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William T. Cahill
United States House of Representatives

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Automobile Liability Insurance
System: Proposals for Pragmatic Reform

BY WILLIAM T. CAHILL*

The importance of insurance to America's social and economic life is difficult to overstate. By providing compensation for personal and business losses, insurance has brought stability to the nation's economy and confidence to the American public.

However, because of its commanding importance to the public interest, I am convinced that the insurance industry must be subjected to some degree of governmental regulation. Moreover, it is clear that the legislative search for an optimally effective system of insurance regulation is not an easy quest. Like care for the elderly and job opportunities for our young, the public's need for insurance presents complex social problems which must be resolved in accordance with modern realities.

Perhaps no other area of the present insurance industry better illustrates the continuing need to adjust public regulation to meet changed social and economic conditions than automobile liability insurance. Certainly, no other form of modern insurance has generated such tremendous concern on the part of the Bar, the insurance industry and representatives of government. Certainly, no other form of modern insurance presents such an urgent demand for regulatory reform.

The conditions leading to universal agreement that a crisis does indeed exist in the automobile liability insurance system have been widely discussed. In short, the major causes of our present national concern are the following:

First, the cost of automobile liability insurance to the consumer has soared during the past few years. Nationwide average

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* United States Representative, 6th District, New Jersey; Member, House Judiciary Committee, Joint Committee on Immigration and Nationality Policy.
premium rates for "regular" liability coverage have increased a staggering fifty-five percent during the past decade. Moreover, disproportionate rate increases in urban and other areas of the country have made it increasingly difficult for motorists in those areas to afford insurance protection.

Secondly, arbitrary and selective risk classification practices of the insurance industry have developed tremendous public hostility towards the industry. Constituent complaints to members of the U. S. Congress and state legislatures reveal numerous instances where the elderly, the young, and members of minority groups have had their policies cancelled or otherwise terminated for reasons unrelated to individual driving abilities.

Thirdly, during the past ten years, over one hundred insurance companies writing automobile liability coverage have become insolvent. It is estimated that some three thousand policy holders and accident victims now hold pending claims in excess of one-half billion dollars against total assets of insolvent companies amounting to less than 25 million dollars.2

Fourthly, inequitable delays in payment of loss compensation to accident victims have become characteristic of the present system. Protracted settlement negotiations and congested court dockets generally require an injured claimant to wait from two to six years before compensation is obtained.

Recent congressional examination3 of these crisis conditions reveals that they are not isolated or unrelated social problems. Rather, it has become clear that they are symptomatic of fundamental defects in the over-all automobile insurance system. As stated by a recent House Judiciary Committee staff report: "By any objective standard the performance of the automobile insurance business in the United States is unsatisfactory. The sys-

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1 See generally STAFF REPORT OF THE ANTI-TRUST SUBCOMM. OF THE HOUSE COMM. ON THE JUDICIARY, 90th CONG. 1st Sess. (Sept. 30, 1967) [hereinafter cited as STAFF REPORT].


The term "automobile insurance system," however, must be understood in its broadest sense. Basically this "system" provides protection against the risk that an individual will negligently cause an accident that injures another person or damages another's property. Because of its social importance, the form, cost and distribution of this protection is regulated by Federal and State governments.

In view of the comprehensive nature of the insurance system, this writer is convinced that legislative and industry reform efforts must be directed to two major areas:

The first requires a pragmatic examination of the tort principles which make accident compensation contingent upon the claimant's ability to establish "negligence" in adversary judicial proceedings. Court dockets congested by minor accident claims, inadequate judicial and administrative facilities and manpower, impracticable rules of evidence and pretrial proceedings, outmoded settlement techniques, restrictive applications of the doctrine of contributory negligence, and other practical aspects of the existing negligence compensation system present possible subjects for reform. However, in my judgment, it is unlikely that the Congress or state legislatures will find sufficient cause in these troubled areas to abolish tort doctrines of compensation in favor of a no-fault plan.

Apart from the powerful opposition of groups which have a vested interest in the negligence system, enactment of a no-fault plan involves many far reaching policy decisions.

Is a system which places the cost of motor vehicle accidents on "innocent" or "good" drivers either desirable or acceptable to the American public?

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4 STAFF REPORT, supra note 1, at 11.
5 For a discussion of the confusion that has developed over the use of the term "system", see House Debate On S. Res. 129, 114 CONG. REC. 3416 (1968).
7 Massachusetts has had unfortunate legislative experience with the plan. In 1967, the lower house of the legislature passed a variation of the widely discussed Keeton-O'Connell No-Fault Plan. Press reports which publicized the bill as a complete answer to the state's insurance woes generated public pressure for the plan's enactment. However, with the discovery of major defects in the plan at the last moment, the senate rejected the bill.
Would such a system involve cost, savings or merely redistribute the responsibility for accident compensation?

Would such a system adequately evaluate claims for serious personal injuries and pain and suffering or, conversely, would it promote fraudulent applications for payment?

Would a no-fault plan administered by the private insurance industry solve existing problems of insurer insolvencies, high premium rates and restrictive underwriting practice?

These issues undoubtedly will take years of research and debate to resolve definitively. In view of the present national concern with insurance industry conditions, it can be anticipated that legislatures will concern themselves with immediate improvements in the existing compensation system rather than engage primarily in costly experimentation and academic speculation.

The second major area of the present system which calls for urgent reform is the insurance industry's regulatory and rate making structure.

In my judgment, it is in this area, which is barely perceived by the general public, that answers to the following important questions will be found:

Why are so many automobile liability policies terminated without apparent reason?

Why is the so-called high risk market and the assigned risk population constantly growing in an industry which speaks glowingly of competition?

Can true competition prevail when the buyer must have the product?

Are premium rates determined by the experience policy holders create, by subjective industry judgments, or by the calculations of actuaries rationalizing predetermined rate increases? 8

I am convinced that most of the automobile insurance problems now confronting the United States derive from the federal-state relationship established in the McCarran-Ferguson Act 9 for regulation of the insurance industry. This pattern of regulation

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8 See generally Hearings on Insurance Industry, supra note 3 (testimony of David Maxwell, Pennsylvania Insurance Commissioner).

had its origin and inception in 1944 as a result of the decision of the United States Supreme Court in the case of *United States v. Southeastern Underwriters Association.* This case originated in 1942 when the Department of Justice instituted an investigation that resulted in a criminal indictment in Georgia against the Southeastern Underwriters Association, twenty-seven of its officers, and one hundred ninety-eight member companies. Two violations were charged, price fixing and agreement to monopolize. The United States District Court, following precedent established in 1868, dismissed the case on the ground that insurance business was not commerce and thus was not subject to regulation under the Sherman Antitrust Act. On appeal, the United States Supreme Court reversed and affirmed the supremacy of the power of Congress to regulate insurance in the public interest in the following terms:

Our basic responsibility in interpreting the Commerce Clause is to make certain that the power to govern intercourse among the states remains where the Constitution placed it. That power, as held by this Court from the beginning, is vested in the Congress, available to be exercised for the national welfare as Congress shall deem necessary. No commercial enterprise of any kind which conducts its activities across state lines has been held to be wholly beyond the regulatory power of Congress under the Commerce Clause. We cannot make an exception of the business of insurance.

Immediately, the insurance industry and State commissioners were presented with a decision. That decision was whether to completely change existing practices or to obtain legislation in the Congress negating the Court's decision. Actually, the decision had been anticipated and legislation was, in fact, pending in Congress when the decision was announced. Thus, to nullify the Supreme Court's decision, the National Association of Insurance Commissioners immediately undertook action to obtain enactment of that legislation and, as a result, on March 9, 1945, the
hurriedly and inadequately debated McCarran-Ferguson Act became Public Law 15 of the 79th Congress.

In effect, the responsibility for insurance regulation was vested in the states and by exempting the insurance industry from federal antitrust jurisdiction, the Congress reestablished the legality of the practices successfully challenged in the *Southeastern Underwriters* case.

However, the effect of this monumental legislation on the public interest was not immediately apparent. Congress was then concerned with World War II; automobile transportation in wartime 1944 was extremely limited. Cars were not being produced and those pre-war vehicles available for civilian use were not capable of the 300 horsepower of modern machinery. Similarly, highway construction projects were limited to providing defense and economic infrastructure. Thus accidents were at a minimum. With the tremendous increase in America's dependence on automotive transportation, however, the problems inherent in the McCarran-Ferguson Act of 1944 have become evident.

First, with all deference to the dedicated efforts of many State commissioners, State governments generally have proved ill prepared, incapable or unwilling to effectively regulate insurance in the public interest. Under the McCarran-Ferguson Act's delegation of supervisory authority, the several states have established diverse systems of insurance regulation and licensing requirements.

However, with respect to ratemaking procedures, a majority have adopted some form of the 1947 All Industry Commissioners Model Bill drafted by the NAIC. Generally, this approach permits individual companies or, alternatively, rating organizations to file applications for rate increase for approval prior to taking effect. The standard applied by the state supervisory authority is whether rate increases are "excessive, inadequate or unfairly discriminatory." Under this fragmented system of regulation, separate determination of the "reasonableness" of rate increases by individual state authorities has proved a vexatious and inconsistent procedure. Generally, the state insurance commissions have been ill-equipped in terms of budgets, staffing and expertise to

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14 Staff Report, supra note 1, at 34-39.
gather and analyze the data indicating the "reasonableness" of premium increases.\textsuperscript{15} Largely this inability results because under conditions of contemporary automotive transportation, rate reasonableness depends on the nationwide profit and loss experience of insurance companies, their internal corporate structure and overhead, and the frequency and seriousness of interstate automotive accidents. Certainly, the state commissions have been at a disadvantage in dealing with centralized insurance rating bureaus which employ specialized personnel and impressive nationwide statistical intelligence and data gathering systems.\textsuperscript{16} Apart from the inadequacies of state administrative and supervisory agencies, in many states, state officials have proved unduly responsive to the interests of the insurance industry and, for political reasons, seem to have substituted cooperative arrangements for arm's-length dealings.\textsuperscript{17} It has only been in recent years that public rate increase hearings have been held and public defenders appointed to cross-examine the experts,\textsuperscript{18} to present arguments against the application, and to represent the public. In the words of the House Judiciary Committee: "All these factors add up to inadequate protection to public interest and too great a reliance on an industry that is all too willing to assist the processes of its own regulation".\textsuperscript{19}

A second major defect of the McCarren-Ferguson Act is that the blanket exemption of the insurance industry from federal antitrust jurisdiction has permitted the automobile insurance industry to maximize profits without regard to the public interest.\textsuperscript{20} Moreover, under exemption from the Sherman and Clayton Acts, the industry has preferred to request rate increase through collaborative rating bureaus rather than on the basis of individual competitive performance of companies.\textsuperscript{21} Accounting methods designed to indicate operational losses rather than the true

\textsuperscript{15} Id.

\textsuperscript{16} Id.

\textsuperscript{17} Id.

\textsuperscript{18} New Jersey policyholders were represented by such counsel at rate making hearings for the first time in 1967.

\textsuperscript{19} See STAFF REPORT OF THE ANTI-TRUST SUBCOM. OF HOUSE COMM. ON THE JUDICIARY, 90TH CONG., 1ST SESS., AUTOMOBILE INSURANCE STUDY (1967).

earnings picture and general marketing inefficiencies have also been charged against some companies.\textsuperscript{22} Further, insurance companies have resisted any effort by State Commissioners to include investment income from prepaid, unearned premium and claim reserves in the consideration of rate increase applications.\textsuperscript{23}

It would, however, seem unfair to place the blame for defects in the automobile insurance system solely with the private insurance industry and State regulatory structures. Industry contentions that higher jury verdicts, more costly repair expenses, and soaring hospitalization and physician costs contribute to the problem seem well founded.\textsuperscript{24} Likewise, increased accident rates, inadequate safety design of cars, and inadequate highway safety engineering\textsuperscript{25} undoubtedly provide contributing causes. Yet, despite these higher costs and causes of increased claims, there appears to be no justification for the industry's performance or for the ineffectiveness of present regulatory agencies. In short, reform of the federal-state structures established pursuant to the McCarrren-Ferguson Act seems required to protect the public interest.

While many interested and knowledgable persons have expressed hope that the insurance industry will undertake voluntary self-reform, federal legislation, in my judgment, is the only means to correct existing defects. This conclusion is based on the industry's response to recent public outcry and its continued absorption with profits.

Rather than embark on a program of voluntary reform, the industry seems to have relied on a massive public relations campaign—a campaign designed to minimize public complaints, to exaggerate valid industry problems, and to shift the blame for abuses of the public away from the industry.

One widely publicized public relations device has been the so-called non-cancellable policy. According to nationally circulated advertisements, motorists are insured for a stated period (5 to 10 years) and are "guaranteed" against cancellation. However, most of these policies do not protect against non-renewals at the end

\textsuperscript{22} Birkensha, Investment Income and Underwriting Profits: And Never the Twain Shall Meet? 8 B.C. IND. & COM. L. REV. 713 (1967).
\textsuperscript{23} Id.
\textsuperscript{24} Remarks by T. Lawrence Jones, President of the American Insurance Association, on release of the Association’s Special Committee Report on the Keeton-O’Connell Plan, Oct. 21, 1968.
\textsuperscript{25} Id.
of the policy term. None guarantee that premium rates will not be raised to a prohibitive level.

A second response by major insurers has been to propose a system of rate regulation which is theoretically based on "open competition". This would abolish the existing regulatory system which requires insurers to justify rate increases prior to their becoming effective. It is argued that competition in an open market will hold rates down and permit insurers to expand their markets. In brief, the proposal is to remedy an inadequate regulatory structure by completely turning over rate making to the insurance industry. In my judgment, the tremendous importance of modern insurance to the public and the industry's continued preoccupation with profits does not permit its regulation to be left to existing market forces and practices. Moreover, in California where this plan has been adopted, the public's experience with rates and policy coverage has not been satisfactory. According to data provided by the Association of California Consumers, rates have soared since enactment and proportionately less premium dollars are used to pay accident claims. It is also interesting to note that California has found it necessary to enact a law regulating policy cancellations. Moreover, the assigned risk population has increased tremendously since adoption of the open competition plan.

The recent situation in New Jersey is an example of the industry's unwillingness to participate in reform programs. In February of 1968, after an unprecedented full public hearing, the New Jersey Commissioner of Banking and Insurance denied applications for a 20.6 percent increase filed by the National Bureau of Casualty Underwriters. The national significance of this decision is based on the factors taken into account by the Commissioner in determining that insurance companies were making a "reasonable" profit at present rates:

First, investment income on "unearned premium" and "loss claims" reserves was considered.

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27 Hearings of the Senate Subcomm. on Anti-Trust and Monopoly, supra note 23, at 7571-76.
28 Id.
Secondly, profits on "excess limits" coverage beyond New Jersey's basic coverage of $10,000, $20,000, $5,000 were included. The response of the insurance industry to this far-reaching decision was incredible. Indeed, it prompted the Deputy Commissioner of Insurance to describe the situation as follows: "The insurance companies are determined to teach New Jersey a lesson so that no other State Insurance Department will ever dare do what New Jersey has done." Principal techniques employed by the industry's campaign were the widespread cancellations and non-renewals of automobile and property coverage; agents' commissions throughout the state were cut; companies denied agents binding authority on automobile coverage; and many companies refused to write automobile coverage unless the applicant purchased other lines of insurance such as life or commercial; and agency agreements were widely terminated.

The industry's campaign in New Jersey also involved widespread avoidance of the Commissioner's decision by a "consent to rate" procedure. This consent to rate procedure is permitted under a 1962 New Jersey law which principally sought to permit motorists with bad driving records to obtain adequate coverage rather than being forced into the assigned risk pool where maximum coverage limits are $10,000, $20,000 and $5,000. Under the procedure, such motorists can obtain any desired coverage with private companies, but they must first sign that they are willing to pay a higher premium. Subsequent to the rate making de-

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29 Deputy Commissioner Horace Bryant, statement reported by Newark-Star Ledger.
30 New Jersey Insurance Department officials received 2,500 complaints from persons having their insurance cancelled during the six months subsequent to the rate decision. Since prior experience indicates that the Department receives only five percent of the total cancellation complaints, a figure of 50,000 cancellations can be projected for this period.
31 A letter from Continental Insurance Companies to its agents, May 1, 1968, directed as follows:
"It is required that you not bind us on any new private-passenger-auto-
mobile risk . . . after receipt of this letter . . . . You may submit ap-
plications without binders for new family automobile policies when we
are, in your judgment, the logical carrier because of other lines that we
now have for the applicant . . . ."
32 Id.
33 During 1966-1967, there were only 7,277 agency cancellations. However, during the first six months of 1968, New Jersey officials reported 6,900 such cancellations.
cision, use of these procedures increased by approximately one hundred percent. In advocating corrective federal legislation, it is not suggested that the Federal Government should or will completely preempt automobile insurance regulation. I am, however, convinced that a more efficient, uniform, and less costly pattern of regulation can be established through coordination or centralization at the federal level. Such a regulatory pattern should include a minimum amount of legislation along the lines of the Federal Deposit Insurance Corporation Act to insure against insolvencies of insurance companies, laws requiring minimum standards in regard to capitalization and reserves with federal authority to make certain they are maintained, laws spelling out bases for cancellation and refusal to renew policies, and legislation eliminating discrimination in relation to age, nationality, and color.

The writer believes that the McCarren-Ferguson Act should be amended to extend federal antitrust jurisdiction to the automobile liability insurance industry. The arguments of the industry that application of the Sherman and Clayton Acts to the business of insurance would result in destructive and excessive competition do not appear substantial. Primarily, these arguments hold that individual companies do not have sufficient experience on which to base rates, and that such experience can only be gathered and collaborated through rating bureaus.

However, in my judgment, the ability of large companies to operate profitably on the basis of their own individual experience has been amply demonstrated by the past and present successes of aggressive independent companies. With respect to the smaller companies, it would not be impossible to establish a publicly controlled statistical bureau which could compute and make available the necessary actuarial and loss experience data. Indeed, in the Southeast Underwriters Association case, the Department of Justice suggested precise guidelines for operation of rating bureaus within a competitive framework. Each company would belong to a privately operated statistical bureau. The activities of the bureau, however, would be subject to public regulation and would

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35 In 1967 there were only 25,051 approved "consent to rate" filings. However, during the first six months of 1968, the figure stood at 26,226.
37 See Staff Report, supra note 1, at 73.
be limited to development of pure premium based on the combined loss experience of all carriers.

Another priority area for reform is the congestion of court calendars, especially in connection with the small claim. The tremendous backlog of court calendars throughout the nation provides persuasive evidence of the need to find some way of expeditiously processing the thousands of claims which arise from minor traffic accidents. This writer would urge careful investigation and analysis of a plan establishing a federal agency that would compensate victims of automobile accidents regardless of fault for their out-of-pocket expenses to a maximum of $2,500.00.38

38 Under the plan, claimants could recover for hospital, medical and drug bills, loss of earnings and other out-of-pocket expenses to be specified in the legislation. There would be no award for pain and suffering and, since most automobiles are covered by collision insurance, which currently provides adequate protection, property damage to automobiles would not be included.

While it appears that Congress has the power to take the automobile accident problem out of the courts [The Moses Taylor, 71 U.S. (4 Wall.) 411 (1866), and NLRB v. Jones and Laughlin Steel Corp., 301 U.S. 1, 48 (1937)], and proclaim an exclusive Federal administrative remedy insulated from judicial review [Switchmen's Union v. National Mediation Board, 320 U.S. 297 (1943)], such coercive action seems unnecessary. The anticipated superiority of the agency relief should allow the plan to operate efficiently on a voluntary basis. Thus, submission of a claim to the federal agency would be completely elective under the plan and the claimant would lose no presently-held negligence recovery rights. Rather, the agency would be established in addition to present court remedies and would be given concurrent jurisdiction with the state and federal courts.

The determination of the agency would not be conclusive on the claimant. No appeal would be provided for from the federal agency. Thus, the claimant could take the award, which would foreclose him from any further proceedings, or he could refuse the award and go to the state court. However, the converse would not be true. A claimant disappointed in a state court by a judgment which is res judicata could not enter the federal forum.

An accident victim would therefore be confronted with a choice of remedies. If his claim of injuries is minor, it is unlikely that he will choose the state court system where recovery depends upon negligence, compliance with rules of evidence and stringent proof as to damages. Rather, it is believed that the many traffic victims with small claims who are now forced into the state court system would choose the easier, quicker, surer and cheaper route to compensation.

Financing the plan would require careful investigation and development of actuarial data and statistics in order to determine both the initial and operating funds necessary. However, as demonstrated by the recent federal legislation with respect to flood insurance, the cooperative efforts and resources of the Federal Government and private industry would seem the best method of funding and operation. Several methods recommend themselves for development of the federal share of the costs. These include, inter alia, an annual federal tax on motor vehicle registration, use of gasoline taxes, and other sources which further dialogue might prove feasible.

Admittedly, there remain many questions with respect to the establishment and the operation of such a plan. However, I would hope its presentation will at least bring about further discussion and that it may have some contribution to make in the ultimate solution of the overall problem. There remain too many questions, too many unknown variables, and too little objective data in the present search for solution to this major social problem to suggest any definitive solutions.
This would permit both state and federal court systems to devote their attentions to the refined and deliberate process of adversary trial in major causes of action where the plaintiff's claims of pain and suffering and loss of future earnings require such careful scrutiny.

As the nature of these proposals indicates, existing congressional concern with the automobile insurance system is not directed to legislation that would make insurance a public utility; nor is there presently any major congressional support for abolition of tort negligence compensation doctrines. Certainly, results of the ongoing study of these problems by the United States Department of Transportation, scheduled for completion in 1970, will spark renewed interest in no-fault plans. However, as previously indicated, I would anticipate that, in seeking corrective measures, the Congress will be primarily concerned with practical reforms along the lines suggested.