CHOICE IN AUTO INSURANCE: UPDATED SAVINGS ESTIMATES FOR AUTO CHOICE

Prepared at the Request of

Senator Mitch McConnell (R-KY)

July 2003

Executive Summary

The auto insurance system in the U.S. suffers from several major failings, including excessive cost, uneven compensation for injuries, extensive fraud and abuse, perverse incentives generated by pain-and-suffering damage awards, and the negative impact on the poor and welfare recipients.

One remedy to these problems is the Auto Choice reform. Auto Choice would produce a number of benefits. This study estimates the potential impact of Auto Choice. The chief findings include:

- Total potential savings from Auto Choice could reach nearly $48 billion in 2003.
- Premiums for private passenger auto insurance would decline by 21 percent on average.
- The average savings would amount to $189 per vehicle.
- Low-income drivers would enjoy average savings of 37 percent.

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INTRODUCTION

Auto insurance is an expensive affair in the United States, costing the typical American household upwards of $1,400 per year.[1] After years of relatively slow premium growth, however, insurance rates are on the rise again. Despite its high price, auto insurance typically fails to provide full compensation for serious auto injuries. Moreover, the system is plagued with fraud and abuse.

One remedy to the shortcomings of the auto insurance system is Auto Choice. Auto Choice legislation would give individuals greater choices in buying auto insurance, lower premiums, increase speed of compensation, reduce incentives for fraud and abuse, and improve compensation for serious injuries.[2] Previous Joint Economic Committee reports have documented the problems in the auto insurance system, as well as the benefits from Auto Choice.[3] This report presents a brief review of the proposal and updated estimates of the potential savings if Auto Choice legislation were enacted.

THE CURRENT SYSTEM

The central goal of auto insurance is to compensate injured victims in auto accidents. The traditional "tort" system relies on lawsuits to accomplish this goal: the injured party sues the negligent party in order to recover any damages. Auto liability insurance protects drivers' assets in the event that they negligently injure someone and as a result are sued. Unfortunately, relying on lawsuits to provide compensation suffers from two critical flaws: it costs too much, and at the same time leaves seriously-injured accident victims grossly undercompensated.

First, there are broad and frequent gaps in compensation. Auto insurance in most states is like a lottery system. If someone is in an auto accident and suffers minor or no injuries, they can collect significant pain and suffering payments by abusing the system. However, if individuals are seriously injured, then they can expect to recover only a portion of their economic losses (i.e., medical costs and lost wages), and frequently will not see a dime for pain and suffering. By definition, the lawsuit-based system offers nothing to many victims of auto accidents – such as
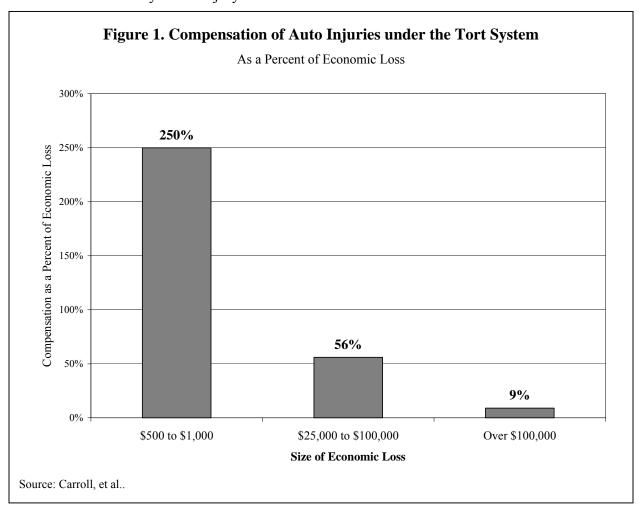
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[1] Joint Economic Committee calculation using data from the 2001 Consumer Expenditure Survey. Amount was calculated as the average expenditure on vehicle insurance among households reporting such an expenditure and reflects the fact that households average about two vehicles per household. U.S. Department of Labor, Bureau of Labor Statistics, unpublished data from the "2001 Consumer Expenditure Survey."

[2] Representatives Richard Armey (R-TX) and Jim Moran (D-VA) introduced Auto Choice legislation in the 107th Congress as H.R. 1704. A detailed review of the legislation is available in Jeffrey O'Connell, Peter Kinzler, and Hunter Bates, "A Federal Bill, with Commentary, to Allow Choice in Auto Insurance," *Connecticut Insurance Law Journal* 7, no. 2 (2000-2001): 511-584.

[3] See the previous Joint Economic Committee reports *Auto Choice: Impact on Cities and the Poor* (1998) and *Auto Choice: Relief for Businesses and Consumers* (1998).

those injured in single-car accidents, by uninsured drivers or through their own negligence – since there is no one to sue.

According to a comprehensive study by the RAND Institute for Civil Justice, a think tank based in Santa Monica, California, accident victims with losses between $25,000 and $100,000 on average recoup only about one-half (56 percent) of their losses (Figure 1).[4] For those victims whose losses exceed $100,000, the average recovery from the tort system is a paltry nine percent. Conversely, claimants with minor injuries typically receive two to three times their economic losses. It is a perversity of the tort system that the ratio of compensation to economic loss declines as the severity of the injury increases.

Figure 1. Compensation of Auto Injuries under the Tort System

As a Percent of Economic Loss

Source: Carroll, et al..

Some states have attempted to compensate for the numerous compensation gaps with a patchwork of add-on policies: uninsured motorist policies, underinsured motorist policies, medical payment policies, and personal injury protection (PIP) policies in add-on states. Other states have enacted no-fault laws, which provide automatic injury compensation without regard

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[4] Figures are gross compensation before court costs and attorneys' fees. 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 Institute for Civil Justice, 1991), 187.

to fault.[5] These measures are a *de facto* recognition that a pure liability-based system is insufficient for auto injury compensation.

The second flaw of the lawsuit-based system of compensation is its excessive cost. The typical American household has about two cars, and spends more than $1,400 annually on auto insurance.[6] Nationwide, A.M. Best data indicate that individuals spent nearly $75 billion on automobile liability premiums alone in 2001, while businesses spent another $28 billion.[7]

One of the primary factors driving up costs is the fact that the lawsuit-based nature of the system engenders widespread fraud and abuse of the system. The tort liability system is embedded with incentives to inflate insurance claims above the actual losses in order to increase damage awards. A central driver of this behavior is awards for non-economic, or "pain and suffering," damages.[8] In contrast to economic losses, such as medical bills, rehabilitation expenses and lost wages, there is no objective way to measure non-economic loss. As a result, the rule of thumb in the legal system is simply to calculate these losses as two to three times the claimant's economic (i.e., lost wages and medical bills) losses.[9] Since pain and suffering awards are calculated as up to three times medical and wage loss, there is a powerful incentive to inflate one's claimed economic damages and pursue legal action.

A study by the RAND Institute for Civil Justice confirms the widespread occurrence of such abuse. Their study found that between 35 and 42 percent of medical costs claimed in auto accidents occur in response to the incentives of the tort liability system.[10] In other words, more than one-third of all medical losses claimed in auto accidents are unnecessary or exaggerated. Even states with no-fault laws, which attempt to limit lawsuits by requiring injured parties' damages to meet a certain threshold before legal action can be taken, suffer from unnecessary and abusive patterns of litigation.[11] Ironically, most payments for pain and suffering go to less serious injuries, while victims with serious injuries often fail to recover all of their economic losses and get nothing for pain and suffering.

An additional cost driver is the high transaction costs, in the form of legal fees, imposed on claimants in auto accidents. Plaintiff attorneys' fees in auto injury cases average about one-

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[5] States that have enacted no-fault laws are Colorado, Connecticut, the District of Columbia, Florida, Georgia, Hawaii, Kansas, Kentucky, Massachusetts, Michigan, Minnesota, Nevada, New Jersey, New York, North Dakota, Pennsylvania, and Utah. Colorado, Connecticut, the District of Columbia, Georgia and Nevada later repealed their no-fault laws or allowed such laws to expire.

[6] See *supra* note 1.

[7] Insurance Information Institute, *The I.I.I. Fact Book 2003* (New York, NY: Insurance Information Institute, 2002), 26. Commercial figure includes estimate of alternative markets; see *infra* note 28.
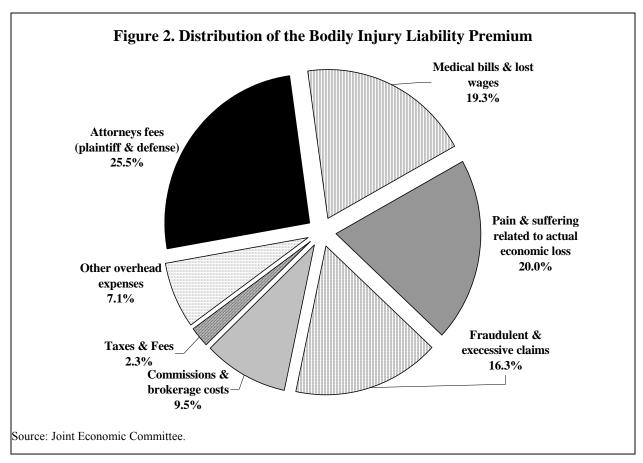
[8] See J. David Cummins and Sharon Tennyson, "Moral Hazard in Insurance Claiming: Evidence from Automobile Insurance," *Journal of Risk and Uncertainty* 12 (1996): 29-50.

[9] According to one legal textbook, "[p]ain and suffering and similar nonmonetary damages probably average three times the monetary damages in personal injury claims." Charles W. Wolfram, *Modern Legal Ethics* (St. Paul, MN: West Publishing Co., 1986), 528 at note 21.

[10] Stephen Carroll, Allan Abrahamse, and Mary Vaiana, *The Costs of Excess Medical Claims for Automobile Personal Injuries* (Santa Monica, CA: RAND Institute for Civil Justice, 1995), 23.

[11] See Sarah S. Marter and Herbert I. Weisberg, "Medical Expenses and the Massachusetts Automobile Tort Reform Law: A First Review of 1989 Bodily Injury Liability Claims," *Journal of Insurance Regulation* 10, no. 4 (Summer 1992): 512.

third (30 percent) of the payment to claimants, but often reach 40 percent or higher.[12] Defense attorneys also are highly paid and receive significant sums from the system. In 2001 alone, attorneys' fees in auto injury cases totaled approximately $17 billion. Appendix A presents the calculations behind this estimate.

Figure 2. Distribution of the Bodily Injury Liability Premium

Medical bills & lost wages 19.3%

Pain & suffering related to actual economic loss 20.0%

Fraudulent & excecssive claims 16.3%

Commissions & brokerage costs 9.5%

Taxes & Fees 2.3%

Other overhead expenses 7.1%

Attorneys fees (plaintiff & defense) 25.5%

Source: Joint Economic Committee.

        The net effect of high attorneys' fees, extensive fraud and abuse, undercompensation of serious injuries and large payments of pain and suffering for minor injuries is an inefficient use of the premiums in the tort liability system. Figure 2 presents the distribution of the typical bodily injury (BI) liability premium dollar.[13] Less than one-fifth (19.3 percent) of the BI premium goes to pay for legitimate medical bills and lost wages. In contrast, more than one-quarter (25.5 percent) of each premium dollar goes to pay attorneys' fees, and payments made for fraudulent and excessive claims consume another 16.3 percent. Pain and suffering damages received by claimants amount to 20 percent of the premium. The remaining premium is
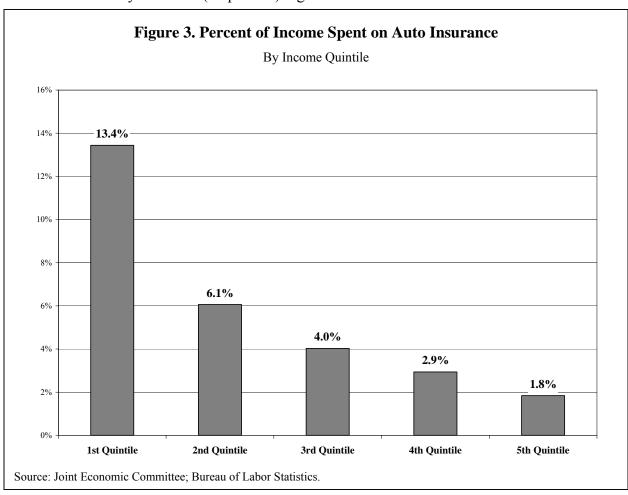
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[12] Insurance Research Council, *Paying for Auto Injuries* (Malvern, PA: Insurance Research Council, 1999), 50-51.
[13] Calculations based on 2001 premium data. The analysis uses RAND's lower bound estimate of excessive claiming behavior to identify the component of the BI premium attributable to fraudulent and excessive claiming. National Association of Insurance Commissioners, "Exhibit of Premiums and Losses [2001]," on-line at http://www.naic.org/1research/Research_Division/Stats/pc2001stat_comp.htm; Insurance Research Council, *Injuries in Auto Accidents* (Malvern, PA: Insurance Research Council, 1999), 50, 59; Insurance Research Council, *Paying for Auto Injuries*, 87; A. M. Best, *Best's Aggregates and Averages: Property-Casualty* (Oldwick, NJ: A.M. Best, 2002), 256; and Carroll, Abrahamse, and Vaiana, 23.

consumed by taxes and fees (2.3 percent), sales commissions and brokerage costs (9.5 percent) and other overhead expenses (7.1 percent).

One of the more unfortunate consequences of the flaws in the auto liability system is the particularly negative impact on the poor and residents of inner cities. As can be seen in Figure 3, families in the poorest fifth of households spend 13.4 percent of their income on vehicle insurance when they buy such coverage, more than seven times the income share of the wealthiest families.[14] Moreover, a study of the very poorest families – those with incomes below 50 percent of the poverty line – found that they spend nearly one-third of their income (31.6 percent) on auto premiums when they purchase insurance.[15]

Inner city residents also suffer from the high cost of auto insurance. A study by the National Association of Insurance Commissioners found that the average liability premium in urban areas is nearly one-third (32 percent) higher than other areas of the same state.[16]

Figure 3. Percent of Income Spent on Auto Insurance

By Income Quintile

Source: Joint Economic Committee; Bureau of Labor Statistics.

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[14] Joint Economic Committee calculations based on the 2001 Consumer Expenditure Survey. See *supra* note 1.
[15] Robert Lee Maril, "The Impact of Mandatory Auto Insurance Upon Low Income Americans," Prepared Testimony to the Committee on Commerce, U.S. Senate, 9/3/1998.
[16] Robert Klein, "Reducing Urban Auto Insurance Costs," in *Affordable Auto Insurance for Urban Communities: The Universe of Possibilities, 1995 Conference Proceedings, Milwaukee, Wisconsin, May 12-13 and Baltimore,*

Premiums in some inner cities can exceed those in neighboring suburbs by a factor of two or more. This disparity contributes to the higher cost of living in cities and may encourage middle-class families to leave for the suburbs.

One consequence of costly auto insurance for low-income urban residents is the damaging effect on job access and job mobility. Since many "good" jobs are located in the suburbs of large cities, owning a vehicle can be an important aspect of finding and holding jobs. The importance of car ownership is also apparent among welfare recipients. Transportation is a key component of finding and maintaining jobs. A 1996 study found that welfare recipients who owned a car were more likely to work and had higher monthly earnings.[17] A report from the Progressive Policy Institute concluded that "The most important response to the challenge of job access for those leaving welfare is the continued and expanded use of cars by low-income workers."[18] By making legal car ownership prohibitively expensive, the flaws of the tort system hinder the ability of welfare recipients to move from government dependency. The importance of auto insurance as a cost factor in car ownership is made apparent by the fact that the typical low-income household spends more on auto insurance in just two years than the value of their car.[19]

OVERVIEW OF AUTO CHOICE

The Auto Choice reform is designed to increase compensation for actual economic losses, lower premiums and reduce fraud and abuse by eliminating the tort system's perverse incentives. The central feature of Auto Choice is that it would make coverage for pain and suffering optional. With Auto Choice, drivers would have two options. First, they could stay with a modified version of their state's current insurance system at roughly the same cost as today, and they would retain the ability to recover pain and suffering damages. Alternatively, individuals could opt-out of the current lawsuit-based system currently in place, in favor of guaranteed coverage for economic losses, up to limits that they themselves specify.[20]

Drivers who choose the latter option would do so by purchasing personal injury protection (PIP) insurance. Drivers with PIP would be automatically and quickly compensated for all their economic losses, up to policy limits, by their own insurance company, without regard to fault. If their economic losses exceed their policy limits, PIP drivers could then sue based on fault for that remaining uncompensated amount. Drivers who opt for PIP could neither sue nor be sued for non-economic losses, with the important exceptions of injuries inflicted intentionally or as the result of drug or alcohol use. However, PIP drivers could purchase optional first-party coverage for pain and suffering in case of death and serious or permanent bodily injury. Overall,

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Maryland, December 7-8, ed. Guila P. Parker and James L. Brown (Milwaukee, WI: Center for Consumer Affairs, 1995). See also U.S. Congress, Joint Economic Committee, *Auto Choice: Impact on Cities and the Poor*, 8-12.
[17] Paul M. Ong, "Work and Automobile Ownership among Welfare Recipients," *Social Work Research* 20, no. 4 (December 1996): 255-262.
[18] Margy Waller and Mark Alan Hughes, "Working Far from Home: Transportation and Welfare Reform in the Ten Big States," Policy Report, Progressive Policy Institute (8/1/1999).
[19] See U.S. Congress, Joint Economic Committee, *Auto Choice: Impact on Cities and the Poor*, 31.
[20] This level of control stands in contrast to the current tort system, in which payments to injured persons are typically capped at the policy limits chosen by the negligent driver.

PIP drivers would see improved compensation for economic losses, since they would be able to recover from both their own PIP policy and the negligent driver's liability policy.[21]

To remain with their state's existing system, drivers would purchase tort maintenance coverage (TMC). TMC would cover accidents involving PIP drivers. When involved in single-car accidents or accidents with other TMC drivers, there would be no change whatsoever in terms of litigation or compensation. For accidents involving PIP drivers, TMC policies allow recovery of both economic and non-economic losses, much as existing uninsured motorist (UM) policies currently provide first-party, fault-based coverage for such accidents. If losses exceed TMC policy limits, TMC drivers can sue negligent PIP drivers for all of the remaining economic loss.[22] Drivers who elect the TMC option could do so at essentially no extra cost, as the added cost of the TMC policy would be roughly offset by reduced premiums for liability insurance.[23]

Auto Choice seeks to preserve the traditional state role in regulating auto insurance. First, state laws defining negligence and other legal concepts are left largely intact. Second, state insurance commissioners can block the reform if they determine that their state would not experience a specified minimum amount of savings in premiums for bodily injury liability. Finally, and most importantly, the Auto Choice proposal allows states to modify or repeal the federal reform altogether.

PREMIUM SAVINGS FROM AUTO CHOICE

Drivers who elect Auto Choice would realize substantial savings on their auto insurance premiums. The savings would result from lower administrative costs, reduced payments for pain and suffering, and fewer lawsuits. Researchers at RAND's Institute for Civil Justice have examined the cost implications of Auto Choice in a series of reports. According to their 1999

Table 1. Estimated 2003 Savings from Auto Choice

	Private	Commercial	Total
Average premium savings	21%	30%	23%
Average savings per car	$189	---	---
Savings for low-income drivers	37%	---	---
Total available savings if 100% switch (billions)	$33.7	$14.0	$47.7

Source: Joint Economic Committee calculations using data from Carroll and Abrahamse.

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[21] For a more detailed treatment of compensation under Auto Choice, see Peter Kinzler and Jeffrey O'Connell, "More for Less Under Auto Choice," in *The Economics and Politics of Choice No-Fault Insurance*, eds. Edward L. Lascher, Jr. and Michael R. Powers (Boston, MA: Kluwer Academic Publishers, 2001), 303-324.

[22] The version of Auto Choice examined here requires PIP drivers to also purchase supplementary liability insurance to provide additional coverage for certain situations, such as injuries to pedestrians and excess economic losses.

[23] Stephen J. Carroll and Allan F. Abrahamse, *The Effects of a Choice Automobile Insurance Plan on Insurance Costs and Compensation: An Analysis Based on 1997 Data* (Santa Monica, CA: RAND Institute for Civil Justice, 1999). 23.

study, based on the most recent data available, Auto Choice would reduce the cost of injury compensation for PIP drivers by approximately 56 percent.[24] The RAND analysis includes estimates for each state.

In terms of premium dollars, Auto Choice could reduce 2003 premiums nationwide by $47.7 billion, assuming all drivers elect the Auto Choice option (Table 1). As a share of total premiums (including collision and comprehensive coverages), Auto Choice yields a 21 percent average premium reduction. Premium savings from Auto Choice would average $189 per vehicle. Table 2 presents state-by-state savings estimates.

Low-income drivers would enjoy significantly higher savings – 37 percent on average. Since low-income families have less disposable income, they often forgo the optional collision and comprehensive property damage coverages. As a result, the personal injury savings represent a larger share of the liability-only policies that low-income drivers frequently purchase.

Methodology

The cornerstone of the savings estimates presented here is RAND's estimated percentage savings on the personal injury premium. The dollar estimates are Joint Economic Committee calculations that use RAND's savings estimates in conjunction with data from a variety of sources. Savings are estimated separately for each state and for commercial and private passenger lines of insurance for 2003. The calculations require several steps and generally follow the methodology set forth in O'Connell et al.[25] First, to arrive at projections of premiums for 2003, the present analysis developed and applied a series of regression models based on historical growth patterns, data from the Bureau of Labor Statistics, and interrelationships among the different lines of insurance.[26] In addition to premium levels, the analysis estimated the number of insured cars in each state.[27] Commercial premiums include both conventional insurance, as well as alternative markets (such as self-insurance).[28]

The second step is to estimate the relevant portion of premiums that would be affected by the Auto Choice proposal. This amount is calculated using the percent of each liability premium dollar allocated to personal injury coverages, a figure that averages about 68 percent in private

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[24] Notably, the RAND study does not assume any reduction in fraud or abuse of the system. If Auto Choice were to reduce fraud or abuse, consumers could realize additional savings. Ibid., 6, 19-23.

[25] Jeffrey O'Connell, Stephen Carroll, Michael Horowitz, Allan Abrahamse and Paul Jamieson, "The Comparative Costs of Allowing Consumer Choice for Auto Insurance in All Fifty States," *Maryland Law Review* 55, no. 1 (1996): 160-222.

[26] Sources used for projections include premium data from A.M. Best, *Best's Aggregates & Averages: Property-Casualty* (Oldwick, NJ: A.M. Best, various issues) and the consumer price index for motor vehicle insurance from U.S. Department of Labor, Bureau of Labor Statistics, on-line at www.bls.gov/cpi/.

[27] Estimates of the number of insured cars are based on the historical growth rate in each state using data from National Association of Insurance Commissioners, *State Average Expenditures & Premiums for Personal Automotive Insurance* (Kansas City, MO: National Association of Insurance Commissioners, various issues).

[28] Based on figures from Conning, the analysis assumes that alternative markets (which include self-insureds, captives, and risk retention groups) account for 38.7 percent of the total commercial auto insurance market. Conning & Co., *Alternative Markets: An Ever-Evolving Mosaic* (Hartford, CT: Conning & Co., 1999).

passenger insurance.[29] Third, the affected premium amount is then multiplied by RAND's estimated savings percentage from Auto Choice to arrive at a total dollar figure. Average percentage savings are calculated by dividing total dollar savings by total premiums (including property damage coverages).[30] Average savings per vehicle are calculated by dividing total dollar savings by the estimated number of insured cars. These steps are performed separately for each state, and then summed to arrive at a national figure.

In order to estimate total potential savings, the estimates presented here are based on the assumption that 100 percent of drivers switch to the new PIP policy. This report does not predict the actual number of drivers who would switch. Total dollar savings will, of course, be a function of how many drivers elect PIP. Percent and average savings, however, are relatively insensitive to how many drivers elect PIP.[31] Actual savings for particular drivers will depend on the specifics of their policy, as well as other individual risk factors. Drivers who choose to remain with their state's current system would generally see no increase in premium rates.

Data problems and significant changes in state law precluded RAND from estimating savings for Colorado, Hawaii and New Jersey. This analysis therefore assumes that injury savings for Colorado equals the average for all tort states, and for Hawaii the average for all no-fault states. Two states, Pennsylvania and New Jersey, have limited choice systems already in place. In both cases, the savings estimate is a weighted average of savings from the full-tort and limited-tort policies, where the weights are the percent of drivers electing each option. In the case of New Jersey, there were no reliable 1997 data, so this analysis assumes that savings for full-tort policies equal the national average for all tort states, and that savings for limited-tort policies equal the average for all no-fault states. For Pennsylvania, RAND estimated savings for both the full-tort and limited-tort policies.

AUTO CHOICE AND SAFETY

Along with compensating accident victims, a second goal of the auto insurance system is auto safety. One aspect of auto safety is the punishment of bad drivers. In theory, the tort system accomplishes this goal by allowing accident victims to sue negligent drivers. However, the very purpose of liability insurance is to protect negligent drivers' assets from lawsuits. In nearly all instances, collections against negligent drivers are capped at the limits of their liability insurance policy.[32] Thus, the primary penalty for bad driving under the tort system is the threat of higher premiums.

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[29] Insurance Research Council, *Trends in Auto Injury Claims: 2002 Edition* (Malvern, PA: Insurance Research Council, 2002), Appendix C; and U.S. Department of Transportation, National Highway Traffic Safety Administration, *The Cost of Injuries to Employers: A Traffic Safety Compendium*, by Ted R. Miller (Washington, DC: Government Printing Office, 1993), 19.

[30] Differences in the average percentage savings presented here and the estimates in Carroll and Abrahamse are primarily attributable to the use in this analysis of more recent premium data to estimate savings for 2003; average savings in Carroll and Abrahamse are for 1997.

[31] See Carroll and Abrahamse, Section 3.

[32] Less than five percent of all payments for auto injuries come from the at-fault driver personally. Insurance Research Council, *Paying for Auto Injuries*, 76.

The same system of penalizing bad drivers would remain in place under Auto Choice. Drivers who cause accidents – whether they are PIP drivers or TMC drivers – would face higher premiums if they negligently cause an accident. Existing state regulations governing premium rate-setting would be unaffected by Auto Choice. In addition, Auto Choice would not affect the overriding incentive for safe driving, namely self-preservation.

Auto Choice would also introduce additional incentives for auto safety. Under the tort system, liability premiums are largely based on the amount of damages the insured would cause to others in case of an accident. Safety features, such as airbags, that do not affect the severity of injuries sustained by the other driver do nothing to reduce the liability exposure of an insured driver. Thus, the fact that one of their own customers has a safer vehicle means little to an insurer, since the damage payout depends on other automobiles and their occupants.

In contrast to the tort system, insurance companies in a primarily first-party system pay for damages incurred by their own customers. Consequently, insurance companies would have a significant incentive for their customers to have safety features on their cars. A safer vehicle means lower costs in case of an auto injury. Ultimately, an Auto Choice plan could result in insurance companies offering greater discounts for safety features, which in turn would increase demand for safety features by consumers.

Some critics of the Auto Choice proposal suggest that the reduction in lawsuits could reduce the incentive for safe driving.[33] However, a recent study done by the RAND Institute for Civil Justice offers a comprehensive statistical analysis of the issue.[34] The RAND study used regression methodology to estimate the impact of no-fault laws on accident rates. In particular, the RAND study approached the analysis in a way not previously done before, by examining data that cover the years in which no-fault was first adopted. The key results of the RAND study include:

> Inspection of the differences in fatal accident rates in tort and no-fault states both before and after the implementation of no-fault between 1971 and 1976 shows no-fault had no effect on fatal accident rates during that time.… Additional analyses found little evidence that the overall accident rate or the rate of driver negligence in fatal accidents in no-fault states exceeds that in tort states. If anything, no-fault states appear to have lower overall accident rates and a lower rate of driver negligence generally than found in tort states.… **In the United States, there exists little reason to believe that no-fault auto insurance affects incentives to drive safely for the vast majority of drivers.**[35] (emphasis added)

It should be noted that comparisons between no-fault states and tort states do not bear directly on the potential impact of Auto Choice. All current no-fault states still allow, to some degree, lawsuits for pain and suffering. One of the central aspects of Auto Choice is the

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[33] See, for example, Mark S. Mandell, Association of Trial Lawyers of America, "No Punishment for Bad Drivers with Auto 'Choice' Insurance," Letter to the Editor, *The Washington Times*, 5/3/1999.
[34] David S. Loughran, *The Effect of No-Fault Automobile Insurance on Driver Behavior and Automobile Accidents in the United States* (Santa Monica, CA: RAND Institute for Civil Justice, 2001).
[35] Ibid., 37.

elimination of lawsuits for pain and suffering damages for those who choose the new policy (except in the cases of accidents caused intentionally or by drugs or alcohol). A key feature of Auto Choice is that accident victims can in all instances, regardless of type of insurance, sue negligent drivers for economic losses above the limits of their PIP or TMC policy. For instance, a driver who suffers $75,000 in medical bills and lost wages, but only had $50,000 in coverage, could sue the negligent driver for the remaining $25,000. In addition, Auto Choice legislation under consideration would require PIP drivers to carry supplemental liability insurance to cover excess economic losses that they negligently cause.

CONCLUSION

Auto insurance in the U.S. is expensive yet ineffective at compensating serious injuries. Significant resources are spent to overcompensate minor injuries, while accident victims with more extensive injuries go grossly undercompensated. Fraud and abuse of the system are endemic, driven in large measure by the incentives of the tort system. Since liability insurance is essentially a requirement for car ownership, low-income drivers are required to spend a disproportionate share of household income on premiums. Likewise, residents of inner cities typically face exorbitant premium rates.

The Auto Choice reform would present drivers with the option of an entirely new system. Accident victims would have access to greater amounts of compensation for medical costs and lost wages resulting from auto injuries. The incentives to commit fraud and to build-up claims with unnecessary treatments would be greatly reduced. Consumers and businesses alike could reap savings of close to $48 billion in 2003, averaging $189 per vehicle.

The central premise of Auto Choice is to give drivers an alternative to the current system. No driver would be forced to choose Auto Choice, but those who wanted the new system would be free to do so. Given the extensive flaws of the current tort system, it would seem reasonable to grant drivers the option of choosing the less costly, more effective coverage available under the Auto Choice proposal.

Dan Miller
Senior Economist

Table 2. Estimated State-by-State 2003 Savings from Auto Choice*

State	Personal Injury Savings	Overall Premium Savings		Total Potential Savings (millions)	Average Savings**
		Private Drivers	Low-Income		
United States	**56%**	**21%**	**37%**	**$47,743**	**$189**
Alabama	50%	17%	31%	$602	**$112**
Alaska	66%	29%	49%	$124	**$308**
Arizona	49%	17%	32%	$826	**$175**
Arkansas	57%	20%	37%	$386	**$163**
California	45%	15%	28%	$4,109	**$123**
Colorado	51%	21%	36%	$864	**$203**
Connecticut	61%	27%	45%	$966	**$297**
Delaware	55%	28%	43%	$236	**$291**
Florida	61%	29%	44%	$4,110	**$328**
Georgia	49%	14%	28%	$1,109	**$121**
Hawaii	64%	32%	48%	$228	**$252**
Idaho	54%	20%	37%	$190	**$155**
Illinois	52%	16%	32%	$1,444	**$125**
Indiana	55%	18%	34%	$800	**$130**
Iowa	53%	16%	32%	$340	**$98**
Kansas	57%	14%	31%	$300	**$108**
Kentucky	69%	31%	50%	$849	**$243**
Louisiana	70%	27%	50%	$1,032	**$272**
Maine	63%	22%	42%	$224	**$156**
Maryland	54%	21%	37%	$1,051	**$205**
Massachusetts	69%	27%	45%	$1,812	**$333**
Michigan	61%	18%	42%	$1,698	**$186**
Minnesota	69%	27%	50%	$1,144	**$240**
Mississippi	46%	17%	31%	$406	**$145**
Missouri	52%	16%	31%	$658	**$123**

* Assumes 100% of drivers switch. Percent and average savings are relatively insensitive to how many drivers switch.
** Per vehicle.
Source: Carroll and Abrahamse, and Joint Economic Committee calculations.

Table 2. Estimated State-by-State 2003 Savings from Auto Choice, cont.*

State	Personal Injury Savings	Overall Premium Savings		Total Potential Savings (millions)	Average Savings**
		Private Drivers	Low-Income		
Montana	42%	16%	30%	$131	**$122**
Nebraska	48%	15%	29%	$191	**$101**
Nevada	51%	23%	37%	$434	**$268**
New Hampshire	49%	17%	34%	$188	**$150**
New Jersey	62%	29%	52%	$2,386	**$306**
New Mexico	51%	20%	35%	$264	**$163**
New York	61%	33%	48%	$4,829	**$409**
North Carolina	45%	15%	28%	$1,006	**$99**
North Dakota	69%	20%	44%	$86	**$133**
Ohio	58%	21%	37%	$1,820	**$159**
Oklahoma	48%	16%	30%	$451	**$135**
Oregon	50%	21%	34%	$526	**$166**
Pennsylvania	52%	23%	38%	$2,152	**$201**
Rhode Island	70%	33%	52%	$288	**$329**
South Carolina	54%	21%	37%	$739	**$173**
South Dakota	60%	20%	40%	$110	**$120**
Tennessee	47%	15%	29%	$669	**$106**
Texas	45%	14%	27%	$2,357	**$158**
Utah	57%	19%	34%	$294	**$165**
Vermont	63%	22%	44%	$107	**$164**
Virginia	50%	19%	33%	$1,097	**$139**
Washington	54%	23%	39%	$1,051	**$238**
West Virginia	61%	26%	46%	$343	**$211**
Wisconsin	55%	19%	37%	$721	**$167**
Wyoming	59%	20%	41%	$80	**$148**

* Assumes 100% of drivers switch. Percent and average savings are relatively insensitive to how many drivers switch.
** Per vehicle.
Source: Carroll and Abrahamse, and Joint Economic Committee calculations.

APPENDIX A: COMPUTATION OF LEGAL COSTS
IN AUTO INJURY CASES

Automobile accident litigation is the most common type of tort litigation pursued in the United States.[36] Legal costs constitute a major portion of liability premiums and represent a significant source of income for attorneys specializing in auto accident litigation. This Appendix presents an estimate of the magnitude of attorneys' fees in automobile personal injury cases.

Based on the data and calculations presented here, fees paid to attorneys in automobile personal injury cases totaled $16.7 billion in 2001 (Table A.1). Of this total, $11.9 billion (71 percent) went to lawyers representing plaintiffs, while $4.8 billion (29 percent) went to defense attorneys.

Table A.1. Attorneys' Fees in Auto Injury Cases, 2001 (amounts in billions)

	Plaintiff Attorneys	Defense Attorneys	Total Attorneys
Private Passenger	$7.86	$2.98	$10.84
Commercial	$4.06	$1.84	$5.90
Total	**$11.93**	**$4.82**	**$16.74**

Note: Components may not sum to totals due to rounding.
Source: Joint Economic Committee.

METHODOLOGY

Estimating attorneys' fees in auto injury cases involves several steps. The basic approach for plaintiff attorneys is to calculate total dollars paid to claimants, and then to estimate what percentage ends up going to pay attorneys' fees. For defense attorneys, published data on defense costs are broken down to identify the portion related to personal injury cases. The results presented in Table A.1 are a rough approximation only. As indicated below, these calculations draw on data from different sources and sometimes from different years, depending on data availability. A more detailed discussion of the assumptions and methodology follows. Table A.2 and Table A.3 (at the end of the Appendix) present a detailed account of the calculations.

PRIVATE PASSENGER POLICIES

Direct earned premiums in 2001 were $75 billion for private passenger liability policies.[37] The ratio of losses to premiums (the incurred loss ratio) was 76.4 percent.[38] This ratio indicates the proportion of total premium dollars that was paid out to claimants. Multiplying the two numbers yields an estimate of $57.3 billion in gross payments to claimants.

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[36] U.S. Department of Justice, Bureau of Justice Statistics, *Tort Trials and Verdicts in Large Counties, 1996* (Washington, DC: Bureau of Justice Statistics, 2000).
[37] National Association of Insurance Commissioners, "Exhibit of Premiums and Losses [2001]," on-line at http://www.naic.org/1research/Research_Division/Stats/pc2001stat_comp.htm.
[38] Ibid.

Gross payments to claimants (from which plaintiff attorneys are paid) can be broken down by type of insurance policy according to data from the Insurance Research Council (IRC) on the distribution of paid losses. According to IRC data, approximately 31.9 percent of payments were made for property damage (PD) liability claims, with the remaining 68.1 percent distributed over claims under the various personal injury (PI) policies of bodily injury (BI) liability, uninsured and underinsured motorist (UM), medical payments (MP), and personal injury protection (PIP).[39] Thus, all personal injury policies accounted for an estimated $39.02 billion in claims payments.

Plaintiff Attorneys

For each type of policy, the IRC's 1997 survey of closed claims provides an estimate of the percentage of payments that were made to claimants with attorney representation. Approximately 82 percent of BI payments were made to represented claimants, as compared to 79 percent for UM[40] claimants, 39 percent for MP claimants, and 53 percent for PIP claimants.[41]

For BI and UM claims, attorneys' fees are calculated by multiplying total claims dollars paid under each coverage by the percent of dollars paid to represented claimants and by the attorneys' fee share. The analysis makes the conservative assumption that plaintiff attorneys charge an average of 30 percent of their clients' settlements.[42] The formula to estimate the amount of attorneys' fees is as follows:

$$\text{Plaintiff Attorneys' Fees} = \text{Total payments to claimants} * \text{Percent of payments made to claimants with attorney} * \text{Attorney fee share}$$

With respect to BI and UM claims, the calculations yield the following results (all dollar amounts are in billions):

Plaintiff attorneys' fees: BI = $24.5 * 82% * 30% = $6.0
Plaintiff attorneys' fees: UM = $5.0 * 79% * 30% = $1.2

To calculate attorneys' fees in MP and PIP cases, an additional step is required because these are first-party policies. In many MP/PIP cases claimants with an attorney also file a third-

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[39] The split between property damage liability and personal injury claim payments is based on 1999 data. The distribution within personal injury claims comes from 1997 data. Insurance Research Council, *Injuries in Auto Accidents: An Analysis of Auto Insurance Claims* (Malvern, PA: Insurance Research Council, 1999), 1; Insurance Research Council, *Trends in Auto Injury Claims: 2002 Edition* (Malvern, PA: Insurance Research Council, 2002), Appendices A and C.

[40] In the present analysis, UM refers to both uninsured motorist as well as underinsured motorist policies. The figure of 79 percent is an average of the two types of policies weighted by relative premium volume. For uninsured policies, the weight used was 0.59 and the percentage paid to represented claimants was 75 percent. For underinsured policies, the amounts were 0.41 and 85 percent respectively. Insurance Research Council, *Injuries*, 59.

[41] Insurance Research Council, *Injuries*, 59.

[42] Although 30 percent is used here, the standard contingency fee for many personal injury attorneys is 33 to 40 percent. Insurance Research Council, *Paying for Auto Injuries* (Malvern, PA: Insurance Research Council, 1999), 50-51.

party liability claim (either BI or UM). Claimants who successfully recover on a third-party liability claim would therefore pay their attorney out of the liability payment, and such attorneys' fees would be captured under the BI and UM policies noted above. However, MP/PIP claimants who *unsuccessfully* pursue a third-party claim would have to pay their attorneys out of their MP/PIP payments. Thus, when calculating attorneys' fees under MP/PIP claims, the estimate of claims dollars paid to represented claimants should be discounted to exclude those represented claimants who successfully recover on a third-party liability claim. In other words, the analysis assumes that attorneys' fees are paid out of the MP/PIP payments only if any third-party claim fails. This analysis uses RAND's 1991 estimate of unsuccessful third-party recovery of 45.4 percent.[43] With respect to MP and PIP claims, the calculations yield the following results:

Plaintiff attorneys' fees: MP   =   *$2.5* * * *39%* * * *45.4%* * * *30%* = *$0.13*
Plaintiff attorneys' fees: PIP   =   *$7.0* * * *53%* * * *45.4%* * * *30%* = *$0.51*

Thus, claims made against private passenger auto insurance policies in 2001 produced approximately $7.86 billion in plaintiff attorneys' fees.

Defense Attorneys

Defense attorneys' fees are estimated using the direct defense and cost containment expense (DDCCE) ratio. The DDCCE ratio measures legal defense costs as a percentage of earned premiums. Although the DDCCE includes a number of factors, attorneys' fees account for virtually all of the DDCCE. NAIC data indicate that the DDCCE ratio for private passenger auto liability policies (personal injury plus property damage) was 4.67 percent in 2001.[44]

However, the present analysis is concerned only with attorneys' fees in personal injury cases. Thus, it is necessary to estimate DDCCE in property damage cases so such costs can be subtracted from the total DDCCE as published. Since no direct measure of DDCCE in PD liability claims is available, a proxy is needed. This analysis assumes that the DDCCE in PD liability claims equals the DDCCE in Fire and Allied insurance policies (two lines of property damage insurance). According to A.M. Best data, the DDCCE ratio for Fire and Allied lines combined was 2.2 percent in 2000.[45] The DDCCE ratio in personal injury cases can then be calculated as a residual, equaling 5.8 percent.[46] Total personal injury premiums are assumed to

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[43] 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 Institute for Civil Justice, 1991), 79 at note A, 112.

[44] National Association of Insurance Commissioners.

[45] A.M. Best, *Aggregates & Averages: Property/Casualty* (Oldwick, NJ: A.M. Best, 2001), 256.

[46] The figure of 5.8 percent for PI liability was arrived at by treating the 4.7 percent figure (for PI and PD liability combined) as a weighted average of the DDCCE for each of the two sub-lines, where the weights are the respective premium shares, as such:

DDCCEE total =   [(PD weight)*(DDCCEE PD)] + [(PI weight)*(DDCCEE PI)]

Substituting in the available data and solving for the missing variable, DDCCEE PI, yields the following equation:

$$\text{DDCCEE PI} = \frac{4.67\% - (31.9\%)*(2.2\%)}{68.1\%} = 5.83\%$$

correspond to the distribution of paid losses (i.e., PI premiums equal 68.1 percent of total premiums). Multiplying total PI premiums of $51.1 billion by 5.8 percent yields an estimate of $2.98 billion in defense attorneys' fees.

COMMERCIAL POLICIES

Total commercial auto liability premiums in 2001 were approximately $26.5 billion. This figure includes both conventional commercial policies as well as an estimate of the alternative segment of the market.[47] The ratio of losses to premiums (the incurred loss ratio) for commercial policies was 81.4 percent in 2001, indicating that such policies paid out approximately $21.6 billion to claimants.[48]

Data from the U.S. Department of Transportation indicate that approximately 23.5 percent of commercial auto liability premiums go to cover property damage liability.[49] The present analysis assumes that the remaining 76.5 percent of premiums, totaling $16.5 billion, has the same characteristics as private passenger BI claims.[50] Using the same approach as above yields:

*Plaintiff attorneys' fees: Commercial   = $16.5   *   82%   *   30%   = $4.06*

The estimate of defense attorneys' fees stemming from commercial policies follows the same methodology used for private passenger policies. Data from NAIC indicate that commercial PI policies have a somewhat higher DDCCE of 9.1 percent, yielding an estimate of $1.84 billion in defense attorneys' fees.

Conclusion

This analysis has presented detailed calculations to estimate the magnitude of attorneys' fees in personal injury auto accidents. These calculations indicate that attorneys, both plaintiff and defense, were paid approximately $16.7 billion in 2001 to handle auto accidents involving injuries to people. On average, more than one premium dollar out of five (23.5 percent) goes to pay attorneys' fees in the auto injury insurance system, although different lines have different averages.[51]

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[47] Based on figures from Conning, this analysis assumes that alternative markets (which include self-insureds, captives, and risk retention groups) account for 38.7 percent of the total commercial auto insurance market. For the sake of simplicity, the analysis assumes that alternative markets exhibit the same characteristics as conventional commercial auto liability policies. Conning & Company, *Alternative Markets: An Ever-Evolving Mosaic* (Hartford, CT: Conning & Company, 1999).

[48] National Association of Insurance Commissioners.

[49] U.S. Department of Transportation, National Highway Traffic Safety Administration, *The Cost of Injuries to Employers: A Traffic Safety Compendium*, by Ted R. Miller, DOT HS 807-970 (Washington, DC: Government Printing Office, 1993), 19.

[50] Since workers compensation already provides first-party coverage for on-the-job injuries, businesses generally have no need for first-party auto insurance coverage.

[51] For example, attorneys' fees in the third-party liability lines of BI and UM account for a higher percentage of premiums, while attorneys' fees in the first-party liability lines of MP and PIP are lower.

Table A.2. Calculations for Attorneys' Fees in Private Passenger Auto Liability Policies

| | | Private Passenger Liability | | | | | |
| | | Property | Personal Injury | | | | |
	Total	Damage	BI	UM	MP	PIP	PI Subtotal
Aggregate premiums and paid losses							
Direct liability premiums earned	$75.05						
Incurred loss ratio	76.39%						
Total paid losses	$57.33						
Percent distribution			31.93%	42.73%	8.80%	4.29%	12.24%	
Dollar distribution			$18.31	$24.50	$5.05	$2.46	$7.02	$39.02
Plaintiff attorneys' fees							
Percent of losses paid to represented claimants			82.0%	79.1%	39.0%	53.0%	
Percent of claims covered by contingency fee			100.0%	100.0%	45.4%	45.4%	
Fee share of plaintiff lawyers			30.0%	30.0%	30.0%	30.0%	
Subtotal: Plaintiff attorneys			$6.03	$1.20	$0.13	$0.51	**$7.86**
Defense attorneys' fees							
Personal injury premiums							$51.08
Legal defense cost (DDCCE) ratio to premiums							5.83%
Subtotal: Defense attorneys							**$2.98**
Total lawyer fees in personal injury cases							**$10.84**

Note: Components may not sum to totals due to rounding.
Source: Joint Economic Committee calculations. See text and accompanying footnotes for data sources.

Table A.3. Calculations for Attorneys' Fees in Commercial and Total Auto Liability Policies

		Commercial Liability*		Total
		Property	Personal	Personal Injury
	Total	Damage	Injury	(all lines)
Aggregate premiums and paid losses				
Direct liability premiums earned	$26.53			
Incurred loss ratio	81.38%			
Total paid losses	$21.59			
Percent distribution		23.50%	76.50%	
Dollar distribution		$5.07	$16.52	
Plaintiff attorneys' fees				
Percent of losses paid to represented claimants			82.0%	
Percent of claims covered by contingency fee			100.0%	
Fee share of plaintiff lawyers			30.0%	
Subtotal: Plaintiff attorneys			**$4.06**	**$11.93**
Defense attorneys' fees				
Personal injury premiums			$20.30	
Legal defense cost (DDCCE) ratio to premiums			9.06%	
Subtotal: Defense attorneys			**$1.84**	**$4.82**
Total lawyer fees in personal injury cases			**$5.90**	**$16.74**

* Commercial figures include both conventional and alternative markets. See *supra* note 47 and accompanying text.
Note: Components may not sum to totals due to rounding.
Source: Joint Economic Committee calculations. See text and accompanying footnotes for data sources.

APPENDIX B: SAVINGS FROM EARLY OFFER REFORM

A legal reform that applies to all areas of personal injury litigation is early offer reform. Critics of the personal injury tort system have promoted various versions of such reforms, including legislation in the U.S. Congress.[52] A previous Joint Economic Committee study examined one version of early offer reform, as have numerous legal scholars.[53]

Generally speaking, early offer reforms limit attorneys' contingency fees, which typically run one-third of the award and can reach 40 percent or 50 percent, in cases settled quickly without trial. Early offer reforms are targeted to cases where the defendant makes and the claimant accepts a settlement offer within a 60-day or 90-day window. The motivation behind early offer reforms is twofold. The first is to provide a mechanism to quickly compensate personal injury claims. For most personal injury claims, it typically takes at least three years for a case to progress from incident to a jury verdict.[54] The second goal is to oblige plaintiff attorneys to adhere to ethics rules which require contingency fees to be reasonable.[55] For cases that settle quickly, claimants' attorneys often spend little time on the case, and there is little "contingency" or risk in cases where the defendant offers to settle early. In any case, the claimant could refuse without penalty the defendant's early offer.

DESCRIPTION OF PROPOSAL

This Appendix presents estimates of savings that would result from one version of early offer reform. Although this early offer reform would apply to all personal injury cases, savings in auto injury cases are presented here because of easy data availability. The major provisions of this early offer reform are:[56]

- Attorneys for personal injury claimants must notify defendants of the claims.
- Defendants then have 60 days to investigate and research the claim, and to make an early settlement offer if they wish to do so.
- If the defendant accepts the early settlement offer, the fee for the plaintiff attorney is limited to the attorney's customary hourly rate for time actually spent on the case.
- If the defendant accepts the early settlement offer, the attorney's fee could not in any circumstance exceed 10 percent of the first $100,000 of the settlement amount and 5 percent of any amount over $100,000.
- The claimant is under no obligation to accept an early offer, nor is the defendant obligated to make an early settlement offer.

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[52] Of particular interest, see H.R. 3084 introduced in 1985 (99th Congress) by Representative Richard Gephardt.
[53] U.S. Congress, Joint Economic Committee, *Improving the American Legal System: The Economic Benefits of Tort Reform* (1996); see also Lester Brickman, "ABA Regulation Of Contingency Fees: Money Talks, Ethics Walks," *Fordham Law Review* 65 (October 1996): 247-298.
[54] Jury Verdict Research, *Current Award Trends in Personal Injury*, 2002 Edition (Horsham, PA: LRP Publications, 2003), 12, 15, 19, 23.
[55] See American Bar Association, Standing Committee on Ethics and Professional Responsibility, *Formal Opinion 94-389* (Chicago, IL: American Bar Association, 1994).
[56] The proposal is summarized in Daniel Wise, "Group Targets Lawyer Fees in Rapidly Settled Personal Injury Suits," *New York Law Review*, 5/27/2003. A sample legal petition setting forth all the provisions and arguments is available online at http://ourcommongood.com.

- If no early settlement is reached, the claim proceeds normally under existing rules.

PREMIUM SAVINGS

If this reform proposal were implemented, individuals would receive substantial savings from reduced attorneys' fees. Since little research has been done on the potential effect of early offer reform, Table B.1 presents two estimates for each state, based on different assumptions. Total savings under these assumptions are $3.4 billion and $4.3 billion. The former estimate reflects the more conservative assumptions of Scenario 1, while the latter estimate is based on the assumptions of Scenario 2 (see Table B.2 and accompanying text for additional detail). Readers should use the estimates based on the assumptions they feel are most appropriate. The text below presents a sensitivity analysis and description of the methodology and assumptions.

Table B.1. Potential Savings on Auto Insurance from Early Offer Reform

State	Savings	State	Savings
United States	**$3,436 - $4,301**	Missouri	$44.0 - $54.8
Alabama	$37.1 - $46.3	Montana	$9.6 - $12.0
Alaska	$7.8 - $9.7	Nebraska	$14.8 - $18.5
Arizona	$59.3 - $74	Nevada	$33.7 - $42.1
Arkansas	$25.1 - $31.3	New Hampshire	$14.5 - $18.2
California	$349.4 - $437.0	New Jersey	$214.4 - $270.0
Colorado	$57.3 - $71.2	New Mexico	$17.4 - $21.7
Connecticut	$70.4 - $88.4	New York	$345.7 - $433.6
Delaware	$15.9 - $19.9	North Carolina	$74.2 - $92.7
District of Columbia	$5.4 - $6.8	North Dakota	$3.9 - $4.8
Florida	$273.9 - $342.9	Ohio	$119.7 - $149.8
Georgia	$77.2 - $96.5	Oklahoma	$30.4 - $37.9
Hawaii	$13.6 - $16.9	Oregon	$38.8 - $48.3
Idaho	$11.6 - $14.5	Pennsylvania	$184.1 - $230.9
Illinois	$106.4 - $133.3	Rhode Island	$22.0 - $27.7
Indiana	$54.2 - $67.8	South Carolina	$56.3 - $70.7
Iowa	$19.1 - $23.8	South Dakota	$6.1 - $7.6
Kansas	$15.6 - $19.3	Tennessee	$44.9 - $56.1
Kentucky	$49.2 - $61.4	Texas	$207.4 - $259.4
Louisiana	$67.3 - $84.5	Utah	$17.8 - $22.2
Maine	$10.6 - $13.2	Vermont	$5.6 - $7.0
Maryland	$81.7 - $102.5	Virginia	$79.7 - $99.7
Massachusetts	$116.6 - $146.4	Washington	$82.3 - $102.9
Michigan	$83.0 - $103.5	West Virginia	$23.6 - $29.5
Minnesota	$63.1 - $78.7	Wisconsin	$45.6 - $56.9
Mississippi	$23.9 - $29.9	Wyoming	$5.3 - $6.6

Note: Amounts in millions of dollars.
Source: Joint Economic Committee calculations. See Table B.2 and accompanying text for additional detail.

SENSITIVITY ANALYSIS

To assess the robustness of the figures in Table B.1, this analysis includes a sensitivity analysis to estimate savings under a variety of assumptions. The analysis considers two Scenarios, each of which includes a Low, Medium and High estimate. Thus, there are in total six different combinations of assumptions, summarized in Table B.2 below. The estimates in Table B.1 reflect the assumptions of the Medium estimates from Scenarios 1 and 2, respectively.

Table B.2. Summary of Key Assumptions in Analysis of Early Offer Reform

	Scenario 1			Scenario 2		
	Low	Medium	High	Low	Medium	High
Early Offers accepted	33%	50%	67%	33%	50%	67%
Current system:						
Plaintiff attorney fee	30%	30%	30%	33%	33%	33%
Defense attorneys: DDCCE	5.83%	5.83%	5.83%	5.83%	5.83%	5.83%
Proposed reformed system:						
Plaintiff attorney fee for:						
Amounts ≤ $100,000	10.0%	10.0%	10.0%	7.5%	7.5%	7.5%
Amounts >$100,000	5.0%	5.0%	5.0%	2.5%	2.5%	2.5%
Defense attorneys: DDCCE	1.94%	1.94%	1.94%	1.31%	1.31%	1.31%

Source: See text.

Table B.3 presents the estimated U.S. savings for each combination of assumptions. As the data show, the potential savings from the early offer reform are substantial, regardless of which set of assumptions are used. Under the most conservative set of assumptions, attorneys' fees would be reduced by nearly $2.3 billion in automobile personal injury cases. Under the most generous set of assumptions, the savings would reach $5.7 billion. In the two Medium sets, the estimated savings are $3.4 billion and $4.3 billion, respectively.

Table B.3. Estimated Savings for Early Offer Reform under Different Assumptions

	Scenario 1			Scenario 2		
	Low	Medium	High	Low	Medium	High
Plaintiff Attorneys	$1,634	$2,451	$3,268	$2,104	$3,156	$4,208
Defense Attorneys	$657	$986	$1,314	$764	$1,146	$1,528
Total Attorneys	**$2,291**	**$3,436**	**$4,582**	**$2,868**	**$4,301**	**$5,735**

Note: Amounts in millions of dollars.
Source: Joint Economic Committee calculations.

METHODOLOGY

The savings estimates presented here indicate the reduction in attorneys' fees that would result from this early offer reform. In order to estimate the effect of the reform, two sets of calculations are needed: a "baseline" estimate of attorneys' fees with no reform in place, and a "reform" estimate that includes the effects of the reform's provisions. The difference between

these two estimates is the estimated savings.[57] This procedure is repeated for all fifty states, and under each of the six sets of alternative assumptions presented above. The calculations use 2001 premium data.

For baseline estimates, the methodology used to calculate attorneys' fees is largely the same as that utilized in Appendix A. For plaintiff attorneys' fees, paid premiums are disaggregated to estimate payments made to claimants. That amount is then multiplied by the percent of dollars that are paid to claimants with an attorney, and then by the attorney's fee share. These calculations are done separately for third-party liability policies and first-party policies. Defense attorneys' fees are based on the direct defense and cost containment expense (DDCCE) ratio. The DDCCE ratio measures legal defense costs as a percentage of earned premiums and consists mainly of attorneys' fees. The DDCCE ratio is multiplied by the relevant portion of premiums to arrive at an estimate of defense attorneys' fees. Estimates of fees with the reform require additional steps to account for the different caps on attorneys' fees based on the size of the settlement amount. Essentially, the same analysis as above is carried out, but payments to claimants must be broken out to amounts below and above the $100,000 threshold.

The following bullet points explain what the different assumptions signify and discuss the values used:

- *Percent of cases in which an early settlement offer is made by the defendant and accepted by the plaintiff.* Since there are no data on which to directly base an estimate, a range of possible values is considered: 33 percent, 50 percent, and 67 percent.
- *Average plaintiff attorneys' fee in the current system.* Two values are tested: 30 percent and 33 percent. The former value reflects the results of a survey that asked about attorneys' fees in automobile accident claims,[58] while the value of one-third is generally considered the industry's standard rate.
- *Average plaintiff attorneys' fee under the proposed reform.* The assumption is actually twofold, as there are different caps on attorneys' fees for amounts for the first $100,000 and for any subsequent amounts. Lacking an empirical basis for making an assumption, differ values are used in each category. For settlements up to $100,000, the analysis uses values of 7.5 percent and 10 percent; for more than $100,000, the values are 2.5 percent and 5 percent.
- *Average defense attorneys' fee in the current system.* In 2001, the direct defense and cost containment expense (DDCCE) ratio for the automobile personal injury policies was 5.83 percent.[59] The same value is used for all states.
- *Average defense attorneys' fee under the proposed reform.* The analysis assumes that there will be a reduction in defense attorneys' fees proportional to the reduction in average plaintiff attorneys' fees for settlements up to $100,000. Thus, Scenarios 1 and 2 assume defense attorneys' fees drop to a DDCCE ratio of 1.94 percent and 1.31 percent, respectively.

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[57] The analysis does not attempt to estimate what change there would be, if any, in net payments to claimants. Theoretically, the effect on net payments to claimants is ambiguous. Opponents of contingency fee reform contend that contingency fees encourage lawyers to maximize gross payments. Alternatively, claimants would no longer have to pay 30 percent or more of the settlement amount to their attorneys.

[58] Insurance Research Council, *Paying for Auto Injuries* (Malvern, PA: Insurance Research Council, 1999), 50-51.

[59] See notes 44 to 46 and accompanying text for data sources and calculations.

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