earnings, etc.), which can be reviewed objectively and thus can be predicted within a given range, non-economic damages are entirely subjective and unpredictable.

REPORT OF TORT POLICY WORKING GROUP, *supra* note 2, at 66 (footnote omitted).

[26] Obviously, it would be difficult to justify an attempt to cap what are clearly actual out of pocket costs, and few, if any, states have actually taken that approach. Many states have taken some action to control the escalating costs of non-economic damages. *See, e.g.*, Geisel & Taravella, *Tort Reform Explodes: 34 States Enact Laws to Help Solve Liability Crisis*, BUS. INS., Aug. 18, 1986, [hereinafter *Tort Reform Explodes*]; *What Some States Have Done to Limit Liability Claims in their Courtrooms*, Wall St. J., Aug. 1, 1986, [hereinafter *What Some States Have Done*].

[27] States have acted on this issue as well. *See Tort Reform Explodes*, *supra* note 26; *What Some States Have Done*, *supra* note 26.

[28] *See Tort Reform Explodes*, *supra* note 26; *What Some States Have Done*, *supra* note 26.

grantly malicious or willful, it makes more sense to apply criminal prosecution.

In tort reform, the average claim size can be reduced, and premium levels can and will reflect that reduction. For example, in 1975 the California Legislature passed the Medical Injury Compensation Reform Act,[29] a comprehensive tort reform measure applicable to medical malpractice. Various California medical groups investigated the effects of that legislation, and their opinions were that the changes in the law had helped to moderate both malpractice awards and the increase in costs of malpractice insurance.[30] Nationwide, medical malpractice insurance policy costs have risen sharply since the early 1980's, but the rate of increase in California compares favorably with the rate of increase in other states,[31] even though California's premiums remain relatively high in an absolute sense.[32] Given the opportunity, tort reform can be highly effective in limiting the cost of both the civil justice system and liability insurance.

The challenge of tort reform requires everyone's cooperation. Certainly, society must protect the needs of those injured by the wrongful acts of others. However, society must agree at what price it is willing to do so.

Another issue involved in this discussion is the economic mechanism of competition. Competition is the motherhood and apple pie of the eighties. Society as a whole wants to be more competitive, and everyone connected with the insurance industry seems to be advocating more competition. It is confusing how advocates of adding another level of regulation on the presently existing structure or enacting the many suggestions for govern-

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29 1975 Cal. Stat. 1 (codified variously at CAL. CIV. CODE §§ 364-65; CAL. BUS. & PROF. CODE §§ 125.5, 800).

30 GENERAL ACCOUNTING OFFICE, MEDICAL MALPRACTICE: SIX STATE CASE STUDIES SHOW CLAIMS AND INSURANCE COSTS STILL RISE DESPITE REFORMS, GAO/HRD-72-21, 25-27 (1986). This is not to say that awards have not increased during that time. Awards have increased, but the *rate of increase* has been lower than in other jurisdictions that the GAO surveyed. *Id.* at 4.

31 *Id.* The differential in the *rate of increase* in the claims was reflected in the lower rate of insurance in malpractice insurance premiums.

32 *Id.* As the report notes, the insurance rates for physician's malpractice coverage in North Carolina increased at a more accelerated pace than California, but the physicians in North Carolina paid considerably less than those in California.

mental price controls is going to make the insurance business more competitive.

The McCarran-Ferguson Act[33] provides for state regulation of insurance[34] and for a limited exemption from antitrust laws.[35] This mechanism allows rating bureaus and industry-wide statistical agencies to operate.[36] Small insurance companies which number in the hundreds make more use of these agencies than the larger companies.[37] These carriers maintain that they would be at a competitive disadvantage without them.[38] Most proponents of removing the limited antitrust exemption argue that the purpose is to provide for greater competition. It remains unclear whether we want more competition or not.

In conclusion, the liability situation which is a crisis, is neither an insurance crisis nor an attorney's crisis, but rather is a broad societal issue. When the tort system over-emphasizes the notion of compensation and entitlement, and minimizes the issue of actual fault, the system is out of balance. Because the insurance industry serves as a transfer mechanism of spreading the risks, this creates an imbalance which is reflected in the higher premium costs and the insurance availability problems that exist for certain coverages. In this situation where everyone is hurt by the continuing imbalance, pointing fingers at one another does not help. Empty rhetoric serves no purpose for any of the participants. It is only by working together that all the parties will develop the effective and equitable solutions which can then be enacted for the benefit of all.

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33 15 U.S.C. §§ 1011-1015 (1982).

34 *Id.* § 1012(a).

35 *Id.* § 1013.

36 These organizations collect raw data from their member or subscribing companies, and their actuarial staffs analyze it and develop rating methods and schedules.

37 Larger companies have more data of their own upon which they can draw to develop rates, and they are more likely than smaller organizations to have professional actuarial staffs and data processing capabilities to analyze it.

38 Many small insurance companies actually have no professional actuaries at all, and say that they cannot afford to hire any. Without access to professionally developed rating schedules, one wonders if they could continue to exist at all.