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(A project of the Center for Justice &  
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# **TOWERS PERRIN: “GRADE F” FOR FANTASTICALLY INFLATED “TORT COST” REPORT**

**PADDED, INEXPLICABLE DATA STILL SHOW  
COSTS LOWER THAN 1983 LEVELS**

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#### Executive Summary

The insurance industry-consulting firm, Towers Perrin, issued a “study” in December 2009 that estimates what it calls the overall “cost” of the U.S. tort system in 2008. Towers Perrin puts this figure at a whopping \$254.7 billion, saying this translates to \$838 per person. These figures are highly unreliable and completely inappropriate for evaluating the U.S. tort system. They have been effectively debunked over and over again. Towers Perrin has no excuse for its misleading and shoddy work. Policymakers and opinion leaders should be extremely wary of this document and how it is used. It gives no credence to the notion that tort costs are out of line.

**The report and its promotion are highly skewed and political.** Despite being severely criticized by business journalists, consumer groups and academics, Towers Perrin has issued these “tort costs” annually for over two decades and it continues to be used by those seeking to attack the nation’s tort system. The report has no other purpose; it is of no use for individual businesses.

**Even with its flaws, the report provides no support to those claiming that “tort costs” are growing beyond what would be expected, much less any problem or crisis.** It calls the tort cost environment in the U.S. “relatively benign” and says that medical malpractice trends are stable. By its own admission, “tort costs” are growing slower than medical inflation and “the ratio of tort costs to GDP decreased substantially since 2003.” Moreover, today’s tort costs are less, compared to GDP, than they were in 1983.

**Although “tort costs” by Towers Perrin’s definition are not increasing, that should not excuse the multitude of problems with this report.**

- The company admits that its figures have nothing to do with the costs of the legal system. The report does not examine jury verdicts, settlements, lawyers’ fees or any actual costs of what might generally be considered the “tort” system.
- Towers Perrin examines only insurance losses whether or not a lawsuit was filed, plus insurers’ “guess” (historically, widely overstated) of what future losses could be, plus all of the industry’s bloated overhead (salaries, bonuses, lobbying costs, jet planes etc.).
- Towers Perrin greatly pads its numbers by:

- incorrectly counting as a “tort cost” the transfer of money from wrongdoers to victims, such as \$500 to fix a dented car fender, which the insurance company of the person who caused the accident pays; these are not “tort costs” and were not created by the person whose car needs fixing.
- including insurance costs whether or not a lawsuit was filed; fully 52 percent of the total “tort costs” are auto liability claims (such as fender-benders), which typically are settled without claimants hiring attorneys or suing anyone.
- including billions of dollars of insurer estimates - not actual costs - that insurers make in rate filings and that have in the past proved to be wildly overstated.
- including billions of dollars of certain first party coverages, like auto insurance medical payments, which can cover anyone hurt in the car, as well as uninsured motorists (UM) and underinsured motorists (UIM).
- including the immense costs of operating the wasteful and inefficient insurance industry, an industry that is not fully competitive due to its exemption from anti-trust laws; fully 26.1 percent of Towers Perrin’s total “tort cost” figures are these administrative expenses, such as multi-million dollar salaries and bonuses of insurance industry executives, perks like private jets and country club memberships, lobbying and advertising expenses, rent and utilities for insurance company headquarters and commissions paid to agents.

**Towers Perrin “tort cost” studies are filled with unverifiable data and broad assumptions that other data contradict.**

- Towers Perrin adjusts figures without any basis and fails to provide explanations or sources.
- There is good reason to question Towers Perrin’s accuracy. For example, its medical malpractice calculations are based on its own internal studies, which are not revealed, and it finds these medical malpractice costs to total \$29.8 billion. Yet 36.1 percent of these “costs” are largely unverifiable insurer expenses. Moreover, what is left - \$19 billion in actual medical malpractice claims and reserves - is still out of whack with the insurance industry standard calculated by A.M. Best, which puts losses *and* “Loss Adjustment Expenses” at only \$6 billion – less than a third of Towers Perrin’s calculation.

**Towers Perrin does not measure the countervailing costs saved by the tort system, which provides the financial incentive for companies and institutions to act more safely.**

- Towers Perrin entirely ignores the amount of money the civil justice system saves the economy in terms of injuries and deaths that are prevented due to safer products and practices, wages not lost, health care expenses not incurred, and so on.
- Towers Perrin’s calculations are not discounted one cent for the benefit that is gained from repairing damage.

**Tort Tax Fiction.** The term “tort tax” or “litigation tax” is a public relations gimmick, derived from these very same Towers Perrin numbers that do not represent tort system costs at all, but rather insurance losses, likely exaggerated estimates of future claims that have not even been filed yet, and all of the insurance industry’s bloated expenses.



## TOWERS PERRIN: “GRADE F” FOR FANTASTICALLY INFLATED “TORT COST” REPORT

### PADDED, INEXPLICABLE DATA STILL SHOW COSTS LOWER THAN 1983 LEVELS

#### INTRODUCTION

The insurance industry-consulting firm, Towers Perrin,<sup>1</sup> issued a “study” in December 2009 that estimates what it calls the overall “cost” of the U.S. tort system in 2008. Towers Perrin puts this figure at a whopping \$254.7 billion,<sup>2</sup> saying this translates to \$838 per person.<sup>3</sup> This number is the latest Towers Perrin “tort cost” calculation, which this company has unfortunately issued annually for over two decades. It has been roundly criticized by business journalists, consumer groups and academics. For example:

- *The Wall Street Journal* said in a March 2006 article, “...[C]ritics of past years’ studies – and there are many – say the number and the projections that come with it are deeply flawed. For instance, they include payments that don’t involve the legal system at all. Say somebody smashes his car into the back of your new SUV and his insurance company sends you a \$5,000 check to fix the damage. That gets counted as a tort cost in [Towers Perrin]’s number. Critics say it’s just a transfer payment from somebody who wasn’t driving carefully to somebody who has been legitimately wronged. How is that evidence of a system run amok?”<sup>4</sup>
- A May 2005 study by the Economic Policy Institute said, “Any work that relies on [Towers Perrin’s] seriously flawed reports is, to that extent, also unreliable. An example of work that is largely dependent on [Towers Perrin]’s flawed reports is the 2004 Economic Report of the President, which is published by the president’s three-member Council of Economic

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<sup>1</sup> Now called Towers Watson. <http://www.towersperrin.com/tp/lobby.jsp?country=global>

<sup>2</sup> 2009 Update on U.S. Tort Cost Trends.

<sup>3</sup> The number is sometimes improperly called a “tort tax” or “litigation tax” by business lobbyists. See later discussion.

<sup>4</sup> Liam Plevin, “Math Divides Critics as Startling Toll of Torts is Added Up,” *Wall Street Journal*, March 13, 2006, found at <http://online.wsj.com/article/SB114221023993396116.html>

Advisors (CEA). In 2004 the CEA devoted nearly 20 pages of its Economic Report to the tort system, relying extensively—and mistakenly—on [Towers Perrin]’s flawed estimates for its facts.”<sup>5</sup>

- On March 14, 2005, *Business Week* called the Towers Perrin report a “wild exaggeration,” stating that it “includes everything from payouts for fender-benders to the salaries of insurance industry CEOs.”<sup>6</sup>
- A January 2005 *Congressional Quarterly* article said, “Nearly all the assertions about the growing cost of the tort system are based on the figures from just one actuarial and management consulting firm, Tillinghast Towers-Perrin, that works for the insurance industry, which has a stake in limiting lawsuits . . . The company’s estimates of tort costs include the insurance industry’s administrative expenses and payments on claims that never involve courts or lawyers, such as auto collisions.”<sup>7</sup>
- In October 2004, Stephanie Mencimer wrote in the *Washington Monthly*, [Towers Perrin] “includes in its definition of the ‘tort system’ insurance company administrative costs and overhead and the salaries of highly paid insurance company CEOs . . . One thing [Towers Perrin] doesn’t include: court budgets, which makes its study seem a lot more like an assessment of the insurance industry than of the legal system.”<sup>8</sup>
- In a January 29, 1999 report, Daniel H. Capra, Philip Reed Professor of Civil Justice Reform for Fordham University School of Law, called the Towers Perrin figures “folly,” “disingenuous,” “nothing but absurd and self-serving overkill” and “vastly overinclusive.” Moreover, he pointed out, “[M]ost of the system’s cost are the result of corporate wrongdoing causing injury, and ‘hardball’ litigation tactics of insurance companies that deny legitimate claims.”<sup>9</sup>
- Ralph Nader testified before Congress in 1991, “If consumer advocates came to Congress asking for a complete overhaul of the nation’s regulatory laws based on made up and mischaracterized numbers like these, we would rightfully be laughed out the door.”<sup>10</sup>

Americans for Insurance Reform has issued several analyses of past Towers Perrin “tort cost” studies, analyses which are highly critical of Towers Perrin’s methodology.<sup>11</sup> The following

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<sup>5</sup> “Lawrence Chimerine and Ross Eisenbrey “The frivolous case for tort law change: Opponents of the legal system exaggerate its costs, ignore its benefits,” Economic Policy Institute, May 17, 2005, found at <http://www.epi.org/publications/entry/bp157/>

<sup>6</sup> “How Partisanship Puts Big Solutions Out of Reach,” *Business Week* editorial, March 14, 2005, found at [http://www.businessweek.com/magazine/content/05\\_11/b3924140\\_mz029.htm](http://www.businessweek.com/magazine/content/05_11/b3924140_mz029.htm)

<sup>7</sup> John Cochran, “‘Tort Reform’ Battle: A Simple Case of Complexity,” *Congressional Quarterly Weekly*, January 29, 2005.

<sup>8</sup> Stephanie Mencimer, “False Alarm,” *Washington Monthly*, October 2004, found at [http://www.washingtonmonthly.com/features/2004/0410\\_mencimer.html](http://www.washingtonmonthly.com/features/2004/0410_mencimer.html)

<sup>9</sup> Daniel Capra, “An Accident and a Dream: Problems With the Latest Attack on the Civil Justice System,” 20 *Pace L.Rev.* 339 (2000). Capra’s original report seems based on a 1998 publication entitled “An Accident and a Nightmare,” by Joanne Doroshov, Citizens for Corporate Accountability & Individual Rights (predecessor to Center for Justice & Democracy), on file with the Center for Justice & Democracy.

<sup>10</sup> Committee on Commerce, Science and Transportation, Sept. 19, 1991.

critique repeats and expands upon these earlier critiques. Indeed, the Towers Perrin document has become even more politicized than in the past. It continues to be cited by those seeking to attack our nation's tort system and limit individual's rights to go to court.

## A PATENTLY POLITICAL DOCUMENT

As will be shown later, the annual Towers Perrin "tort cost" studies are filled with unverifiable data and broad assumptions that the reader is expected to trust and take on face value. Despite its role as an insurance industry consulting firm, Towers Perrin insists that there is no reason to distrust their data, and no reason to disclose or show their work. They claim that this report and similar earlier versions have been objective and non-political.

Yet for over two decades, Towers Perrin has been fully aware that its "tort cost" reports, despite severe criticism of their methodology, have been used repeatedly by political forces to attack the civil justice system and push for so-called "tort reform."<sup>12</sup> Indeed, the only conceivable purpose of the "tort cost" report is to insert itself into this policy debate. It has no other purpose, and certainly it is of no use for individual businesses. By now, it is implausible for Towers Perrin to deny its purpose as an advocacy piece. To simply trust its undocumented data and speculation as objective and unbiased would be a huge error.

There are additional reasons to suspect that politics shape the Towers Perrin report. The firm's own press release promoting the report is subtitled, "Financial Crisis Fallout and Medical Malpractice Litigation Could Fuel Future Increases."<sup>13</sup> It highlights this despite Towers Perrin's own medical malpractice findings and other data suggesting the opposite trend. For example, its major finding is:

Despite the chaos in the financial markets, the tort cost environment in the U.S., in total, was relatively benign. The increased cost of gasoline led to a decrease in miles driven, putting some downward pressure on both personal auto and commercial auto costs. Medical malpractice trends continued to be stable. While there was certainly upward pressure on directors and officers liability costs, overall, this element has been a small component of total U.S. tort costs.

The only possible reason for this news release banner is that both issues are currently in the news and therefore it was meant to generate headlines. Incredibly, Towers Perrin goes on to speculate on such "tort cost" increases for the next years: 3 percent for 2009, 4 percent in 2010 and 6 percent in 2011. It places much blame for the speculative 2009 increase on insurance costs

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<sup>11</sup> "Tillinghast's 'Tort Cost' Figures Vastly Overstate the Cost of the American Legal System," January 5, 2006, found at [http://www.centerjd.org/air/pr/Tillinghast\\_Overstates.pdf](http://www.centerjd.org/air/pr/Tillinghast_Overstates.pdf)

<sup>12</sup> See, e.g., "A False Ad About 'Lawsuit Abuse'", Factcheck.org, May 11, 2007, found at [http://www.factcheck.org/misleading-ads/a\\_false\\_ad\\_about\\_lawsuit\\_abuse.html](http://www.factcheck.org/misleading-ads/a_false_ad_about_lawsuit_abuse.html)

<sup>13</sup> Towers Perrin News Release, "Despite Volatile Economic Climate, U.S. Tort Costs Up Slightly in 2008, According to Towers Perrin Study; Financial Crisis Fallout and Medical Malpractice Litigation Could Fuel Future Increases," December 15, 2009, found at [http://www.towersperrin.com/tp/showdctmdoc.jsp?country=global&url=Master\\_Brand\\_2/USA/Press\\_Releases/2009/20091215/2009\\_12\\_15.htm](http://www.towersperrin.com/tp/showdctmdoc.jsp?country=global&url=Master_Brand_2/USA/Press_Releases/2009/20091215/2009_12_15.htm)

related to the financial collapse and recession, such insurance costs for directors and officers.<sup>14</sup> Nowhere does Towers Perrin attempt to evaluate the state of civil litigation in this area, or its costs. If they had, they would find that while recession-related employee lawsuits may rise in 2009, although that is just speculation, federal securities fraud class actions, which are the focus of significant corporate complaining, are actually “sharply down in 2009,” according to the Stanford Securities Class Action Clearinghouse.<sup>15</sup>

As far as 2010 and 2011, Towers Perrin seems to guess that, in addition to potential future inflation, President Obama and his federal judicial appointments will shift tort cost growth. So far, that would be one Supreme Court Justice, three United States Courts of Appeals judges and seven United States district court judges (as opposed to George W. Bush’s two Supreme Court justices including Chief Justice, 62 United States Courts of Appeals judges and 261 United States district courts judges - or 40 percent of the federal judiciary). The firm declares without any basis that the legal rulings of Obama’s judges over the next couple years will significantly change “tort cost” numbers and asserts that “[i]n this regard, medical malpractice is very susceptible to a quick change in costs.”

Aside from the fact that only actual data in the Towers Perrin’s study show the opposite – that that medical malpractice costs are *not* trending up - federal judges handle only a small percentage of tort cases resolved in this country and almost no medical malpractice cases. These are state cases – not that actual cases have anything to do with Towers Perrin “tort costs” anyway. They don’t, as is explained below. And while Towers Perrin is more than willing to make this gratuitous and unsupported comment about Obama’s judges, they completely ignore the impact on costs that Obama and Congress’ national health care reform could have. In fact, because the health insurance situation would improve for so many, a large chunk of Towers Perrin “tort costs” would simply drop out of the system. The only conceivable reason for making inflammatory comments about Obama’s as-yet unappointed and unknown federal judges, while not recognizing the extent that “tort costs” would be sliced with health care reform, is simply politics.

## GOOD NEWS IS NO NEWS

Even with all its flaws, which are extensive and explained herein, the Towers Perrin report provides no support to those claiming that “tort costs” are growing beyond what would be expected, much less any evidence of a problem or crisis. As noted earlier, the report calls the U.S. tort cost environment “relatively benign.” It says “tort costs” are growing slower than medical inflation (a 1.1 percent increase from its 2007 number) and that “the ratio of tort costs to GDP decreased substantially since 2003.”

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<sup>14</sup> In fact, class actions resulting from the financial collapse are going down, not up. For example, there are so many new restrictions on investor lawsuits that many believe this helped create the financial mess in the first place. *See, e.g.,* Robert Weissman and James Donahue, “Wall Street’s Best Investment: Ten Deregulatory Steps to Financial Meltdown,” *Multinational Monitor*, Jan/Feb. 2009.

<sup>15</sup> *Securities Class Action Filings 2009: A Year in Review*, Cornerstone Research, January 2010.

During the current decade, Towers Perrin tort costs as a percentage of GDP is down 0.3 percent; they were 1.79 percent of GDP in 2008, which is a lower percentage than in 1983 - 1.82 percent. In other words, even though the analysis vastly overstates tort costs and really makes no sense, these costs are still less, compared to GDP, than they were in 1983.

## A MULTITUDE OF PROBLEMS

Although clearly “tort costs” by Towers Perrin’s own definition are not increasing, that should not excuse the multitude of problems with this report.

**NO ACTUAL LEGAL COSTS ARE EXAMINED.** To begin, despite the title that Towers Perrin insists on giving the report – “2009 Update on U.S. Tort Cost Trends” - and how it promotes it,<sup>16</sup> the company admits that its figures have nothing to do with the costs of the legal system. The report does not examine jury verdicts, settlements, lawyers’ fees or any actual costs of what might generally be considered the “tort” system. It states that its evaluation of the tort system does not include “costs incurred by federal and state court systems” and incredulously suggests that these costs are not relevant to its estimates.<sup>17</sup> That admission is similar to one made by Towers Perrin in its 2005 “tort cost” paper stating, “the costs tabulated in this study are not a reflection of litigated claims or of the legal system.”<sup>18</sup>

**ONLY INSURANCE “LOSSES,” PLUS CONJECTURE OF FUTURE LOSSES, PLUS ALL INSURANCE INDUSTRY EXPENSES, ARE EXAMINED.** Instead of looking at legal costs, Towers Perrin examines insurance losses whether or not a lawsuit was filed, plus insurers’ “guess” (historically, widely overstated<sup>19</sup>) of what future losses could be, plus all of the industry’s bloated overhead (salaries, bonuses, lobbying costs, jet planes etc.).

- **Insurance “Losses” are not “Tort Costs.”** The transfer of money from wrongdoers to victims are not “costs.” This was clearly pointed out by the Economic Policy Institute in its 2005 critique of Towers Perrin’s methodology:

[Towers Perrin] improperly treats the transfer payments of the tort system as “tort system costs”: Almost half [of the 2005 version of the Towers Perrin analysis] estimated costs are transfer payments that are not true economic costs. [Towers Perrin] admits that it includes transfer payments—all of the compensation tortfeasors pay to the persons they injure—as tort costs. But transfer payments merely shift money from the injurers or their insurers to the injured. They are not costs to society or the economy. The Congressional

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<sup>16</sup> Towers Perrin News Release, “Despite Volatile Economic Climate, U.S. Tort Costs Up Slightly in 2008, According to Towers Perrin Study; Financial Crisis Fallout and Medical Malpractice Litigation Could Fuel Future Increases,” December 15, 2009, found at [http://www.towersperrin.com/tp/showdctmdoc.jsp?country=global&url=Master\\_Brand\\_2/USA/Press\\_Releases/2009/20091215/2009\\_12\\_15.htm](http://www.towersperrin.com/tp/showdctmdoc.jsp?country=global&url=Master_Brand_2/USA/Press_Releases/2009/20091215/2009_12_15.htm)

<sup>17</sup> 2009 Update on U.S. Tort Cost Trends, at 10.

<sup>18</sup> U.S. Tort Costs and Cross Border Perspectives: 2005 Update, at 8.

<sup>19</sup> See, e.g., Jay Angoff, *Falling Claims and Rising Premiums in the Medical Malpractice Insurance Industry*, July 2005, found at <http://www.centerjd.org/ANGOFFReport.pdf>

Budget Office has recognized that including transfer payments inflates the tort cost estimate [quote and citations omitted].

Transfer payments are not created by the tort system or by those who must resort to it for compensation. They are created by those who cause the losses and damage in the first place. Thus, the only way to reduce transfer payments is to prevent the injuries from occurring: the damage has been done, whether the victims are compensated or not. Someone—the wrongdoers, taxpayers (through government-sponsored social programs), other insurers (such as health insurance), charities, or the victim—will need to pay or absorb these costs.<sup>20</sup>

One wonders what Towers Perrin would prefer the nation do - let injured people lie there in the road? The entire concept of equating insurance losses with tort costs is absurd.

- **Insurance Disputes Resolved Without Litigation, Like Fender Benders, are Not “Tort Costs.”** Despite knowledge that for two decades the business community has mistakenly used its inflated “tort cost” numbers as the basis to attack the legal system, Towers Perrin continues to pad its numbers by totaling insurance costs whether or not a lawsuit was filed. This is irresponsible, and another huge error.

As AIR Exhibit 1 shows, total adjusted insurance costs for personal auto insurance in 2008 were \$101 billion. This represents 52 percent of the total “tort costs.” This is an absurd way to measure “tort costs.” Typical auto liability claims (such as fender-benders) are overwhelmingly settled without claimants hiring attorneys or suing anyone, and with most claims paying for only the damage to the car and perhaps some medical expenses (economic loss) but without any compensation at all for noneconomic loss. To count all the tiny scrapes of fenders as “tort costs,” as Towers Perrin does, is a massive mistake.

- **Insurance Industry “Losses” that have *Not Yet Occurred* are not “Tort Costs.”** Towers Perrin’s numbers are calculated from the most exaggerated possible source: insurance industry “incurred losses,” which are not really “losses” at all. They include billions of dollars of estimates - not actual costs - that insurers make in rate filings and have in the past proved to be wildly overstated.<sup>21</sup> “Incurred losses” increase when insurers increase reserves to pay claims. During hard market periods, the increases in reserves are not the result of actual increases in claims or payouts (e.g., lawsuits, jury verdicts or other tort system costs). Rather, they are an accounting device used by insurers to mask profits and justify rate hikes.<sup>22</sup>

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<sup>20</sup> “Lawrence Chimerine and Ross Eisenbrey “The frivolous case for tort law change: Opponents of the legal system exaggerate its costs, ignore its benefits,” Economic Policy Institute, May 17, 2005, found at <http://www.epi.org/publications/entry/bp157/>

<sup>21</sup> See, e.g., Jay Angoff, *Falling Claims and Rising Premiums in the Medical Malpractice Insurance Industry*, July 2005, found at <http://www.centerjd.org/ANGOFFReport.pdf>

<sup>22</sup> For a more detailed explanation of how the insurance cycle works, see Americans for Insurance Reform, *True Risk: Medical Liability, Malpractice Insurance and Health Care* (July 22, 2009), found at <http://insurance-reform.org/TrueRiskF.pdf>. Over-reserving is typical during hard market periods. Historically, reserves have been later “released” to profits during the “softer” market years. For example, according to a June 24, 2002, *Wall Street Journal* front page investigative article, St. Paul, which until 2001 had 20 percent of the national medical malpractice market, pulled out of the market after over-reserving during the last hard market and mismanaging its

And they are certainly not actual “tort costs.” Further, as the Economic Policy Institute asked, “[H]ow does [Towers Perrin] assign the various component tort costs, such as attorney fees, claims-handling costs, insurance industry overhead, and economic and non-economic benefits, none of which has occurred? This isn’t measurement; it’s guessing.”<sup>23</sup>

- **Insurance Industry “First Party” Coverages are not “Tort Costs.”** Towers Perrin says it deducts from its figure certain first party coverage - workers compensation and no-fault auto insurance (PIP),<sup>24</sup> where policyholders do not seek compensation from a wrongdoer but cover their losses through their own insurance. However, other first party coverages are not deducted. This includes some major auto insurance system costs, like medical payments, which can cover anyone hurt in the car, as well as uninsured motorists (UM) and underinsured motorists (UIM). These all should have been deducted. They amount to many billions of dollars, none of which should have been included in Towers Perrin’s “tort costs.”
- **Insurance Industry Bloated Overhead and Expenses are not “Tort Costs.”** Towers Perrin’s definition of tort system costs is calculated by including the immense costs of operating the wasteful and inefficient insurance industry, an industry that is not fully competitive due to its exemption from anti-trust laws.<sup>25</sup> It should be noted that these costs are over and above what the industry spends to investigate and handle claims, and legal fees to fight policyholders in court, which are known as “Loss Adjustment Expenses” or LAE. Such expenses are commonly considered in calculating the cost of claims. Administrative expenses are not.

In fact, in 2008, fully 26.1 percent of Towers Perrin’s total “tort cost” figure are these administrative expenses. This includes all overhead and such things as the multi-million-dollar salaries and bonuses of insurance industry executives,<sup>26</sup> perks like private jets and country club memberships, lobbying and advertising expenses, rent and utilities for insurance company headquarters and commissions paid to agents. Towers Perrin calls these expenses “a real cost of the tort system.” The Economic Policy Institute noted the obvious in 2005 when it wrote, with a good deal of understatement that, “most of these costs do not belong in an estimate of tort system costs, regardless of how consistently they are measured or even if they are real costs—because they are insurance costs, not tort costs.”<sup>27</sup> As EPI put it, these costs “are vastly above and beyond the actual costs of handling claims or the legal costs of defending them,” or LAE. Indeed, when tacking on the LAE costs, the insurance industry expense portion of its total “tort costs” explodes.

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reserves. Christopher Oster and Rachel Zimmerman, “Insurers’ Missteps Helped Provoke Malpractice ‘Crisis,’” *Wall Street Journal*, June 24, 2002.

<sup>23</sup> Lawrence Chimerine and Ross Eisenbrey “The frivolous case for tort law change: Opponents of the legal system exaggerate its costs, ignore its benefits,” Economic Policy Institute, May 17, 2005, found at <http://www.epi.org/publications/entry/bp157/>

<sup>24</sup> Towers Perrin does not make clear how it makes this deduction.

<sup>25</sup> McCarran-Ferguson Act, 15 U.S.C. §§ 1011-1015.

<sup>26</sup> For example, according to the SEC’s compensation data for 2008, Allstate’s Thomas Wilson received \$8 million; Jay Fishman at Travelers received \$14 million; AIG’s Robert Willumstad got \$38 million and Martin Sullivan, \$29 million. See, *The Insurance Forum*, Vol. 36, No. 7, July 2009.

<sup>27</sup> “Lawrence Chimerine and Ross Eisenbrey “The frivolous case for tort law change: Opponents of the legal system exaggerate its costs, ignore its benefits,” Economic Policy Institute, May 17, 2005, found at <http://www.epi.org/publications/entry/bp157/>

According to our calculations, based on A.M. Best's *Aggregate and Averages, 2009 edition*, the LAE ratio is 13.8 percent.<sup>28</sup> Combining this expense figure with the additional overhead figure listed in the Towers Perrin report (Towers Perrin Appendix 3, Column 4) of 26.1 percent would put total expenses at a whopping 39.9 percent. In other words, just under 40 percent of the Towers Perrin "tort costs" are insurer expenses loaded onto claims, some of which have not even happened yet, and which include first party coverage like medical payments in auto cases. This is a preposterous padding of numbers.

Taking a look just at just one line of insurance - medical malpractice – the impact of this padding become clear. In its Appendix 5, Towers Perrin identifies an underwriting expense ratio, estimating it to be 12.9 percent for 2008. A.M. Best shows LAE to be 23.2 percent for 2008.<sup>29</sup> Add these two numbers, and the expense portion of medical malpractice tort cost number rises to 36.1 percent of total medical malpractice costs. In other words, only 63.9 percent, or \$19,021,881, are actually medical malpractice claims and reserves (as opposed to the hyped-up \$29.8 billion figure cited throughout the report). Yet even that number - \$19 billion – is out of whack with A.M. Best. According to Best, medical malpractice direct premiums earned in 2008 were \$10,397,198.<sup>30</sup> The loss and LAE ratio, including reserves, totaled 57.4 percent.<sup>31</sup> Thus, losses and LAE, according to Best, were \$5,967,992.<sup>32</sup> Towers Perrin calculations, which calculations they do not reveal, produce a result over three times as high as the A. M. Best figure and must be documented to be believed.

Towers Perrin also insists these administrative costs are not bloated because the U.S. insurance system is "subject to the same cost and competitive pressure that most industries face." This is a baffling statement given that the insurance industry is exempt from most anti-trust laws, allowing it to price fix, collude and engage in other anti-competitive behavior that would be illegal in every other industry. Such exemptions make the insurance industry one of the most anti-competitive industries in America.

## **TOWERS PERRIN'S SECRET METHODOLOGY AND HIGHLY SUSPECT RESULTS**

Towers Perrin adjusts figures without any basis and fails to provide explanations or sources. On the rare occasion when it does provide "sources," they include such impossible-to-verify citations as "internal Towers Perrin study,"<sup>33</sup> "various studies and estimates by Towers Perrin"<sup>34</sup> and a multitude of other "estimates."<sup>35</sup> As the Economic Policy Institute put it, "Although [Towers Perrin's] estimate is widely cited by journalists, politicians, and business lobbyists, it is impossible to know what the company is actually measuring in its calculation of tort costs, and

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<sup>28</sup> AIR Exhibit 1, "LAR Ratio" column.

<sup>29</sup> *Bests Aggregates and Averages, 2009 Edition*, at 382.

<sup>30</sup> *Ibid.*

<sup>31</sup> *Ibid.* The sum of the loss ratio of 34.2% and the LAE ratio of 23.2%.

<sup>32</sup> *Ibid.*

<sup>33</sup> *2009 Update on U.S. Tort Cost Trends* App. 5 notes 2, 3, 4.

<sup>34</sup> *Id.* App. 4, note 6.

<sup>35</sup> *Id.* variously at 9-11.

impossible to verify its figures, because [Towers Perrin] will not share its data or its methodology, which it claims are ‘proprietary.’”<sup>36</sup>

The lack of disclosure would be one thing if the data were in line with other estimates. But it is not and there is good reason to question Towers Perrin’s accuracy. For example, in its Appendix 5, “Medical Malpractice Tort Costs,” Towers Perrin lists “Loss and LAE costs” based on nothing but “internal Towers Perrin stud[ies].” These must be some studies, since at \$25.9 billion, such costs are substantially higher than A.M. Best’s \$6 billion. Clearly, Towers Perrin should reveal their sources and explain this huge disparity.

Towers Perrin’s Appendix 2, “Summary of All Tort System Costs” cites prior estimates appearing in Appendices 3, 4 and 5 that include calculations “estimated by Towers Perrin” and “various studies by Towers Perrin.” For example, Towers Perrin adds to its total tort costs number an additional \$46.5 billion, to cover what it guesses to be “Self - (Un) insured tort costs.” To reach this huge figure, the company says it:

relied on the various estimates available, as well as Towers Perrin’s experience in this field, in developing the costs for this category. We have assumed that the administrative expense component in this category is 10 percent lower than the insured category.

Towers Perrin provides neither numbers nor calculations to verify any of these estimates, which show up in columns 3 and 6 of its Appendix 4, “Comparisons of Personal Lines to Commercial Lines Costs and the Impact of Self Insurance” respectively, and column 4 of its Appendix 2, “Summary of All Tort System Costs.” In other words, it’s all one big unverifiable guess.

Some other examples include:

- **Administrative Costs.** The 26.1 percent overhead number is an insurance cost, not a “tort cost,” as discussed above. Towers Perrin provides no source for the figure. But it appears close to the 26.6 percent we calculate using A. M. Best Aggregates and Averages.
- **PIP or No Fault Auto Costs.** Towers Perrin says that they exclude PIP (auto no-fault) in their methodology. However, Best’s *Aggregate and Averages* provides no such break-out so this must have been done internally by Towers Perrin. There is no documentation or explanation as to how this calculation was made and there is good reason to question the firm’s figures. Using their method, “costs” for personal lines of insurance would be \$107 billion with PIP included. (See AIR Exhibit 1). This is in excess of what Towers Perrin shows for personal lines - \$92.3 billion.<sup>37</sup> The disparity is likely the PIP exclusion, but Towers Perrin must show that work to be sure. AIR Exhibit 1 also shows \$87 billion for commercial line “costs,” which is close to Towers Perrin’s \$86.1 billion,<sup>38</sup> even with PIP still included. The disparity

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<sup>36</sup> Lawrence Chimerine and Ross Eisenbrey “The frivolous case for tort law change: Opponents of the legal system exaggerate its costs, ignore its benefits,” Economic Policy Institute, May 17, 2005, found at <http://www.epi.org/publications/entry/bp157/>

<sup>37</sup> The figures we compare exclude self-insured and uninsured estimates of Towers Perrin (Columns 2 and 5 of Appendix 4) so they are directly comparable.

<sup>38</sup> *Ibid.*

does not seem to be PIP since PIP should have been a bigger impact here. Clearly, Towers Perrin must show their work so readers can understand what they are doing.

- **Homeowners and Farm Owners Multiperil.** Towers Perrin estimates that 8 percent of these costs are tort, based on Towers Perrin's own experience. No data are provided to support this estimate.
- **Non-US. Business.** Towers Perrin says, "Total tort costs from the A.M. Best data are reduced slightly to reflect an estimate of non-U.S. business in the data. The reduction varies by line of business and is approximately 2 percent." No data are provided to support this estimate. It does raise an odd question, however. While we can export insurance coverage, can we really export "tort costs," as Towers Perrin's 2 percent reduction seems to imply?

### OTHER COSTS AND SAVINGS ARE IGNORED

Towers Perrin does not measure the countervailing costs *saved* by the tort system, which provides the financial incentive for companies and institutions to act more safely. Towers Perrin entirely ignores the amount of money the civil justice system saves the economy in terms of injuries and deaths that are prevented due to safer products and practices, wages not lost, health care expenses not incurred, and so on.

In a January 29, 1999 independent study prepared for the New York State Bar Association, Daniel Capra, Philip Reed Professor of Civil Justice Reform at Fordham University School of Law, wrote, "[T]he quasi-statistical analysis about the costs of the tort system fails to mention that the system provides the essential benefits of victim compensation and product safety. Any focus on costs without consideration of countervailing benefits is completely irresponsible."<sup>39</sup>

Moreover, the right of injured people to sue and collect compensation from the perpetrators of their harm is one of the great achievements of American democracy. In our system, the poorest and most vulnerable, including those who are in need of medical care, who are the disrupted families of sick and injured children or who have suffered violations of their fundamental civil rights, can challenge the largest corporation or government agency and hold them accountable for causing harm. This is a precious and priceless right, the value of which Towers Perrin entirely overlooks in its report.

Most importantly, Towers Perrin's calculations are not discounted one cent for the benefit that is gained from repairing damage. If a fender-bender caused \$500 in auto repairs to fix, which the insurance company of the person who caused the accident pays, Towers Perrin calls that a "tort cost" (even though no lawyers were involved). Towers Perrin does not deduct a cent from the \$500 spent as a benefit to society. This is absurd.

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<sup>39</sup> See, Daniel Capra, "An Accident and a Dream: Problems With the Latest Attack on the Civil Justice System," 20 *Pace L. Rev.* 339 (2000).

## THE TORT TAX FICTION

One of the most misleading ways business groups use the Towers Perrin “tort costs” numbers is to argue that they are “passed on to consumers and taxpayers”<sup>40</sup> in the form of a “tort tax” or “litigation tax,” which Towers Perrin conveniently calculates in its “Key Findings.” (This is done by dividing its inflated “tort cost” figure by the population.) Although this is little more than a public relations gimmick, it is often used by the special interests behind the “tort reform” movement to deflect attention away from insurance industry excesses and onto those who use the civil courts, the costs of which are explicitly not examined by Towers Perrin.

But as made clear above, this is a serious error. As noted, this number does not represent tort system costs at all, but rather insurance losses, likely exaggerated estimates of future claims that have not even been filed yet, and all of the insurance industry’s bloated expenses. This includes everything from the costs of repairing scratched up cars to the multi-million-dollar salary and bonuses for insurance industry executives - costs that have nothing to do with the civil justice system or those who use the courts. As Professor Daniel Capra, said, the notion of a “tort tax” is “nothing but absurd and self-serving overkill.”<sup>41</sup>

## CONCLUSION

In its evaluation of an earlier Towers Perrin report, the Economic Policy Institute said,

The actual costs of resolving tort claims through the legal system are a fraction of the total insurance industry costs [Towers Perrin] has estimated, and the fraction that would be affected by tort law changes affecting punitive damages, non-economic damages, or class action law suits is even smaller. [Towers Perrin] does not estimate the size of the real, incremental costs. If it did, it would be clear that the effect of those costs on the economy would be insignificant. [Towers Perrin]’s approach is akin to estimating the cost of the criminal justice system by counting all of the costs of crime, rather than the lesser costs of law enforcement, the judiciary, and the prison system.

While it is certainly worthwhile to undertake the difficult task of analyzing the actual costs of the tort system, Towers Perrin certainly has never done this and has not done so with its new report. Their figures are highly unreliable and completely inappropriate for evaluating the U.S. tort system. They have been effectively debunked over and over again. Towers Perrin has no excuse for its misleading and shoddy work. Policymakers and opinion leaders should be extremely wary of this document and how it is used. It gives no credence to the notion that tort costs are out of line. If anything is out of line, it’s Towers Perrin.

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<sup>40</sup> Sean Parnell, “‘Tort Tax’ Costs Illinois Jobs, Economic Growth,” *Heartland Institute*, February 2006. *See also*, James R. Copland (Manhattan Institute), “The Tort Tax,” June 13, 2003. These numbers have even ended up on Sarah Palin’s Facebook page. Sarah Palin, “No Health Care Reform Without Legal Reform,” Friday, August 21, 2009, found at [http://www.facebook.com/note.php?note\\_id=120607013434](http://www.facebook.com/note.php?note_id=120607013434)

<sup>41</sup> Daniel Capra, “An Accident and a Dream: Problems With the Latest Attack on the Civil Justice System,” 20 *Pace L. Rev.* 339 (2000).

## AIR Exhibit 1 2008 Direct Insurance Data

### PERSONAL LINES

	Earned Premium	Loss Ratio	LAE Ratio	Losses and LAE	TP Reduction Factor	Underwriting Expense	Total Adjusted Insurance Cost
Auto liability	\$96	65.9%	13.0%	\$76	PIP (unknown)	24.7%	<b>\$101</b>
Homeowners	\$63	72.8%	10.5%	\$52	92%	28.2%	<b>\$6</b>
Farmowners	\$3	82.7%	10.3%	\$2	92%	28.8%	<b>\$0</b>
<b>Total Personal</b>	<b>\$162</b>		<b>11.9%</b>	<b>\$130</b>		<b>26.1%</b>	<b>\$107</b>

### COMMERCIAL LINES

CMP	\$13	41.2%	21.6%	\$8		32.6%	<b>\$12</b>
Auto liability	\$21	53.8%	12.0%	\$14	PIP (unknown)	29.4%	<b>\$20</b>
Other Liability	\$51	54.3%	17.5%	\$37		25.3%	<b>\$49</b>
Product Liability	\$4	68.3%	46.0%	\$4		28.3%	<b>\$6</b>
<b>Total Comm.</b>	<b>\$89</b>		<b>18.2%</b>	<b>\$63</b>		<b>27.4%</b>	<b>\$87</b>
<b>GRAND TOTAL</b>	<b>\$251</b>		<b>13.8%</b>	<b>\$193</b>		<b>26.6%</b>	<b>\$194</b>

Towers Perrin showed Medical Malpractice as a separate exhibit, so we report Best's medical malpractice figures separately

<b>Medical Malpractice</b>	<b>\$10</b>	<b>34.2%</b>	<b>23.2%</b>	<b>\$6</b>	<b>NA</b>	<b>17.9%</b>	<b>\$7</b>
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Notes: Dollar figures in Billions

Figures may not add up due to rounding

Source: Best's *Aggregates and Averages, 2009 Edition*

### AIR EXHIBIT 1 METHODOLOGY

Unlike Towers Perrin, we do show our work in Exhibit 1. We used Best's *Aggregates and Averages, 2009 Edition* to obtain Earned Premium, Loss Ratio, LAE Ratio and Underwriting Expense Ratio information. The other column, Towers Perrin Reduction Factor, is the discount they give for claims that are first party in nature, like PIP (auto no-fault), as explained in their Methodology discussion. (While they explain their method of discounting in their Methodology section we do not know, from that discussion, what PIP losses were removed. That is unexplained.)

The column, "Losses and LAE," on AIR Exhibit 1 is calculated for each subline of insurance by multiplying the earned premium by the sum of the loss ratio and the LAE ratio.

The column "Total Adjusted Insurance Cost" is calculated by dividing the "Losses and LAE"

column by unity minus the “Underwriting Expense” column.

Towers Perrin “Tort Cost” figures are what we more accurately call “Total Adjusted Insurance Cost.” Here is how our figures, excluding estimates for “self” and uninsured compare:

	<u>Towers Perrin</u>	<u>AIR Calculation</u>
Personal Lines	\$92.3 billion	\$107 billion
Commercial Lines	\$86.1 billion	\$87 billion

Presumably the difference of roughly 15 percent in personal lines is due to PIP, but that must be verified by Towers Perrin. It must explain its method more completely. The similar number for commercial lines is odd as we have not removed PIP from our number and Towers Perrin says they have. Obviously this must be explained by Towers Perrin. The company must show its work.

Using Best’s *Aggregates and Averages*, we also estimate claim distributions, that the LAE in Column 3 of Towers Perrin Appendix 3 is 13.8%. That calculation is made by multiplying each subline’s earned premiums by the loss ratio and using those pure losses to weight the LAE ratio.

## ABOUT AMERICANS FOR INSURANCE REFORM AND THE AUTHORS

Americans for Insurance Reform (AIR), founded in 2003 by Joanne Doroshow and J. Robert Hunter, is a coalition of nearly 100 consumer groups from around the country working to strengthen oversight of insurance industry practices. It is a project of the Center for Justice & Democracy.

**J. Robert Hunter**, an actuary, is Director Of Insurance for the Consumer Federation of America. He was formerly the Commissioner of Insurance for the State of Texas, the Federal Insurance Administrator under both Presidents Carter and Ford, and President and Founder of the National Insurance Consumer Organization. As a consultant on public policy and actuarial issues for various government agencies, his clients have included the U.S. Department of Housing and Urban Development, the General Accounting Office and the Environmental Protection Agency, as well as state governments including California, Florida, Georgia, Massachusetts, Maine, North Carolina, New Jersey, New York, Oklahoma, South Carolina and Texas. Other experience includes work in the private sector, including as Associate Actuary for the Mutual Insurance Advisory Association and Mutual Insurance Rating Bureau (now AIPSO), Actuarial Supervisor for the National Bureau of Casualty Underwriters (now ISO) and Underwriter, Atlantic Mutual and Centennial Insurance Companies. His awards include the Award for Excellent Service for the Secretary of the Department of Housing and Urban Development (HUD), for work performed from 1971 to 1977. He is the author of numerous publications on insurance and related topics and has served as an Executive Committee member and advisor to the National Association of Insurance Commissioners (NAIC).

**Joanne Doroshow** is founder and Executive Director the Center for Justice & Democracy (CJ&D), the first and only national consumer organization dedicated exclusively to educating the public about the importance of the civil justice system. Joanne is an attorney who has worked on civil justice issues since 1986, when she first directed a project for Ralph Nader on liability and the insurance industry. In that capacity, she wrote *Goliath: Lloyd's Of London In The United States* (1988) among many other papers. As CJ&D Executive Director, she has testified before the U.S. Congress many times and appeared before numerous state legislatures around the country. She has written or co-authored numerous CJ&D studies and White Papers on civil justice issues. She has appeared on *CBS, ABC, NBC, CNN, CNBC, MSNBC, PBS* and *Fox News*, as well as numerous radio programs around the country, and has been quoted in numerous newspapers around the country. In 1991, Joanne was a member of the Steering Committee of the Brookings Institute/American Bar Association's Advisory Committee on the Future of the Civil Jury, and was an invited participant in the American Judicature Society's Conference on the Future of the American Jury System in 1999. She was also selected by the Stern Family Fund as the Public Interest Pioneer for 1999, an honor that was accompanied by two \$100,000 grants.