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No-Fault Automobile Insurance — An Attempt at a Realistic Evaluation

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Introduction

No-fault automobile insurance has become a national issue. It is being discussed by motorists of all walks of life. When a subject gets this much attention there is going to be considerable misleading and inaccurate information that will accompany the facts and realistic assumptions regarding it. The problem is accentuated in this instance by the input of vested interest groups who hope to influence the changes that are going to take place in the current automobile insurance scheme. These groups are guilty of exaggerations and generalizations that do not do justice to the important facts that relate to the subject of no-fault automobile insurance.

The Objective

In this paper it will be my objective to evaluate realistically and impartially the no-fault automobile insurance issue. In my judgment the office of state insurance commissioner provides the best opportunity of all to become familiar with the inadequacies of the present system as well as the possibilities of improving the system. Further I am convinced that state insurance commissioners may occupy the only position that offers the proper perspective from which to evaluate the various forms of modified no-fault insurance law which may be proposed.

Historical Setting

Columbia Plan

Let us put the subject in its proper historical setting. The first no-fault proposal for automobile insurance was presented in 1932 and was known as the "Columbia Plan," since it was the result of an intensive Columbia University study of the automobile insurance environment. The plan suggested a compensation system which would eliminate damages for pain and suffering. The right to tort recovery was abolished and replaced by a schedule of benefits similar to those found in workmen's compensation laws. The plan

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was viewed as an interesting and novel idea but few seemed to take it seriously enough to prepare a bill for state legislatures to consider.

Saskatchewan Plan

Fourteen years later, however, the Providence of Saskatchewan, Canada, did enact a low-benefit compulsory automobile insurance for compensation in cases of death, loss of income arising out of the accident and medical payments — all without regard to fault. This no-fault system continued to operate satisfactorily for this Canadian Providence.

Keeton-O'Connell

It was not until the decade of the 1960's that people in this country began to question seriously the cost-benefit relationship of their automobile insurance. Increasing discontent with the automobile insurance environment created the opportune time for professors Keeton and O'Connell to publish their best selling book: *Basic Protection for the Traffic Victim: A Blueprint for Reforming Automobile Insurance.*[1] The 1965 publication was extremely critical of the present tort liability system as applied to automobile insurance and proposed significant changes in the system — all centered around the no-fault concept.

In reality Keeton and O'Connell's solutions to the automobile insurance problems were not new, but had been around for a long time. People were merely becoming increasingly dissatisfied with the automobile insurance environment and were more receptive to any change that might improve the system. This public attitude was captured by numerous federal politicians who began probes and studies into the reasons for increased automobile insurance costs, adverse claims handling and underwriting, and the insolvencies of many automobile insurance carriers. The insolvency issue was the focal point in the early 1960's but by the latter part of the decade the focus had broadened to the entire automobile insurance environment.

Department of Transportation Study

As a result of the widespread interest, Congress authorized in 1968 the beginning of a two million dollar study by the Department of Transportation to include all aspects of the automobile insurance

[1] R. KEETON & J. O'CONNELL, BASIC PROTECTION FOR THE TRAFFIC VICTIM: A BLUEPRINT FOR REFORMING AUTOMOBILE INSURANCE (1965).

subject. The study which included seventeen separate reports was completed late in 1970. Shortly thereafter Secretary of Transportation John Volpe publicly stated that if satisfactory change was to take place in the field of automobile insurance, it would have to center around the adoption of the no-fault concept. Secretary Volpe took the position that the states should be given an opportunity to enact their own forms of no-fault legislation; but in the event they did not act, he would advocate a federal no-fault insurance law that would bring the federal government into the regulation of automobile insurance. This also seems to be the position of Congress in general.

The Emerging Facts

It is relatively clear at this stage that there are two general facts emerging that have significant bearing on no-fault automobile insurance. First, the present system is not working to the satisfaction of the insurance buying public; and second, the federal government has told the states that if they do not pass some form of no-fault automobile insurance at the state level, the federal government will pass legislation for them.

The dissatisfaction with the present system has been broadly expressed and the criticisms were reiterated in the Department of Transportation's study. The study concluded that the present system is inefficient and costly — less than fifty cents of every dollar of premiums paid for liability insurance flows back as claims benefit payments. The DOT study also concluded that the present system does not compensate losses adequately in view of the fact that an estimated $10.5 billion of economic loss was experienced in 1969 while the system compensated only $6.5 billion of those losses. What is also significant is that those seriously injured too often go without compensation for their losses. For example, it was estimated that only about forty-five percent of those killed or seriously injured recover anything at all from the tort liability system. Yet, the less seriously injured fared much better and in many cases were more than indemnified for their losses. Losses of less than $1,000 sustained thirty-three percent of total losses but received forty-six percent of total tort payments.[2]

Another common criticism of the present system is that it is slow to respond to the financial needs of the injured. The benefits

[2] DEPARTMENT OF TRANSPORTATION, MOTOR VEHICLE CRASH LOSSES AND THEIR COMPENSATION IN THE UNITED STATES, AUTOMOBILE INSURANCE AND COMPENSATION STUDY (1971).

are not provided promptly nor in installments that relate to the injured's financial losses. Thus, the system does not motivate the injured party to begin an immediate rehabilitation program.

A criticism of the system as it exists in West Virginia is that under the present financial responsibility law the motorist does not have to show financial responsibility until after the first accident. Only about sixty-five to seventy percent of West Virginia's motorists carry any automobile liability insurance. This means that about every third driver who passes you on our highways has no liability insurance and probably cannot meet his financial responsibility if he is found to be the negligent party in an automobile accident.

The Department of Transportation studies also found that many motorists have experienced difficulty communicating effectively with someone else's insurance company if the other party is at fault. There often exists a most impersonal and indifferent attitude toward the party experiencing the loss when he is trying to collect from an insurance company with which he may never again have contact.

Congress has become aware of the broad public dissatisfaction with the present automobile insurance environment. As a result they are prepared to act if the states are unwilling to change the present system. Such action at the federal level would bring under their regulatory jurisdiction an industry which has been regulated by the states for well over one hundred years.

State Regulation Should Prevail

This writer is a strong proponent for state regulation of insurance. It is an accepted fact that there are numerous activities of our dynamic and complex life that may best be regulated by the federal government, but insurance is not one of them. When viewed in its proper perspective, there is no legitimate reason why states cannot do an effective job of regulating automobile insurance as well as the entire field of insurance. It would be unfortunate if we pass along to the federal level yet another responsibility which can and should be handled at the state level.

State regulation provides increased capacity for experimentation during the developmental stages of a no-fault automobile loss reparation system, with a corresponding decrease in the danger of major displacements which could occur under a monolithic federal system. There have been no major changes in this system since it began,

and there is no assurance that any one individual or group of individuals have the optimum solution in the form of a proposed automobile insurance law. Thus, with each state legislature making a sincere effort to develop an insurance scheme for its own state, the opportunity to experiment with a variety of no-fault plans is possible. Various degrees of the no-fault concept and variations of techniques in applying it can be put into practice on a state by state implementation.

In reality then there are no alternatives left for the states other than those which include the introduction of the no-fault concept into the state's automobile loss reparation system.

An Explanation of the No-Fault Concept

At the risk of insulting the reader's intelligence, it is appropriate that the meaning of the no-fault insurance concept be reviewed once again. No-fault automobile insurance is often described as first party insurance protection as opposed to third party protection. Examples of popular first party insurance protection coverages used today are fire insurance, health insurance, and automobile collision insurance. Under these plans the insurance company pays your loss regardless of who was responsible for it. If your neighbor carelessly let a fire get out of control and the fire spread to your house and destroyed it, your own fire insurance would pay the loss as soon as a proof of loss had been placed in the hands of the insurer. A similar example is a health insurance contract. If the insured enters the hospital with pneumonia, the health insurance policy agrees to pay regardless of how the insured contacted the illness. Clearly there is no concern regarding payment even though the family maid may have inadvertently left the insured's bedroom window open the night before the illness became acute, and it was clearly her negligent act that brought on the pneumonia.

Third-party insurance is liability insurance designed to protect the insured from his own negligent or wrongful acts that may cause bodily injury or physical damage loss to another party. The primary objective of this type of insurance has been to protect the financial interests of the insured with little concern for the complete economic compensation of the injured third party.

A Modified No-Fault Insurance is Recommended

Most recommendations concerning the present automobile loss reparation system have not advocated a total switch to the no-fault

concept but contemplate some combination of the two. The Department of Transportation study made certain recommendations pertinent to any system the states may consider. The system as envisioned by DOT should be based on compulsory first-party insurance for all motor vehicle owners covering all economic losses (above voluntarily accepted deductibles) up to reasonably high limits. Insurers should be free to offer additional insurance coverage above these limits. Victims should retain their present right to sue in tort for specified intangible losses, but the right should be restricted to the truly serious cases.[3]

Effects of a Modified No-Fault Insurance Law

At this point it is important that we attempt to analyze the possible effects of a modified no-fault insurance law similar to that recommended by the Department of Transportation.

It is Not a Panacea

Many will imply that no-fault automobile insurance will cure the current ills of the automobile insurance environment. This at best is only partially true because any automobile insurance system will continue to be adversely affected by conditions in our society outside the insurance field. Examples of these include the failure of the automobile manufacturer to build a car for both passenger safety and durability; the failure of hospitals to maintain adequate cost control; the failure of our judicial system to control the type of driver given the privilege of a driver's license; and the failure of government to provide a reasonably safe highway network. No-fault automobile insurance can have only limited success in view of these factors which influence any automobile insurance plan.

The Cost-Saving is Uncertain

Many will attempt to emphasize the cost-saving that will be realized with a no-fault automobile insurance plan. The fact of the matter is that no one really knows what the long-term costs for such a plan will be to the motorist. There are indications that the short-run effect is lower cost insurance under the no-fault concept. Massachusetts, the first state to adopt a modified no-fault law, has experienced significantly lower insurance costs for the first nine months of experience of their plan. This appears to have been

[3] *Id.* at 133.

partially brought about by less litigation under the no-fault plan. It is logical to assume that the limitation on suits for pain and suffering associated with less serious injuries will reduce the total claim costs. Regardless of the optimism expressed regarding short-run cost reduction, there is no legitimate means of estimating what the real costs of such a plan will be three to eight years from now. The other cost variables mentioned previously could conceivably keep the overall cost of automobile insurance on an increasing trend, counterbalancing any savings experienced through use of the no-fault concept.

Efficiency of Premium Dollar Utilization

Where the no-fault insurance concept should greatly improve our present tort liability system is in efficiency of utilization of the premium dollar paid for the insurance. Instead of something less than fifty percent of the premium dollar returning for claims payment, the no-fault concept should make it possible to realize close to eighty percent of the premium for claims payment.

Equitable Distribution of Claims Payments

Another significant improvement that should result from a no-fault system is a more equitable distribution of claim payments because the emphasis under no-fault is placed upon economic or out-of-the-pocket losses which are readily measurable. The less serious accidents, which in the past have provided too many opportunities for negotiating the insurance companies into higher payments than the real economic loss suffered, will be paid on an "actual loss" basis. These are the claims often categorized as "nuisance claims" by the insurer who wants to keep from going to court whenever it is financially possible, even if it means paying more than the actual amount of loss.

Prompt Payment of Claims

Another important improvement that can be expected in a no-fault plan is the prompt payment of claims. Payment for hospital costs and lost wages due to injuries can be made as they occur, rather than experiencing the unnecessary delay that currently happens under the tort liability insurance system. The prompt payment of claims on a basis of periodic payment rather than the lump sum payment makes possible the prompt beginning of a rehabilitation program for the injured party. Under the tort liability system it is generally considered

worthwhile financially to delay the litigation until the full impact of the injuries can be dramatized before a jury. By that time the ability to rehabilitate the accident victim may be severly restricted.

No-Fault Not as Revolutionary as Sometimes Believed

The no-fault concept is not really as revolutionary as many people are led to believe in view of the fact that the present automobile insurance contract currently contains a medical payments coverage which pays on a limited basis without regard to fault. Why then all the controversy over the modified no-fault insurance plans that are being introduced today? Clearly the concern of the vested interest groups such as the trial lawyers is that modified no-fault insurance represents the "foot-in-the-door" phenomenon. They believe, and possibly rightly so, that once no-fault insurance has the smallest of footholds, it will soon jeopardize the whole automobile tort liability system. In many respects it is parallel to the reasoning of the opponents of the Social Security Act of 1935, who saw the passage of that act as the beginning of the welfare state in this country. This is an important point because the modified no-fault automobile insurance laws that are coming into existence today will not appear to be major changes to the average policyholder. However, the concept involved is a major change even though it is being applied on a very limited basis in the beginning.

The type of loss where a modified no-fault plan will bring about the greatest change for the average policyholder will be in the less serious automobile accident losses — where there are no fatalities or critical injuries.

It is reasonable to assume that the no-fault concept, once established, will be allowed over time to develop beyond its restricted confines if society so desires the greater emphasis on reparation of automobile accident losses to be settled without the use of the negligence doctrine. If, however, adverse social repercussions should begin to show as a result of the no-fault concept of loss payment, we can assume that our state legislatures will be responsibile to its citizens' desires and reduce or cease the use of the no-fault concept.

Conclusion

In conclusion, let me again note the most relevant points developed in this paper. First, the present tort liability system used in automobile insurance is only one of several reasons why the

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automobile insurance environment is currently performing at an unsatisfactory level for society. There are other factors contributing to this poor performance. Therefore the no-fault concept is not the panacea that some people might make it out to be. Second, the no-fault concept applied on a limited basis to our present system should greatly improve the efficiency of the system as well as distribute the claims payments in a more equitable and responsible manner than does the present system. Third, the states in actuality have no choice, for the federal government has given them a mandate to act or it will act for the states and thus take over the regulation of automobile insurance.

There is little justification to maintain an attitude of status quo or minor change when nearly everyone admits that our present system continues to perform in an unsatisfactory manner, even though it has been continually affected by periodic minor changes through the years. A modified no-fault approach to automobile loss reparation is a logical approach to needed change and it can be a positive input into a failing system. While no-fault guarantees us nothing, there is sufficient logic in the concept that it deserves an opportunity. Refusal to try the untried because it is untried is self-defeating especially when a position of status quo is unacceptable to society.

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