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MR. FRATIES

Q: Well, I don't mean to critize them as having done anything wrong or immoral or illegal, but what happened was that their investment didn't turn out as well as they thought it would, is that not so?

MR. BLOCK

A: No. I don't think it had anything to do with the investments not turning out, they turned out fine, it's that what they did was the losses were so high compared with the premium they collected to invest, that they got trapped.

MR. FRATIES

Q: Well, that's what I'm getting at. Isn't it true that at that time in an effort to obtain money to invest in this favorable investment climate, that the insurance companies either relaxed their underwriting standards or they went or they lowered their rates disastrously to compete for the money that they needed for investment?

MR. BLOCK

A: Well, what you're saying is that had they not done that, then we would have hit today's point about three years ago.

MR. FRATIES

Q: I'm not saying anything of the sort. What I'm asking you is that aren't you in a way proposing that we revamp or if you like, junk a tort system that has taken us two or

three hundred to develop in order that we may compensate for your disastrous underwriting policies?

MR. BLOCK

A: No, that's not at all what's being said, because what I just said is still true, and that is had the insurance industry not reduced its prices below cost, then we would be at this insurance pricing crisis about three years ago and then we would have the same crisis. The fact of the matter is that whatever may be the prices charged by the insurance industry, the losses continue to go up, that's the problem that has to be addressed and because the insurance industry may have masked it for a period of time by underpricing the product doesn't mean that the problem isn't there. Now if you regard the crisis as this sharp increase, this phenomenon of the cycle, on the sharp increase comparing this years prices with last, yes there is a crisis and that could have been avoided by a continual pattern of increasing pricing and not engaging in this competitive cycle but it doesn't . . .

MR. FRAITES

Q: Mr. Block what I'm really asking you is if you have a loss ratio in any of these categories that we're talking about that justifies the drastic increase in premiums that your asking for, because the normal underwriting standards, isn't it true, that losses and loss ratios and good underwriting dictate what you're going to charge the customer.

MR. BLOCK

A: That is correct, and what I was pointing out here is that the loss ratios justify substantial increase in prices.

MR. FRATIES

Q: The loss ratios as compared to the premiums that you've been collecting.

MR. BLOCK

A: That's correct.

MR. FRATIES

Q: During that period of time when you lowered premiums in order to compete for money in the market in order to invest properly.

MR. BLOCK

A: That and the loss ratios that are developing from years prior to that, that's correct.

MR. FRATIES

Q: Well, is there a possibility Mr. Block to come back to my original question, that the increase in premiums that you're asking for, and the general revamping of this tort system that we're concerned with here, is an effort to collect money that has nothing to do with the impact on the insurance industries of the way we settle our torts claims, is rather a matter of trying to get well from an accident that occurred a few years ago due to improper investment practices in the insurance industry.

MR. BLOCK

A: Well, I think what you're asking me to say here is . . .

MR. FRATIES

Q: I'm not asking you to say anything Mr. Block. Really, I'm not trying to be unfriendly, I'm just concerned because I didn't hear a word up to this time about loss ratios. I haven't heard any indication whatsoever for example, of lawyers as a class have suddenly become a disastrous insurance risk, but anytime that you take somebody's insurance premiums and multiply them by ten you've suddenly gone from pig iron under water to dynamite factories so far as the risk that entering and I'm wondering whether we're looking at the risk or whether we're simply getting wealth from an economic disaster in the industry of some sort.

MR. BLOCK

A: There are three factors that are going to be looked at predominantly. One is the current and past level of profitability and you might want to call it the getting well factor. That plays a role in it. Number 2, the actual reported losses and how those are reflected on the books. The loss ratio that you referred to, that plays a predominant factor. And the third is the perceived exposure based on the development of the law. And if an insurance company's told, that it can only write X number of dollars of insurance, which is less than what it would

have had to be writing in the past for any number of reasons, it's going to tend to be more selective and pick those areas where the legal environment and whatnot predicts the higher level of profitability, and if there are areas where it is either unpreditable or predictedly a high exposure they're going to avoid it or price it in order to minimize that exposure.

MR. FRATIES

Q: Well then let me ask you this final question Mr. Block. You've talked about the get well factor. Now talking about loss ratios and predictability, what is there that you could tell us about for example that in terms of predictability that makes you feel what Mr. Sanders, or in terms of his past loss ratio, and I understand that Mr. Libbey hasn't had any losses, would make you feel that it is necessary to increase their premiums by ten fold and six times respectively?

MR. BLOCK

A: Well, if your past incarnation you were in the insurance business you know that you don't . . .

MR. FRATIES

A: I was.

MR. BLOCK

A: that you don't just evaluate whether how you write legal malpractice based on Mr. Libbey's performance or Mr. Sander's performance. You base it on the performance of

the industry as a whole and what the changing legal environment is as to legal malpractice and as the exposur expands, and you find the courts awarding more liberal awards for whatever reason and in changing law, then the rates are going to have to go up to reflect the exposure. That's not a reflection on Mr. Libbey's practice, it's a reflection on the character of the law affecting lawyers exposure to the public.

MR. FRATIES

Q: That's what concerns me because from my vantage point suc as it is on the Board of Governors of this State, of the Bar of the State, I haven't seen anything whatsoever to indicate that there is a massive increase in exposure on the part of lawyers and that's the only aspect of it that I know about. Well I can see one of my colleagues there in the looking wildly around, but the fact remains that there may be some reserve setup, but I haven't heard of any claims being paid out.

MR. BLOCK

A: Well I would invite you to talk to the legal insurance carriers that are providing legal malpractice insurance. I'm sure they can justify their figures in one way or another, it's not my field, so you'll have to talk to them. Fundamentally, that's what taking place.

MR. FRATIES

Q: Thank you.

MR. BLOCK

Thank you.

MR. BRANSON

Q: Mr. Thompson, you had some questions.

MR. THOMPSON

Q: I have a couple of questions for Mr. Block. I'm sorry if we seem to be picking on you, but you have the most figures of anyone, you actually had numbers that we could come to grips with. You were using numbers which we could come to gri with and many of the people talking general principle. M. Wagstaff asked earlier about the loss of the insurance industry over the last couple of years and I believe his question was predicated on this National Insurance Consumer Organization which I took you're not impressed with.

MR. BLOCK

A: Not really.

MR. THOMPSON

Q: Okay. How about Best review, A and Best, that's sort of the regular handbook of the industry isn't it?

MR. BLOCK

A: It tends to be, yes.

MR. THOMPSON

Q: I mean that's what's externally accepted and its industry creature . . .

MR. BLOCK

A: That's right.

MR. THOMPSON

Q: Alright, I'm bringing this information from Best Review o January of this year in the case that the casualty property casualty insurance industry grew by 7.6 billion dollars in net worth last year, 1985.

MR. BLOCK

A: That's probably so.

MR. THOMPSON

Q: And its increased from 35 billion to 71 billion since 1978, in net worth.

MR. BLOCK

A: Yep, it's probably right.

MR. THOMPSON

Q: I'm not an accountant, that sounds to me like you're making a lot of money.

MR. BLOCK

A: Over the long term we have and I would suspect over the long term we'll continue to for the reasons I pointed out

MR. THOMPSON

Q: Okay. See it's difficult for me as an attorney and not a accountant to tie that kind of profitability to the kind of increases we're seeing in the premiums. These increases allegedly are reflecting losses that are increasing your net worth. Your net worth is blowing up like a balloon.

MR. BLOCK

A: Alright, well, there's other things that contribute to net worth, such as contributions of capital and other things that go to increase the net worth, but you know I think all you're doing is emphasizing the point that I made a little earlier during my main presentation. Insurance industry as long as its permitted to exists is going to continue on the long term to make a profit by charging somewhat more than what it takes to cover the losses and you know there may be a period when we didn't do that and it's going to, the premiums are going to go back up to accomplish that end, and yes there's going to be on the long term, growth in capital and there's going to be growth in earnings and all the things that you're citing. That's the natural, that's the natural thing that you could expect in a free enterprise econoomy.

MR. THOMPSON

Q: I just, I don't understand why the net worth is up 7.6 billion when you lost over 5 billion. I don't, I don't - there's a disparity there that I can't come to grips with.

MR. BLOCK

A: Well I'm not entirely sure, I would have to pull the figures up, make sure I'm reading the same ones you are to explain it, but you know first of all we ought to use a consistent basis of accounting and whatever basis you like

we'll just use it consistently throughout. The problem with the MEECO report is it's making up a few of its own amendments to the standard accounting system.

MR. THOMPSON

Q: Well, I was . . .

MR. BLOCK

A: The best figures which you now are harking back to show comparisons over 1978, almost an eight year period, I have to agree with you that business has been profitable over the eight year period and it's going to continue to be profitable hopefully over the next eight to ten year period no matter what happens to the tort system. That's that's the point I was trying to make.

MR. THOMPSON

Q: The comments that you had about the requirements that you report various information and whatnot, are you aware of the problems we've been having in trying to find out something about legal malpractice rates? I mean we've been scratching for months and we can't get any information that any of us can understand?

MR. BLOCK

A: I'm not intimately familiar with the problem you're having, no, and if you'd like me to help you get that information, I'll point you in the right direction, or work with you to get it.

MR. THOMPSON

Q: I think we knew . . . we were pointed in the right directions and we went and got the information that was there, but it doesn't tell us anything.

MR. BLOCK

A: Well, I don't know what you've got, so I can't, you're ahead of me on that, so I just don't know.

MR. THOMPSON

Q: That's the only question I had concerning the rates.

MR. BRANSON

Q: Mr. Block I have a short question, I wonder is it necessary for you to increase rates . . .

MR. BLOCK

A: What's that?

MR. BRANSON

Q: Is it necessary for the insurance industry to increase rates by the multiple that they've been increased? I mean look at somebody that's never had a claim in 20 years and suddenly they're paying six times as much as he paid before, or ten times as much as he paid before. I recognize that you dipped under that line a little bit and you've got to make that up and I guess you want to make it up right away, because these rates seemed to reflect it. You want that money yesterday, you want it back, so you're going to raise these rates, but do you really have to raise them this high? Do you have to raise 200, 300

percent for some insurers and more to get that line that you showed us awhile ago. To get that, you didn't dip 200, 300%, you didn't dip six times, ten times, but those are the kinds of rate increases we seem to be seeing. Is that, do you, maybe I'm, I'm not a statistician, so maybe I'm looking at the wrong kind of measurements, but seems to me you're raising the rates much higher than you have to, to bring yourself back up on line from this momentary swing in your economic situation.

MR. BLOCK

A: Okay. Well let me give you the short answer to your shor question.

MR. BRANSON

Q: Thank you.

MR. BLOCK

A: The fact of the matter is, I mean I, without knowing what policy or what line of insurers you're specifically referring to, there's another phenomenon that perhaps I didn't dwell on quite long enough, but let me just say that there's another aspect to what happens when you have a significant loss in the insurance business and it eats up a lot of capital. You find that the insurance industr then can provide less coverage overall, and demand begins to exceed supply. And whenever that happens, the insurance industry is going to have to make some choices. Do we sell this kind of insurance? Or that kind of

insurance? Do we sell it in this state, or in that state? Do we accept these large risks, or do we accept the pig iron under water type of risks? And when you start to make those choices, what you find is the insurance industry is naturally going to gravitate to the lines and the level of risks, and the classes, and the state's, and the jurisdictions, where profitability is more predictable. More certain. And so, in the area of property insurance, and workers compensation insurance, there is other lines of insurance you're not seeing. Those kinds of increases, you're seeing increases, but you're not seeing the 2, 3, 5 and 10 manifold by the rate increases. You're seeing 20, 30 or 40 percent increases maybe. Now, what happens is, if they use up that capacity writing those kinds of insurance, then what happens, the demand for these other more risky types of coverages become so critical that I would imagine the insurance industry has got to respond like any other limited availability of vendors, they're going to get the prices up to meet the market. And where you have high risk covers, like legal malpractice has become, or medical malpractices in many classes and daycare centers because of phenomenon in their particular industry the insurance industry has got to respond by rapidly increasing those many manifold pies because of the three things that I said. Because of the recoupment problem that was referred

to over here. Because of the loss ratio that Mr. Fraties referred to. And because of the insurance industry's perception prospectively of the legal environment they're buying into.

MR. BRANSON

Q: Thank you. One other question. Dr. McGuire, during the break you asked me to ask you a question, that you felt something had been misstated and I'd like to give you an opportunity to respond to that. It had to do, I believe with a statement made by Mr. Libbey about the Canadian or Ontario insurance experience, and if you'd like to . . .

DR. MCGUIRE

A: Thank you for that opportunity. We were told in the House labor and commerce hearings in Juneau that Iowa and Ontario had passed substantive tort reform and that they hadn't worked there and so it wasn't going to work anywhere else. Well the fact of the matter is that Iowa didn't pass any substantive tort reform and that's why it didn't work. The second fact is that Ontario passed no legislation in 1970. By case law there was a cap on pain and suffering. There were restrictions on punitive damages and addendum clause and restriction on contingent fees and the penalties for frivilous suits. This is case law, it was not legislated and so to say that it was legislated is misleading. Thank you.

MR. BRANSON

Q: I don't remember Mr. Libbey. Did you say this WAS legislative, case law, or you have a . . .

MR. LIBBEY

A: I said it existed in the 1970s. I may have said it was passed, I listened to the same evidence at the hearing that Dr. McGuire did and that was basically my source.

MR. BRANSON

Q: I have been told by our television director Mary Hughes that I have five minutes left, are there any other questions from the Board? Mr. Ditus.

MR. DITUS

Q: Dr. McGuire did you indicate you're not a member of MICA?

DR. MCGUIRE

A: That's true.

MR. DITUS

Q: Have you ever been?

DR. MCGUIRE

A: No. I have never been.

MR. DITUS

Q: As I recall, where you here in 1976?

DR. MCGUIRE

A: I came in 1976 to start private practice.

MR. DITUS

Q: At that time there was a great crisis from the medical profession indicating they had no insurance.

DR. MCGUIRE

A: That's true.

MR. DITUS

Q: And I believe the legislature gave them six million dollars, interest free to set up an insurance fund.

DR. MCGUIRE

A: I'm not sure if they gave it to them or loaned it them.

MR. DITUS

Q: But it was several million, interest free?

DR. MCGUIRE

A: Yes. It's true.

MR. DITUS

Q: And at that time Mr. Block was the commissioner I believe or the director of the Division of Insurance.

DR. MCGUIRE

A: True.

MR. DITUS

Q: And part of this program was that it would be mandatory.

DR. MCGUIRE

A: True.

MR. DITUS

Q: So that every doctor would have to purchase this insurance and create a fund that in time would build up into something that would perhaps take care of this problem forever?

DR. MCGUIRE

A: That was said.

MR. DITUS

Q: And did you initially join, or you never joined?

DR. MCGUIRE

A: I never joined.

MR. DITUS

Q: And then some physicians refused to join?

DR. MCGUIRE

A: They did.

MR. DITUS

Q: And they were threatened that they wouldn't be able to practice if they didn't join?

DR. MCGUIRE

A: They were.

MR. DITUS

Q: And then later the Attorney General withdrew those demands and they were allowed . . . the law was modified to make it voluntary?

DR. MCGUIRE

A: It's true.

MR. DITUS

Q: How many physicians joined MICA when it was set up?

DR. MCGUIRE

A: Roughly 50 percent of the doctors are presently insured.

MR. DITUS

Q: How many were here at the time MICA was first set up?

DR. MCGUIRE

A: I don't know.

MR. DITUS

Q: You know how many were in MICA at the time it was set up? How many?

DR. MCGUIRE

A: I do not know.

MR. DITUS

Q: You know how many phsicians there are in Alaska today?

DR. MCGUIRE

A: There's 625 in private practice.

MR. DITUS

Q: And how many of them belong to MICA today?

DR. MCGUIRE

A: Roughly half.

MR. DITUS

Q: Approximately 300? So half of them saw fit to use the creature that was created by the State and half haven't?

DR. MCGUIRE

A: May I respond to why?

MR. DITUS

Q: Were you ever a member of it?

DR. MCGUIRE

A: May I respond to why I wasn't?

MR. DITUS

Q: You want to respond?

DR. MCGUIRE

A: I'd like to.

MR. DITUS

Q: Why didn't you ever join?

DR. MCGUIRE

A: Because it was claims made insurance. Because it was mandatory and if we ever got on that bandwagon without any competing factor there would be no upper limit to the premiums that we would be forced to pay and would have no choice as to whether we could continue to practice with or without insurance. It was a dead end.

MR. DITUS

Q: Doctor are you familiar with what we call civil rule 68?

DR. MCGUIRE

A: No. I don't think so.

MR. DITUS

Q: Has any lawyer ever explained that to you?

DR. MCGUIRE

A: No.

MR. DITUS

Q: Have you ever been sued for malpractice?

DR. MCGUIRE

A: Yes.

MR. DITUS

Q: And did you have an attorney?

DR. MCGUIRE

A: Yes.

MR. DITUS

Q: Did he indicate to you that if you made an offer of judgment, and that the recovery of the party who was claiming to have been injured, that if he recovered less than that offer, that you would recover from him not only your attorneys fees and expenses and costs of litigation, but that they would also be denied to him and that would be subtracted from any recovery?

DR. MCGUIRE

A: Now that you remind me he told me that. The problem was he didn't have any money so there wasn't anything to recover. And now that you remind me again, I did have another where we got a judgment to recover and the same problem occurred. So in effect . . .

MR. DITUS

Q: You do remember now?

DR. MCGUIRE

A: I remember that he said that was the case yes.

MR. DITUS

Q: You got another attorney I take it you say?

DR. MCGUIRE

A: No, I . . .

MR. DITUS

Q: You had the same one both times?

DR. MCGUIRE

A: I didn't recall that I had heard the rule. I didn't recognize Rule 68. Now that you explained it to me I understand that he told me that was true that if . . .

MR. DITUS

Q: What do you mean when you say we go bare?

DR. MCGUIRE

A: It means we don't have insurance.

MR. DITUS

Q: I mean what is that? What does that mean?

DR. MCGUIRE

A: It means you're not covered by insurance.

MR. DITUS

Q: That you're willing to let, to accept responsibility for any act or omission on your part from your own resources. Say rather than an insurance company carrier?

DR. MCGUIRE

A: True. That the measure of the cost of insurance relative to what one can possibly pay makes it so that there isn't any choice and so therefore you may not like the risk, but you take it, cause you don't have a choice.

MR. BRANSON

Q: Mr. Ditus we have a public member. We have time for one more question. Our public member Andonia Harrison wantec to ask a question.

MS. HARRISON

Q: Well I do have one general question to ask probably to Mr Block. As I sat on this Board I think somewhere in between attorneys and the insurance industry, I am a little bit concerned of some of the things that I hear that perhaps as a community person, or a public person ma have and to give up some rights that I feel that has been a part of our system for such a long time. And I guess m question would be, what is the insurance industry, its compensating, what are they having to give or what are they offering for this exchange?

MR. BLOCK

A: Andonia, the last place I would want to find myself as a citizen is somewhere between lawyers and the insurance industry. This is not a negotiation or a balancing of interests between the insurance industry and the public, or even between the insurance industry and that segment o the public that you would, say, characterize as the victims, or people who are injured. It's not that kind o a situation. And the situation is a balancing between what we, what you're trying to set up as what should be the legitimate entitlements of people who

are injured at the cost of the people who are paying the cost of that, which isn't the insurance industry. We are the funnel, we're the vehicle for getting that job done. But is the public who pays the premium, or the public who pays the loss directly, that pays that cost. And so, what you have to ask yourself then is, what is the proper balancing? Not between injured victims and the insurance industry. But what's the proper balance between injured victims and the rest of society? How much should society be asked to pay for the injuries of someone who's injured. And you know when you say, should they be compensated fully for their medical expenses? I don't think there's anyone in this room would say that they should receive one dime less than hundred percent compensation of their medical expenses. Should they receive compensation for their lost wages during the time they're disabled? I don't think anyone in this room would argue that they should get a dime less than all of that. And you can march on through the, call them the entitlements and evaluate each one of them and say, is this something they should be getting? And what you're hearing are really arguments about noneconomic or redundant compensations. You're hearing about should they receive twice? Should they receive their medical expenses from their medical insurance provider and then be reimbursed again by society through the tort law system,

and get a double recovery? Well, if you think they should, fine. If you think they shouldn't, then we're going to have to modify the system. Do you think there should be unlimited awards for the noneconomic loss? If you think there should be some or all or none. You have to make up your mind. It's a public policy question. An the same with everyone of these. So it's not a negotiation between the victims and the insurance company

MR. BRANSON

Q: Thank you Mr. Block. Thank you all. That was very enlighting.

A RAND NOTE

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Deborah R. Hensler

March 1986

N-2444-ICJ

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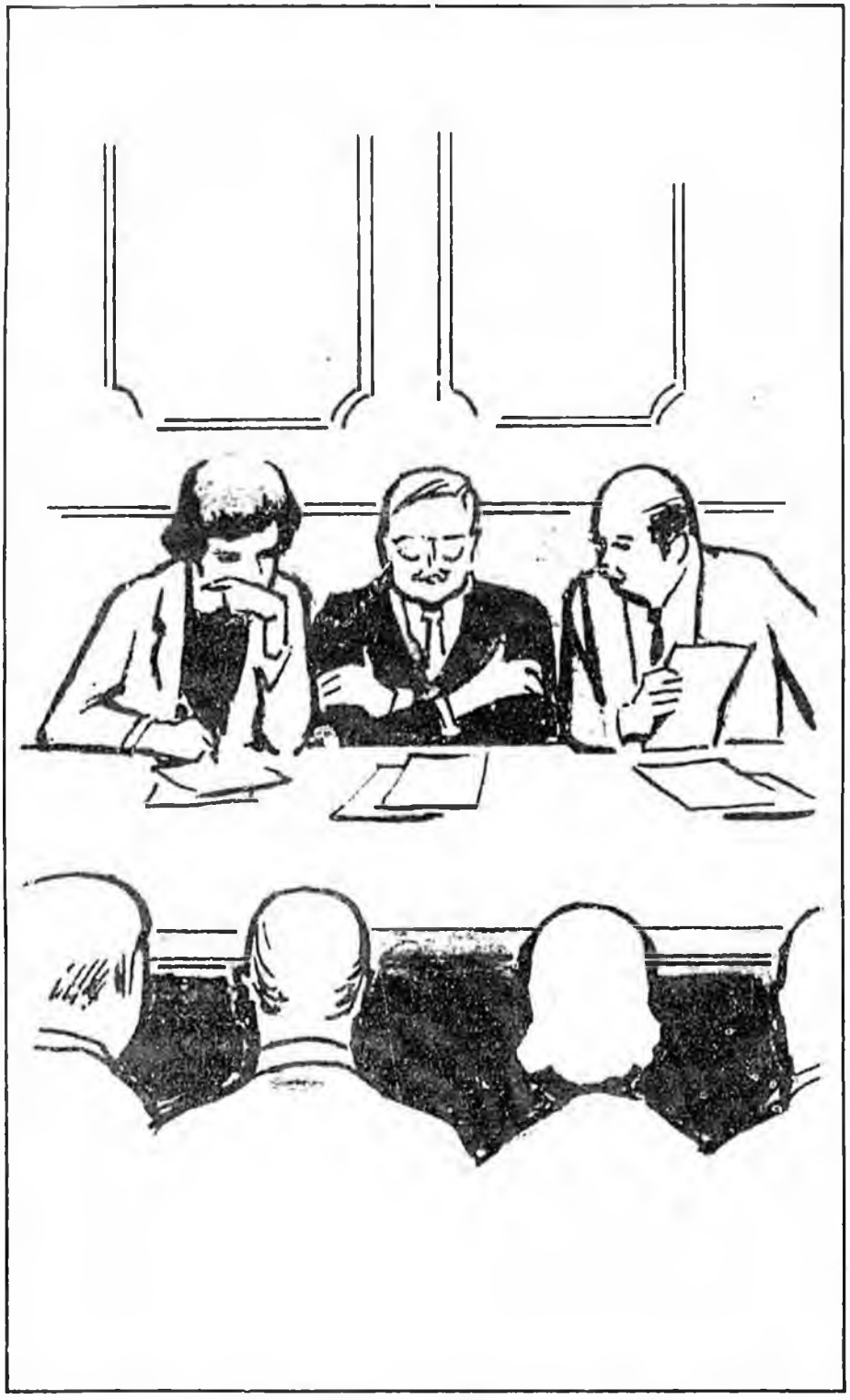
PREFACE

This Note is a reprint of an article that appeared in the February-March, 1986 issue of *Judicature*, Volume 69:5. It summarizes the results of research conducted by The Institute for Civil Justice in the area of court-administered arbitration, describing what we have learned to date and what questions remain to be answered. Other ICJ publications on this subject are listed at the back of this Note and can be obtained from the Institute.



What we know and don't know about court-administered arbitration

by Deborah R. Hensler

Over the past decade, interest in alternative dispute resolution has increased enormously. Initially, attention focused on establishing alternative forums, such as neighborhood justice centers, outside the court system. Proponents of such alternatives believed that they would relieve pressure on the criminal and civil justice systems, while providing a qualitatively better form of dispute processing—one that would be more reflective of community norms and better tailored to the needs of individual disputants. Although many communities now have community-based dispute resolution programs, the available evidence suggests that most disputants do not seek out these programs on their own.[1]

In recent years, as the dispute resolution movement has acquired legitimacy, attention seems to have shifted to the use of alternative dispute resolution procedures within the court system. Most of these alternatives provide some sort of arbitral or mediative process, diverting particular classes of cases from the regular trial court calendar while retaining administrative control over them. Some legislatures view the establishment of such alternatives primarily as a means of reducing judicial workload, and hence, reducing the demand for new judgeships. Judges and court administrators frequently view them as components of a differentiated strategy for caseload management, in which specific categories of cases are assigned to different treatments. Lawyers may view the alternatives as a means of clearing the trial calendar for "more important" litigation. Public and private interest groups may regard alternative dispute resolution procedures as a means of saving litigants' time and money, while perhaps providing a better quality of justice. Just what is meant by "better quality" is often unclear.

Despite the attention that the dispute resolution movement has drawn, there has been little systematic study of its outcomes. It is difficult to determine how much implementation there is to back up the rhetoric, what types of procedures have been established, and what has resulted from different approaches. Thus, it is difficult for policymakers to decide whether they should adopt any of the available approaches and to determine how to design a specific procedure to

maximize its potential for producing benefits to the courts, lawyers and litigants.

Since 1979, the Institute for Civil Justice (ICJ) at the Rand Corporation has been engaged in a program of research on a particular alternative dispute resolution procedure, *court-administered arbitration*, that many court officials and lawyers feel has particular promise for civil lawsuits. In the course of this research we have monitored the spread of court-administered arbitration programs, evaluated the effects of implementing programs, and studied the implications of alternative program designs. Our work has encompassed systematic surveys of court officials, case studies of specific programs surveys of lawyers' and litigants' attitudes toward court arbitration, and technical assistance to local court officials involved in designing or modifying court programs. This article describes what we have learned to date, and what questions remain to be answered.

A profile

Court-administered arbitration programs may be established by statute, by supreme court rule, or by local court rule. However established, all programs authorize trial courts to require arbitration of civil damage suits that fall within a specified jurisdictional limit, as a precondition for placing those suits on the trial calendar. Arbitration results in a verdict that has the force of a court judgment. If any of the parties is dissatisfied with the verdict, however, he or she may reject it and request that the case be calendared for a trial *de novo*. In many programs, appellants who request *de novo* trials are required to reimburse the court for the arbitrators' fees; in addition, in some programs, court costs and attorney fees may be levied on unsuccessful appellants. Such fees are intended to discourage frivolous appeals.

Court-administered arbitration is neither voluntary nor binding.

In all court-administered arbitration programs, cases assigned to arbitration are heard by one or more private attorneys or retired judges who volunteer to serve as arbitrators. Usually, attorneys' time is provided, at least in part, *pro bono*, since they typically receive only a small honorarium for their participation. Arbitration hearings are private, informal, and usually quite brief, the proceedings are generally not recorded, and relaxed rules of evidence prevail. In particular, in lieu of witnesses, medical and other reports are usually sufficient as evidence. In some programs only limited discovery is permitted prior to the hearing. Before they begin the hearing, some arbitrators may ask the parties if they would like assistance in attempting to settle the case, but once a hearing begins, arbitration proceeds as an adjudicative process. The facts of the dispute are heard, albeit in an abbreviated fashion, and the litigants are usually present and may testify. The neutral third party(ies) deliberates and issues a verdict, usually within a few days.

Although court-administered arbitration shares many features with other alternative dispute resolution procedures, it is distinguished from them in several important ways. Unlike private commercial arbitration, court-administered arbitration is neither voluntary nor binding. Unlike a traditional mediator, the arbitrator is not trying to help the disputants fashion a mutually agreeable compromise. And unlike most judicial settlement conferences, there is a true hearing of the case and an opportunity for litigants to participate in that hearing.

The spread of arbitration

The first court-administered arbitration program was established in 1952, in Philadelphia, by amending an 18th century statute that provided for the referral of trial cases to arbitrators. By the 1960s, similar arbitration programs had been established in courts across Pennsylvania, and word of their success in resolving small money damage suits had spread outside the state's limits.[2] In the early 1970s, as many trial courts were struggling to find ways of dealing with sharply increasing civil caseloads, a number of states adopted mandatory arbitration programs patterned after Pennsylvania's.

More recently, during the late 1970s and early 1980s there was a third wave of program adoption. By December 1984, 16 states had authorized mandatory court-administered arbitration programs.[3] A national conference on court-administered arbitration, sponsored by the National Institute of Dispute Resolution in May 1985, may have given further impetus to this recent wave of adoptions; by October 1985, two additional states had passed legislation authorizing mandatory arbitration programs (Illinois and North Carolina).

Early interest in court-administered arbitration was confined to the state court systems. But in 1978, the federal courts decided to experiment with mandatory arbitration in three district courts. Following the formal completion of the experiment, one of the three courts discarded its program while the remaining two maintained theirs. In 1984, under Public Law 98-411, Congress appropriated $500,000 of fiscal year 1985 funds to support a new arbitration initiative in the federal district court system. The new funds are being used to mount mandatory arbitration "demonstrations" in eight districts, bringing the total number of federal courts with authorized systems to ten. Table 1 lists the states and federal district courts that have authorized mandatory court-administered arbitration programs to date.

Once established, arbitration programs have tended to spread within regions from one state to another, and within states from one jurisdiction to another. Table 1 indicates what we learned about the status of local arbitration programs in the course of our last national survey. Based on this information, we estimate that court-administered arbitration programs now exist in approximately 200 of the country's trial courts.

Court-administered arbitration pro-

This article is based in part on a presentation delivered by the author to the First National Conference on Court-Administered Arbitration, sponsored by the National Institute for Dispute Resolution, May, 1985.

1. Merry and Silbey, *What Do Plaintiffs Want? Reexamining the Concept of Dispute*, 9 JUST. SYS. J. 151 (1984).

2. Adler, Hensler, and Nelson, SIMPLE JUSTICE: HOW LITIGANTS FARE IN THE PITTSBURGH COURT ARBITRATION PROGRAM (Santa Monica, CA: The Rand Corporation, 1983).

3. Ebener and Betancourt, COURT-ANNEXED ARBITRATION: THE NATIONAL PICTURE (Santa Monica, CA: The Rand Corporation, 1985).

Table 1 Mandatory court-annexed arbitration programs

Jurisdiction	Program title	Authorization	Earliest date authorized	Current scope
State courts				
Alaska	Arbitration of Small Claims	State Law—A.S. 09.43.190	1972	Never implemented, jurisdictional limit too low to make program useful
Arizona	Arbitration of Claims	State Law—A.R.S. 12-133	1974	Operational in at least 2 counties including Phoenix and Tucson
California	Judicial Arbitration	State Law—C.C.P. 1141.10-32	1978	Operational in 15 counties with 10 or more judges and slowly being adopted in smaller courts
Connecticut	Fact Finding and Arbitration	State Law—Conn. Statutes 52-549N	1983	Statewide implementation but far more cases processed by fact-finding than by arbitration
Delaware	Compulsory Pretrial Arbitration	Superior Court Rule 16(c)	1984	Program began statewide in mid-1984
Illinois	Mandatory Arbitration	State Law—C.C.P. Ch. 110 Part 10A	1985	Rule drafting underway
Michigan	Mediation	Supreme Court Rule (except Wayne County Court); General Court Rule 316	1978	Operational in 28 of 55 circuit courts
Minnesota	Judicial Arbitration	State Law—Minn. Statutes 484.73	1984	Experimental implementation in Hennepin County (Minneapolis)
Nevada	Motor Vehicle Damage Actions Arbitration	State Law—N.R.S. 38.215-245	1971	Very little application, but efforts are underway to launch an expanded voluntary arbitration program for all civil damage cases
New Hampshire	Compulsory Arbitration	Supreme Court Rule, Temporary Rules of Compulsory Arbitration	1978	2 counties (Merrimack, Rockingham)
New Jersey	Judicial Arbitration	State Law—Laws of N.J. Ch 358	1983	Statewide implementation
New Mexico		Supreme Court Rule	1984	Awaiting funding
New York	Alternative Dispute Resolution by Arbitration	State Law 22 N.Y.C.R.R. Part 28	1970	Operational in 31 counties, including New York City
North Carolina	Court-ordered Arbitration	State Enabling Act	1985	Pilot program authorized in 3 districts
Ohio	Varies by county	Local Judicial Rules— Hamilton County Rule 24 Stark County Rule 16 Cuyahoga County Rule 29	1970	Operational in approximately 15 counties including Cleveland and Cincinnati
Oregon	Arbitration Program	State Law—Ch. 670 Oregon Laws	1983	Operational in 9 counties
Pennsylvania	Compulsory Arbitration	State Law—Pa. Con. Stat. Ann. Title 42 7101	1952	Operational in 53 counties, including Philadelphia and Pittsburgh
Washington	Mandatory Arbitration of Civil Actions	State Law—R.C.W. Ch 7.06	1979	Operational in at least 3 counties (King, Pierce, Yakima)
Federal district courts				
California—Northern Dist.	Court-annexed Arbitration	Local Rule—Rule 500	1978	Ongoing program
Florida—Middle Dist.	Court-annexed Arbitration	Local Rule	1985	Operational
Michigan—Western Dist.	Court-annexed Arbitration	Local Rule	1985	Operational
Missouri—Western Dist.	Court-annexed Arbitration	Local Rule	1985	Operational
New Jersey	Court-annexed Arbitration	Local Rule	1985	Operational
New York—Eastern Dist.	Court-annexed Arbitration	Local Rule	1985	Program to commence by January 1986
North Carolina—Middle Dist.	Court-annexed Arbitration	Local Rule—Part VI Rules of Practice and Procedure	1984	Operational
Oklahoma—Western Dist.	Court-annexed Arbitration	Local Rule	1985	Operational
Pennsylvania—Eastern Dist.	Court-annexed Arbitration	Local Rule—Civil Procedure 8	1978	Ongoing program
Texas—Western Dist.	Court-annexed Arbitration	Local Rule	1985	Operational

Source: Ebener, and Betancourt, **Court-Annexed Arbitration: The National Picture** (Santa Monica, CA: The Rand Corporation, 1985), updated to January 1, 1986

grams have also expanded by extending their case jurisdiction: typically, the first arbitration program(s) within a state is established with a monetary jurisdictional limit in the neighborhood of $15,000; over time the limits are increased to $25,000 or more. In recent years, the initial jurisdictional limits of programs have been set higher, especially in the federal district courts. Figure 1 shows the change in monetary jurisdictional limits across courts from 1979 to 1985.

Program objectives

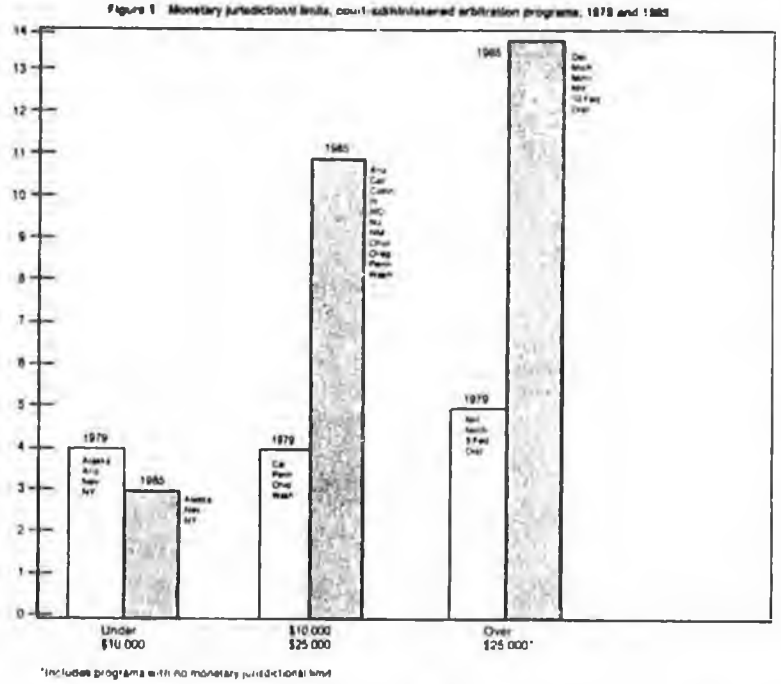
Whatever their historical origins, most court-administered arbitration programs now share the following objectives:

- Reduce congestion on the trial calendar by diverting and dispose of cases through arbitration;
- Reduce (or stabilize) court costs by reducing judicial time spent on the civil caseload;
- Reduce time to disposition by providing an expedited process for arbitration-eligible cases and by removing these cases from the trial queue, thereby reducing time to trial for other cases;
- Reduce litigation costs for parties;
- Improve access to court for diverse users by reducing the time and expense required and by providing a simpler and, perhaps, fairer form of dispute resolution.

Supporters of court-administered arbitration programs do not generally expect to change case outcomes. Instead, the distribution of outcomes prevailing prior to establishing an arbitration program is frequently viewed as the benchmark for assessing arbitration's effect on equity, and a program is viewed as successful if it does not perceptibly alter that distribution to the advantage or disadvantage of any of the major participants in the system.

Evaluating effectiveness

As in the case of other "court reforms" there has been no comprehensive attempt to evaluate court-administered arbitration programs' effectiveness in meeting these objectives. During the past five years, however, the ICJ has conducted evaluations of arbitration programs in California, Pittsburgh (Allegheny County) and Bucks County, Pennsylvania, and Burlington and Union Counties in New Jersey that shed considerable



light on the issue.[4] The empirical data from these studies suggest that court-administered arbitration can contribute significantly to reducing court congestion, costs and delay and to diminishing the financial and emotional costs of litigation for parties. But the data also indicate that arbitration's ability to fulfill this potential is critically dependent on program design and implementation decisions, and on lawyers' responses to arbitration, and that arbitration cannot, by itself, be depended upon to "solve" all of the problems that characterize contemporary civil litigation.

Reducing court congestion. In both California and Pittsburgh, about 50 per cent of civil money suits (including personal injury, property damage and contract disputes) are diverted to arbitration; in Bucks County the percentage is closer to 90 per cent. The percentage of cases diverted by any particular program is dependent on the program's eligibility rules, the proportion of cases that are eligible under those rules and the procedures that are used for determining eligibility. Some state program rules permit so few cases to be diverted to arbitration that local jurisdictions have been reluctant to invest resources in program implementation. Some assignment procedures provide incentives and opportunities for parties and their lawyers to bypass arbitration and obtain placement on the trial calendar. And in every court it is possible for arbitration cases to appear on the court's trial calendar after arbitration is completed, as a result of the trial *de novo* process.

It is clear, however, that it is possible for any court to develop rules and procedures that will result in the diversion of a substantial fraction of its civil money suits and it is likely (as we shall see below) that most of these cases can be permanently diverted. Policymakers should note, though, that a court's total civil damage caseload may only represent a modest fraction of its overall caseload which will generally include many criminal cases, family law cases, equitable disputes, and other matters. As long as arbitration is considered appropriate only for civil damage suits, and only for the lower-value cases among these,[5] it may ease court congestion but cannot eliminate it.

Reducing court costs. Cost savings due to arbitration depend on three factors: how much the court would spend on arbitration-eligible cases in the absence of an arbitration program, how much it costs to administer the arbitration program itself, and how many cases require court attention after arbitration. Unfortunately, most courts cannot provide reliable data on all three factors, making estimation of savings due to arbitration extremely problematic.

The best data available relate to program administration costs. These generally have two components: costs to process cases (determining eligibility, notifying parties of assignment to arbitration, selecting arbitrators to hear specific cases, etc.) and fees to arbitrators. How much it costs to administer an arbitration program depends critically on program design and implementation decisions. California's statutory requirement that the court assess whether a case is eligible for arbitration placed a new burden on judges' time. In addition, a complex procedure that provides for the parties' attorneys to participate in arbitrator selection adds to the tasks that must be carried out by the program's administrative staff. An honorarium of $150 per day paid to the single arbitrator who hears each case further drives up the cost of the program. A recent Judicial Council report estimated that the cost to process a case through arbitration in California in Fiscal Year 1982 was about $123 for each case assigned to the program, and about $299 for each case actually heard by an arbitrator.[6] These estimates do not include the cost of judge time allocated to determining arbitration eligibility.

In Pittsburgh, when the plaintiff's attorney files a case, he or she is asked whether it is eligible for arbitration. If it is declared eligible, the court clerk automatically assigns it to the program and schedules a hearing date for it. Arbitrators are assigned to hear cases on the day of the hearing, using a pragmatic approach to achieve a roughly random assignment. Three-person panels hear each case, but in a single day they are likely to hear four or five cases. Although each arbitrator is paid $100 per day, the average arbitrator fee per case works out to about $65. When

4. The California study, conducted during the first year of program implementation, focused on arbitration's potential for cutting congestion, court costs and delay (Hensler, Lipson, Rolph, JUDICIAL ARBITRATION IN CALIFORNIA: THE FIRST YEAR (Santa Monica, CA: The Rand Corporation, 1981)). The Pittsburgh study focused on the effects of arbitration on litigants (Adler et al., *supra* n. 2). Bucks County is one of three sites in an on-going ICJ study of litigants' perceptions of "procedural justice." Burlington and Union Counties were pilot sites for the New Jersey arbitration program; the ICJ collaborated with the Administrative Office of the New Jersey Court in designing and analysing surveys of lawyers and litigants (see Hensler, REFORMING THE CIVIL LITIGATION PROCESS: HOW COURT ARBITRATION MAY HELP (Santa Monica, CA: The Rand Corporation, 1984)).

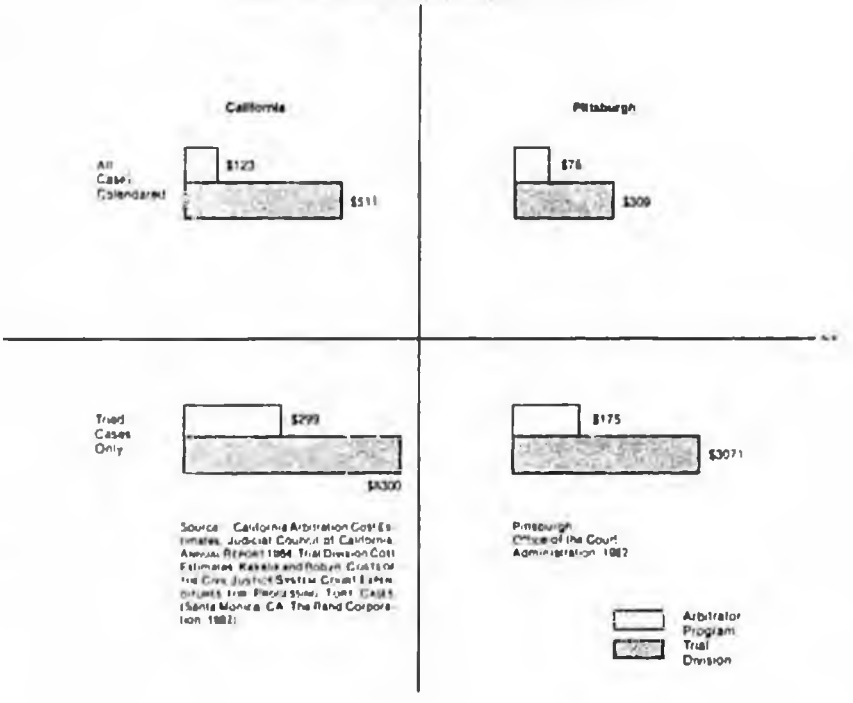
5. This assumption is being challenged in some locales which are considering broader jurisdiction for arbitration programs.

6. Judicial Council of California, ANNUAL REPORT, 1984.

fee reimbursements from appellants are taken into account, this amount is reduced even further. The average cost to process a case diverted to arbitration in Pittsburgh in 1982 was about $76 for each case assigned to the program, and about $175 for each case heard.[7]

Figure 2 compares the costs of processing arbitration cases to the costs of processing non-arbitration cases that remain on the civil trial calendar. In the upper section of the figure, we see the cost differential between the average per case processing costs for California and Pittsburgh. In the lower section, we have broken out the costs of those cases "tried" (either by arbitrators or jury). These comparisons suggest that, overall, arbitration offers a three- to five-fold savings over traditional civil case processing. The difference in the average cost to "try" a case in arbitration and the average cost to try a case before a jury is many times greater.

Figure 2 Comparative case processing costs (per case)



The cost differentials shown in Figure 2 may be deceptive, however, if a substantial fraction of the arbitrated cases turn up on the trial calendar thereafter, as a result of *de novo* appeals. It is reasonable to assume that cost savings will be substantial where appeal rates are low, and smaller or non-existent where they are high. (Indeed, one can imagine situations in which arbitration programs would actually increase the net costs of processing civil cases.)[8]

Across the country, *de novo* appeal rates vary substantially from program to program. In California, the rate of appeal has been running in the neighborhood of 50 per cent. In the older Pennsylvania programs it ranges between 15 per cent and 25 per cent of all cases heard, and some court administrators elsewhere report even lower appeal rates.[9] But the majority of appealed cases in all jurisdictions settle without trial. In California, a Judicial Council docket study in a sample of four Superior Courts found that the rate of trial after arbitration was about seven per cent.[10] In Pittsburgh, the ICJ found that three-quarters of all cases that were appealed settled without trial.[11] It is an open question whether the costs to courts of disposing of these *de novo* appeals generally outweigh the savings attributable to arbitration.

Expediting disposition. Success in expediting cases through arbitration depends on formal program rules and informal implementation practices. When courts want to use arbitration to speed case disposition, when they have the resources available to process cases efficiently, they are not unduly constrained by statutory or other formal limits on the speed of disposition, and when attorneys cooperate in making the program work, arbitration can result in speedy case disposition.

In California, we found that arbitration's effectiveness in reducing time to disposition was constrained by the availability of judge time to assess case value, by statutory requirements that established relatively lengthy time intervals for different stages of the process, by the practice of placing administrative control over the hearing process in the arbitrators' hands, and by the lack of court resources to monitor the arbitrators' performance in carrying out these responsibilities. As a result of these factors, we found that in some courts arbitration did little to expedite case resolution, while in others it *increased* time to disposition. Time to disposition by arbitration varied between nine months and more than three years.

In Pittsburgh, on the other hand, the practice of scheduling cases for arbitration at the time of filing, a policy of encouraging all active bar members, regardless of type or length of experience, to serve as arbitrators, and a centralized form of program administration combine to expedite case processing. The average time to reach arbitration hearing in Pittsburgh is three months from the filing date; awards are decided immediately after the hearings and sent to the parties at the close of business each hearing day. Other Pennsylvania courts have achieved similar results: in Philadelphia in recent years cases have reached arbitration hearings within eight months of filing. In Bucks County, cases are heard within four months of the filing of a certificate of readiness.

Whether speeding cases through arbitration actually reduces the time to disposition for cases on the regular trial calendar is still an open question. The factors that affect time to disposition generally are so complex and so difficult to measure that there has yet to be an empirical analysis of the connection between expediting arbitration cases and expediting regular jury trial cases.

Reducing costs to litigants. Some supporters of court-administered arbitra-

7. Cost information for 1982 provided to the author by Mr. Charles Starrett, Allegheny County Court Administrator.

8. Hensler et al., *supra* n. 4, at 62-67.

9. In most programs, 25 to 50 per cent of the cases assigned to arbitration settle before the hearing date. Thus, the per cent of appeals as a fraction of all cases assigned to the program may be as little as 5 to 10 per cent.

10. *Supra* n. 6, at 9.

11. *Supra* n. 2, at 46.

tion assume that it will produce substantial cost savings for litigants. Our research suggests that such savings are possible, but whether they are realized depends on the behavior of lawyers in response to arbitration.

Individual plaintiffs' costs to litigate generally have three components: the value of their own time spent on the process, lawyers' fees, and expert witness and other direct expenses. In Pittsburgh and New Jersey we found that litigants on average spent 1 to 1½ days preparing for and participating in arbitration hearings. As might be expected given liberal evidentiary requirements, they spent less than $50 on expert witness fees and other direct expenses.

Lawyers' fees were by far the largest component of litigants' expenses. Plaintiffs in Pittsburgh either had a traditional contingent fee arrangement with their lawyer (typically paying one-third the amount obtained in arbitration or settlement) or paid a flat fee to the lawyer (usually $250) for preparing the case and representing them at the hearing. Lawyers offering flat fee arrangements to clients usually conducted a high volume arbitration practice, representing several different clients at hearings in the course of a single morning. This type of practice was made possible by the brief duration of the hearings (45 minutes on average) and tightly-administered hearing schedule. Efficient use of attorney time was also reflected in hourly rate defense costs of approximately $400 per arbitrated case.

In California and New Jersey, on the other hand, most plaintiff and defense lawyers have apparently not changed their billing practices as a result of arbitration.[12] Thus, any cost savings due to the streamlined arbitration procedure may be passed on to defendants, who are usually billed on an hourly rate basis, but not to plaintiffs who retain lawyers on a contingent fee basis.[13]

Even if fee arrangements are not substantially revised litigants on both sides should save when their cases are arbitrated rather than tried, because they will generally spend less of their own time in arbitration than at trial, and they will pay less in expert witness fees and other direct expenses. In the absence of arbitration programs, however, most civil money damage suits are not tried, but settled. The difference between litigants' costs to arbitrate cases and their costs to settle these cases is not yet known.[14] Current ICJ research comparing litigants' outcomes when different modes of disposition are used may shed some light on this question.

Access to justice

When considering the adoption of court-annexed arbitration programs, some policymakers assume that litigants must benefit from the provision of a rapid, inexpensive form of dispute resolution. Others, however, are concerned that arbitration, with its abbreviated procedures and rapidly decided outcomes, will provide "second-class" justice. Our study of court arbitration in Pittsburgh systematically examined what litigants obtain from the program and how they feel about it. We investigated the pattern of program usage, the distribution of arbitration awards, and the role of the appeals process. We also measured litigants' satisfaction with arbitration, and, in particular, their views of the fairness of the arbitration procedure. More recently, we have been able to replicate some of these analyses among New Jersey and Bucks County litigants.

Based on the results of these analyses, we have concluded that court-administered arbitration delivers generally acceptable outcomes and is viewed by most individual litigants as a fair way of resolving civil disputes. Attorneys sometimes demur at court arbitration's departure from traditional trial norms, but most view arbitration as an acceptable procedure for resolving smaller civil damage suits.

Program usage. In Pittsburgh, we found that the program was used by a diverse set of litigants, with a broad range of disputes involving money. Arbitrated cases included consumer disputes (sometimes brought by the consumer, sometimes brought by a business person seeking payment), contract disputes, automobile and other property damage cases, and personal injury cases. The amount of money involved in these cases was generally less than $5000. (At the time of our study the jurisdictional limit in Pittsburgh was $10,000.) The types of disputants included private citizens, small and large businesses, and public agencies. Our Bucks County sample was limited to personal injury cases, although the program handles all money damage suits worth $20,000 or less. Preliminary data analyses in Bucks indicate that arbitration litigants are a cross-section of that county's population.

Case outcomes. About 80 per cent of the Pittsburgh plaintiffs whose cases we sampled obtained some amount of compensation from the arbitrators. Burlington County, New Jersey pilot program data indicate a similarly high level of plaintiff victories. Of course, in both Pittsburgh and Burlington many plaintiffs obtained lower awards than the amount they originally claimed. In Pittsburgh, there was some variation in the relative success of plaintiffs (i.e. award amount compared to prayer) but we could find no evidence that any particular class of litigants or suits is disadvantaged by arbitration. The only exception in this finding regards *pro se* litigants: surprisingly numerous in Pittsburgh, these litigants appeared to be systematically disadvantaged when they faced represented opponents.

Outcomes of appeals. About 25 per cent of the arbitrated cases in our Pittsburgh sample were appealed, but most of the appealed cases were settled without further court intervention. After examining the outcomes of settlement and trial after appeal, we concluded that the appeal mechanism serves its intended purpose as a corrective device for individual arbitration errors or misjudgments, while preserving the pattern of outcomes delivered by the arbitrators. We also concluded that the costs of appealing were rarely worth the mone-

12. It may be that volume arbitration practices of the sort we observed in Pittsburgh take many years to develop.

13. Insurance company representatives frequently assert that lengthy court calendars increase their transaction costs for small cases. If arbitration reduces time to disposition for these cases, these defendants may obtain additional cost savings as a result.

14. In many jurisdictions, plaintiff lawyers charge a somewhat lower contingent fee for settling a case rather than trying it, for example, 33 per cent compared to 40 per cent. In California and perhaps elsewhere plaintiff lawyers may treat the arbitration hearing as a trial, charging the same percentage of the amount won if a case is arbitrated as they would if it had been tried. Since many cases that reach arbitration hearings formerly would have been settled, plaintiffs could actually be paying *increased* fees with the advent of arbitration. Of course, if outcomes at arbitration are significantly better for plaintiffs then plaintiffs might nevertheless obtain a net benefit.

tary gain obtained post arbitration.

Litigants' perceptions. We have now measured litigant satisfaction with arbitration programs in four different jurisdictions, with substantially different program rules. In each jurisdiction, the overwhelming majority of individual litigants whom we surveyed were quite satisfied with the program. Although winners are generally more satisfied than losers, a majority of the latter are at least somewhat satisfied with the program. This high level of satisfaction is apparently attributable to litigants' satisfaction with the arbitration *procedure* itself. We have found that most individual litigants have a simple definition of what constitutes a fair dispute resolution procedure: they want an opportunity to have their cases heard and decided by an impartial third party. In courts that offer an arbitration alternative, unlike most metropolitan courts in which an expensive and time-consuming trial is the only alternative to settlement, litigants with small suits are accorded this opportunity. Most find it a fair process.

Program design variations

As should be clear from the discussion above, although all court-administered arbitration programs share certain key features, program design varies substantially. Even within a state, where all programs are operating under the same authorizing statute, there may be considerable variation from jurisdiction to jurisdiction. Typically, programs are designed in part through legislative decisionmaking (with inputs from state judicial councils or court administrative offices, from the bar, and from other lobbying organizations) and in part through the formal court rulemaking process. Often special bench and bar committees are established locally as well to draft rules of local program operation.

Historically, there was a tendency for these groups to fashion new programs after previously established programs in neighboring states and jurisdictions. Now that information about program design is more readily available, the process of program design may be somewhat more systematic. But ensuring that a program is acceptable to key constituencies—lawyers, insurance companies, public advocates—is still a key component of program design. Our evaluation research suggests that there are many ways of designing court-administered arbitration programs to meet their objectives.

ICJ researchers have identified a small number of key decisions that must be made in designing and implementing court-administered arbitration programs. We discuss the range of options open to policymakers and administrators in making these decisions, and their implications for program outcomes, in a manual entitled *Introducing Court Arbitration: A Policymaker's Guide.*[15] Below I briefly summarize this material, highlighting the most significant design features.

What cases should be eligible for the program? Most programs are limited to money damage suits that fall below a specified dollar amount. The higher a program's jurisdictional limit, the greater the proportion of the caseload that may be diverted from the trial calendar, and the greater the potential for reducing congestion on that calendar.

Who should determine eligibility? In the normal court routine, the court does not attempt to determine the dollar value of a suit, and the plaintiff's own assessment has a strategic purpose, which raises questions about its accuracy. If court personnel assess case value, they can be assured of diverting most eligible cases to arbitration, but the time they must take to do so increases court costs. If litigants (e.g., the plaintiff's attorney) assess eligibility, a considerable number of cases may evade the program[16] and be placed on the trial list, but the court will be spared additional expense.

What qualifications should be required of those who volunteer to serve as arbitrators? If arbitrators are required to have extensive and/or specialized experience (e.g., at least five years of personal injury trial experience), then they are more likely to deliver awards that are satisfactory to other practitioners. But the candidate pool will be limited, and the supply of arbitrators may therefore be insufficient to hear cases in a timely fashion. If qualifications are loose, the supply will be greater but the decisions may be less acceptable, leading to more appeals for trial.

How many arbitrators should decide a case? If only one arbitrator is required to hear each case, it will be easier to administer the program and easier to meet the demand for volunteer arbitrators. But attorneys may be more inclined to question the decision of a single arbitrator, leading to a higher rate of appeal. If three or five arbitrators are required, the task of administering the program will be greater, and the per case costs for arbitrator fees may be more, but practitioners may be more inclined to accept the arbitration outcome.[17]

Who should select the arbitrators to hear each case? If the attorneys have some say in the selection, they may be more inclined to accept the award, but providing for attorney participation may require a cumbersome and time-consuming process. If the court is in charge of assigning the arbitrators, the process may be expedited but litigant and attorney satisfaction may decrease.

Where should the hearings be held? If they are held outside the courthouse, there is no need to set aside space for them, and litigants will be spared the possible emotional strain of coming into court. But it will be more difficult for the court to monitor the scheduling of hearings, and the arbitrators may grow lax in adhering to the court's guidelines for timely disposition. If the hearings are held in the courthouse, court personnel can maintain control over the schedule and the litigants may be more inclined to feel they have had their "day in court." Rather than moving cases "out of the courthouse," however, the court will simply have set up another specialized division to resolve cases.

Should there be a financial disincentive for appeal? If there is no disincentive, the rate of appeals may be so high as to wipe out any reductions in the size of the trial list due to case diversion. If the disincentive is too high, achieving political acceptance of the program will be difficult, and the disincentive itself may ultimately be declared an unconstitutional burden on the right to trial.

Who should fund the arbitration program? If a legislature requires courts to adopt the program, perhaps the state

15. Rolph, INTRODUCING COURT ARBITRATION: A POLICYMAKER'S GUIDE (Santa Monica, CA: The Rand Corporation 1984).

16. Plaintiffs' attorneys may bypass arbitration because they wish to delay setting a value on the claim, because they want to send a signal to the defense regarding the strength of their position, or because they object to the program per se.

17. Multiple-arbitrator panels are often constructed to represent plaintiff and defense perspectives, which may lead to greater acceptance of their decision.

should pay for the additional administrative expenses. (Traditionally, most trial court expenses are borne by county governments.) But if the program effectively reduces trial court workload, the court should experience savings in the trial division that it can divert to supporting the arbitration program and it may, over the long run, actually experience a reduction in total court costs. Alternatively, if arbitration provides litigants with a more expeditious and less expensive means of resolving their disputes, perhaps they should pay a special arbitration fee to support the program. If the court requires such a payment, however, it is put in the perhaps questionable position of charging litigants with small-value suits a higher fee to file their cases than is charged for filing higher-value, trial-bound cases.

Necessary information

With the multiplication of research monographs and conferences on court-administered arbitration, judicial policymakers may find themselves in the position of having more assistance in designing and implementing programs than they can handle. But it is too early to conclude that we understand the full ramifications of instituting mandatory arbitration requirements. As pressure from legislatures and interest groups to adopt and expand arbitration mounts, I believe we need to give more attention to answering the following questions.

What kinds of cases are not good candidates for arbitration? As jurisdictions become comfortable with arbitration, there is often a move to expand the jurisdictional limits of a program, either by incorporating new kinds of cases, or raising the monetary limits on money damage suits, or both. Is it sensible to subject all kinds of civil suits to mandatory court arbitration? In my conversations with court officials and practitioners, I frequently ask: "What kinds of cases do you think are inappropriate for arbitration?" The usual reply is that some cases are simply too complicated to be amenable to a streamlined process: they require extensive discovery, briefing of the issues and the full panoply of a court trial. Complicated cases, I am told, occur with some frequency among smaller value monetary claims and there are simple cases in which large amounts of money are at stake. Should we relegate all small cases to alternative dispute resolution mechanisms, while preserving more expensive traditional procedures for big stakes cases whether or not they "need" them? We need to do more hard thinking, and perhaps some careful experimentation, regarding this question.

What factors affect decisions to appeal? Most judicial policymakers feel that some financial disincentives are necessary to discourage frivolous appeals from arbitration but that it is improper (and probably infeasible) to require that litigants pay substantial amounts of money as a precondition for appeal. We know very little about how the average litigant decides whether to appeal, or indeed whether the lawyer or the litigant plays the primary role. Where appeal rates from arbitration are low, we tend to assume that most litigants find the arbitration verdicts roughly acceptable; instead, they may simply decide that they have no other option but to "lump it."[18] Institutional litigants presumably assess the costs of appeal somewhat differently; even if these costs outweigh the amount at stake in the individual case, they may take appeals as a matter of policy, in order to "keep the system honest"—that is, operating in a fashion that is acceptable to them. Understanding the role of appeals in the arbitration litigation process is important to understanding the equity implications of instituting mandatory arbitration programs.

How does arbitration affect settlement? Much of the discussion and research about arbitration focuses on differences between arbitration and trial, but most cases that are currently arbitration-eligible have little or no likelihood of being tried. The real significance of instituting arbitration may lie in its effects on the settlement process. How does arbitration affect lawyers' and insurers' negotiation strategies? How does it affect the timing of settlements? Perhaps most important, how does it affect settlement outcomes? We need to focus more attention on these questions as well.

How does arbitration affect the practice of law? Finally, underlying all these questions is perhaps the most important of all, how does arbitration affect what lawyers do? Lawyers in many jurisdictions are understandably wary of arbitration programs. Some believe mandatory arbitration represents a small but dangerous step away from the right to jury trial. Some see it as moving further in the direction of production line litigation that is the antithesis of the individually-crafted form of lawyering that they learned at school. Underlying many lawyers' discomfort with arbitration is a concern about its impact on their fees. How lawyers modify their behavior in the light of arbitration may ultimately determine the future of this form of alternative dispute resolution. □

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18. Felstiner, Abel, and Sarat, *The Emergence and Transformation of Disputes: Naming, Blaming, Claiming...*, 15 Law & Soc'y Rev. 631 (1980-81).

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LIMITING LIABILITY FOR AUTOMOBILE ACCIDENTS: ARE NO-FAULT TORT THRESHOLDS EFFECTIVE?

James K. Hammitt, John E. Rolph

October 1985

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PREFACE

This Note is a reprint of an article that appeared in *Law & Policy*, Volume 7:4, 1985. Using insurance claims data, the authors analyze the effectiveness of no-fault tort thresholds in limiting the number of automobile accident victims who seek compensation through the tort system.

The analysis contained in this Note is described in greater detail in the first two volumes of a four-volume study on automobile accident compensation, conducted by the authors for The Institute for Civil Justice. These four reports are included in a listing of current ICJ publications at the back of this Note and can be obtained from the Institute.

Limiting Liability for Automobile Accidents: Are No-Fault Tort Thresholds Effective?

JAMES K. HAMMITT and JOHN E. ROLPH*

"No-fault" automobile insurance plans are designed to supplant the tort system by requiring motorists to purchase no-fault insurance and allowing victims to file liability insurance claims and tort suits only if their injuries exceed a legislated "tort threshold." While thresholds vary among states, many are satisfied if the victim incurs medical expenses as low as a few hundred dollars. Using insurance claims data, we estimate the effectiveness of several states' thresholds. We find that tort thresholds are surprisingly effective: modest tort thresholds reduce the number of successful tort claimants by half, and the strictest thresholds may exclude nine-tenths of potential claimants. Moreover, we find little evidence of claimants "padding" their claims to exceed the dollar thresholds.

No-fault compensation plans for automobile accident victims were developed to replace the traditional tort liability system. Early no-fault advocates criticized the tort system under which the motorist who is legally at fault or his liability insurance company compensates the accident victims as providing "too little, too late, unfairly allocated, at wasteful cost, and through means that promote dishonesty and disrespect for the law." (Keeton and O'Connell, 1965: 3). In contrast, no-fault plans establish mandatory "no-fault" insurance that reimburses the policyholder, his passengers, and any pedestrians he may injure, without regard to who "caused" the accident. No-fault insurance is intended to provide quicker and more certain compensation, at less cost, because there is no need to ascertain legal responsibility for the accident.

No state has yet adopted a no-fault plan that totally replaces the tort system. All no-fault states attempt to prevent certain automobile accident victims—those with less severe injuries—from using the tort law to obtain compensation, but allow more seriously injured victims to pursue tort compensation in addition to collecting no-fault insurance benefits. The two classes of victims are defined by whether their injuries exceed a "tort threshold," which may be either a "dollar" or "verbal" threshold.[1]

Under a dollar tort threshold, accident victims are not entitled to tort compensation unless their medical expenses exceed the threshold value.

* The Institute for Civil Justice, The Rand Corporation. We thank Joseph Ferreira, Robert Houchens, Sandra Polin, Timothy Quinn, Donald Segraves and three anonymous reviewers for their contributions to this research.

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Thresholds range from $200 (net of hospital and diagnostic expenses) in New Jersey to $4,000 in Minnesota. To breech a verbal threshold, victims must have suffered one of a specified set of injuries. Verbal thresholds are typically quite stringent, requiring permanent and significant disfigurement, disability, or death. In a few states, however, the verbal threshold is satisfied by less serious injuries: a fracture (Massachusetts), or any injury not confined to soft tissue (New Jersey).[2]

All states with dollar thresholds also have verbal thresholds, but three no-fault states (Florida, Michigan and New York) have only verbal thresholds. In these states, regardless of medical expenses incurred, a victim is not entitled to tort compensation unless his injuries exceed the stringent verbal threshold.

Whether an accident victim is entitled to tort compensation or must be satisfied with no-fault insurance benefits can have a substantial effect on the amount of compensation he or she receives. No-fault insurance pays only for a victim's economic losses (called "special damages"), primarily medical expenses and lost wages.[3] In contrast, under tort law the victim can potentially collect compensation for "pain and suffering" and other nonpecuniary losses (called "general damages") as well as for special damages. Although payments for general damages differ widely between accident victims, they often exceed the victim's special damages. For automobile accident victims with $500 in medical expenses the median payment for general damages in our data (described below) is about $1,000. For those with $5,000 in medical expenses the median payment for general damages is about $6,500. (Hammitt, 1985, see figure 1.) Thus the lure of compensation for general damages provides a substantial incentive for a victim to seek tort compensation if another motorist is arguably liable for his injuries.

Because payments for general damages can be so large relative to the compensation a victim can obtain from no-fault insurance, one would expect accident victims to file lawsuits or claims against another driver's liability insurance in all but minor cases. Indeed, one might expect that some victims would attempt to circumvent the tort threshold either by fraudulently claiming medical expenses in excess of the dollar threshold, or by incurring additional, unnecessary, medical treatment in order to surmount the threshold. In some cases accident victims do receive liability insurance payments, including compensation for general damages, even though their injuries may not have exceeded the tort threshold. These payments are made because almost all automobile liability claims are settled without recourse to trial. In cases where it is not clear whether a claimant could prove that his injuries exceed the tort threshold the liability insurer may offer some payment to settle the claim and avoid further expense.

Because the possible gain in seeking compensation from a liability insurer is so large, there is some debate about how effectively tort thresholds, especially low-to-moderate dollar thresholds, reduce the

number of victims who file liability claims.[4] In this article we present an analysis of insurance claims data designed to address this issue. In the states studied, we find that even relatively weak thresholds appear to prevent a large proportion of accident victims from obtaining tort compensation. For example, we estimate that the $500 tort threshold in Massachusetts reduces the number of victims who are paid under automobile liability insurance there by more than half. Stricter tort thresholds, such as the verbal one in Michigan, appear to prevent about 90 percent of auto accident victims from obtaining tort compensation. We surmise that the much smaller chance of recovering compensation if one's injuries do not exceed the tort threshold discourage large numbers of victims from filing liability claims and lawsuits. Interestingly, we find no evidence to suggest that victims systematically exaggerate their expenses, or incur additional medical expenses, to surmount dollar tort thresholds.

We turn now to describing the closed automobile insurance claims data that we analyze. We then describe our two methods for estimating the proportion of automobile accident victims excluded from tort claims by the tort threshold. Finally we present our analysis of claims to determine whether they have been padded or exaggerated in an effort to surmount the tort threshold.

DATA

The data we analyze consists of claims paid by automobile insurers under the Bodily Injury (BI) and Personal Injury Protection (PIP) coverages. BI insurance is liability insurance; it pays damages to a third party (the accident victim) for which the policyholder is liable. PIP insurance is no-fault insurance; it pays benefits to the policyholder, his passengers, and pedestrians without regard to legal fault.

The data were collected by the All-Industry Research Advisory Council (AIRAC), an insurance-industry association, and include all claims that were closed with some payment to the claimant by the participating insurers during a two-week period in autumn, 1977; claims that were denied payment are not included. At the time of the survey, the twenty-nine participating insurers had a 62 percent share of the national market for private passenger automobile insurance. For each closed claim, insurance company claims adjusters and supervisors provided detailed information on the claimant's personal characteristics, medical and other economic losses, type and severity of injury, and the payment made by the insurer. The data are described more fully in AIRAC (1979).

As part of a study of compensation under tort and no-fault rules (Hammitt, 1985; see also Rolph et al., 1985), we selected four no-fault states for analysis—Massachusetts, New Jersey, Pennsylvania and Michigan. Generalization of results from one state to another is always problematic; however, based on the frequency with which claimants retain attorneys and file

Table 1. Cumulative Distribution of Total Payments

Payment Less than	Personal Injury Protection		Bodily Injury	
	Michigan	Massachusetts*	California	Massachusetts
	Percentage of Claimants Paid			
$100	34	40	12	6
$300	59	65	29	13
$500	69	72	37	18
$1,000	80	82	51	28
$5,000	95	100	89	74
$15,000	98	100	98	93
$50,000	100	100	100	100
	Percentage of Dollars Paid			
$100	1	4	0	0
$300	5	12	1	0
$500	8	18	3	1
$1,000	15	32	7	2
$5,000	42	94	42	32
$15,000	64	100	70	64
$50,000	100	100	88	100

* PIP policies in Massachusetts are required to provide for medical benefits of at least $2,000; additional coverage is available as an option.

lawsuits, these four states appear to be more litigious or claims-conscious than most other states. Consequently the proportions of accident victims that the thresholds prevent from recovering tort compensation in these states is likely to be smaller than the proportion that similar thresholds would bar in other, less claims-conscious, states.[5] There may be other states however, that are even more claims-conscious than the four we analyze. For example, knowledgeable insurance industry followers assert that the original $1000 tort threshold in Florida had almost no effect on the number of BI claims paid there; it was not until Florida established an entirely verbal threshold, and an anti-fraud bureau, that the number of victims receiving tort compensation declined (Personal communication; see also O'Connell, 1977: 159–60, and U.S. Dept. of Transportation, 1977). Thus there may be some states where our conclusions do not hold. However, we believe our analysis is based on assumptions that apply in all but exceptional circumstances.

Table 1 presents an overview of claims payments under both PIP and BI insurance, for three representative states. The majority of claims are quite modest; as shown in the first panel of the table, more than half the PIP claimants are paid less than $300, while about four-fifths receive less than $1,000. BI payments are somewhat larger, because they usually include payments for general damages in addition to economic loss. Even so, half of the California BI payments are less than $1,000. The Massachusetts BI payments are much higher than the California payments, because the Massachusetts tort threshold excludes claimants with relatively mild injuries.

As a result, only 28 percent of Massachusetts BI payments are less than $1,000.

The second panel of the table reveals that the distribution of dollars paid by insurers is dominated by the larger claims. While most claims payments are modest, these account for only a small share of total payments. As shown in the second panel, both the two percent of Michigan PIP claimants and of California BI claimants who were paid more than $15,000 each received about one-third of the total dollars paid.

METHODS

Our strategy for estimating the effect of tort thresholds in each of the four states studied is to generate independent estimates for each state. When we compare these states to states without tort thresholds using the "BI-file method" (described below), we also generate independent estimates for each comparison of states. This disaggregated estimation approach is appropriate in view of the diversity of the states we are comparing. The alternative of simultaneously estimating the effects of tort thresholds for all states with a statistical model (like regression) that shares information about relationships across states is not feasible without comprehensive and comparable data for litigation affecting factors in each state. Such data are needed to statistically adjust for differences between states that might affect how tort thresholds operate. We have not been able to locate such sufficiently comprehensive data.

We estimate the fraction of accident victims who are denied tort compensation because of tort thresholds using two different methods and compare the results. First, we use the "PIP-file method" to compare the number of PIP claimants who are eligible to obtain BI compensation (as reported by the survey respondents) to the number who would have been eligible prior to the adoption of the tort threshold in their state. Since PIP pays all victims without regard to fault or injury severity the PIP claims file includes most types of accident victims (the main exception is uninsured motorists and their passengers). The fraction of PIP claimants who would have been eligible for BI payments prior to the threshold, but who are no longer eligible, is our PIP-file method estimate of the effect of the tort threshold in reducing the number of successful BI claimants in that state. Note that this method estimates only the number of potential claimants that are no longer entitled to tort compensation, but does not account for their likelihood of actually filing BI claims.

Our second method, the "BI-file estimate," is based on a comparison of the populations of claimants who are paid by BI insurance in the no-fault state and in a reference state that has no tort threshold. The validity of this estimate depends on the extent to which the distributions of accident victims in the no-fault and the reference state are similar, with respect to economic loss, type of injury, legal fault, propensity to file insurance claims

and to retain an attorney, and other factors that might affect the number of successful BI claimants. We attribute the difference between the numbers of successful BI claimants to the tort threshold. Unlike the PIP-file method, the BI-file method does account for victims' likelihood of filing BI claims. However, it does not allow for the estimation of any separate effect (in addition to the tort threshold) that the existence of no-fault insurance has on the number of liability insurance claims filed. (Since victims can almost always collect under PIP, they may be less likely to also file a BI claim.) However, since the results of both of our estimation methods are in general agreement, we conclude that tort thresholds are the primary cause of fewer liability insurance claims in no-fault states.[6]

To determine the accuracy of the BI-file method we generate independent estimates of the tort-threshold effect using several different reference states. If the potential-claimant populations are distributed identically in all states, the estimates would be the same for all reference states up to statistical fluctuations. The extent to which the choice of reference state affects the estimate is an indication of the degree to which the populations differ, and thus is a measure of the precision of the method.[7]

Some commentators have suggested that the adoption of a no-fault system will increase the number of automobile accidents, since drivers may be less careful when the deterrent of tort liability is removed.[8] Others doubt such an adoption will have a significant effect, since the tort deterrent is largely diluted by liability insurance, and other factors are probably more important influences on driving behavior. Our estimates do not take account of this effect, should it exist. We estimate the change in the proportion of accident victims who are paid by BI insurance; if the adoption of a no-fault plan increases the number of accident victims our estimates will overstate the reduction in BI claims paid. We describe both our methods and results in more detail below.

ANALYSIS AND RESULTS

A large proportion of accident victims in the four no-fault states we studied did not seek or were denied payment under BI insurance because of a tort threshold. Our estimates of the fraction affected by the threshold vary, depending on the method used and the reference state chosen. But, as shown below, the order of the estimates is consistent with the order defined by the apparent stringency of the thresholds.

Table 2 gives our estimates of the proportion of BI claimants excluded by the thresholds using both the PIP-file method and the BI-file method with our four reference states. The New Jersey threshold ($200 medical loss, net of hospital and diagnostic expenses) was the weakest of the four.[9] We estimate that roughly half of the potential claimants were excluded by this threshold. Stated another way, the number of accident victims obtaining compensation from another motorist's liability insurance company

Table 2. Estimated Percentage of Potential BI Claimants Excluded by Tort Thresholds

No-fault State (threshold)	PIP-file Method	BI-file Method			
		Reference State			
		California	Washington	North Carolina	Maryland
New Jersey ($200)	48%	39%	51%	66%	41%
Massachusetts ($500)	60%	50%	64%	76%	69%
Pennsylvania ($750)	72%	—	—	—	—
Michigan (verbal)	89%	—	—	—	—

Note: We did not calculate BI-file estimates for Pennsylvania and Michigan because too few BI claimants were paid in those states to generate reliable estimates.

would have been about twice as large if there were no threshold. We estimate that Massachusetts' $500 threshold excluded roughly 60 percent of potential claimants, Pennsylvania's $750 threshold excluded about 70 percent, and Michigan's verbal threshold excluded almost 90 percent of all victims who would otherwise have been paid under BI.[10] (We did not calculate BI-file method estimates for Michigan and Pennsylvania because the number of BI claimants in our sample is too small to give reliable estimates.)[11]

While there is substantial variability among the estimates for each state, the relative ordering of the no-fault states is the same for each set of estimates. The exact percentages differ with the method, but all of our estimates suggest that even modest tort thresholds have a large (if not precisely known) effect on the number of BI claims paid.

Large decreases in the number of BI claims paid do not, however, translate to equally large effects on total BI payments. Because the claimants who are prevented from making claims are those with the smallest economic losses and least serious injuries, they account for a relatively small share of all BI payments. By comparing the total BI payments to reference-state claimants, classified by whether or not they exceeded the no-fault states' thresholds, we estimate that total BI payments are about 7 to 16 percent lower in New Jersey (compared to 39 to 66 percent of claimants excluded) and 15 to 31 percent lower in Massachusetts (compared to 50 to 76 percent of claimants excluded), than they would be in the absence of a threshold.[12] Moreover, because of inflation in the costs of medical care, the fixed-dollar thresholds in New Jersey, Massachusetts and Pennsylvania are undoubtedly less effective in reducing both the number of BI claims and claims costs today than they were in 1977, the year to which our estimates apply. We turn now to a discussion of the details of each of the analyses.

PIP-FILE ESTIMATES

The PIP-file method for estimating the number of potential claimants who were denied BI compensation because of a state's tort threshold is based on data for victims who filed claims under a no-fault (PIP) policy. For each PIP claimant, claims adjusters reported 1) whether the claimant qualifies for a BI or tort payment under his state's current no-fault law, and 2) whether the claimant would have qualified prior to the imposition of the law. Although the instructions that accompanied the survey forms do not define "qualification," respondents seem to have interpreted the question as asking whether the claimant would be likely to obtain some payment if he filed a BI claim.[13]

The PIP-file estimate of the proportion of potential BI claims that were either denied or not filed because of the tort threshold is the number of PIP claimants no longer qualifying for BI recovery divided by the number who would have qualified before the threshold was imposed. That is:

$$\text{PIP File estimate of fraction denied} = 1 - \frac{\text{Number of PIP claimants eligible for BI with threshold}}{\text{Number of PIP claimants eligible for BI without threshold}}$$

Although a claimant who qualified for BI recovery would not necessarily have filed a BI claim, the direction in which this factor would bias our estimate is unclear. Our PIP-file estimate is based only on victims who filed PIP claims. The incentives to file BI claims are in some respects stronger than the incentives to file PIP claims, and in other respects weaker.[14] On balance, we believe that the PIP-file estimates are more reliable than the BI-file estimates since they rely solely on data for the particular no-fault state in question. As a comparison of the two sets of estimates shows, however, the two methods produce roughly consistent results.

BI-FILE ESTIMATES

To estimate the proportion of potential claimants denied payment because of a tort threshold using the BI-file method we categorize potential BI claimants in no-fault states into three groups, as illustrated in Figure 1. Claimants in Group 1 have injuries greater than the tort threshold and are paid by BI insurance. Claimants in Group 2 have injuries that are not serious enough to breach the threshold, but nevertheless these claimants also obtain BI payments, presumably because the BI insurer would rather make some payment to settle the claim than continue to defend it. Claimants in Group 3 have injuries that do not exceed the threshold and are unable to obtain BI payments. As a result, Group 3 claimants are not included in our sample; it is their number that we estimate.[15]

The successful BI claimants in a reference (tort or add-on) state include all three groups, though we cannot, of course, distinguish between Group 2

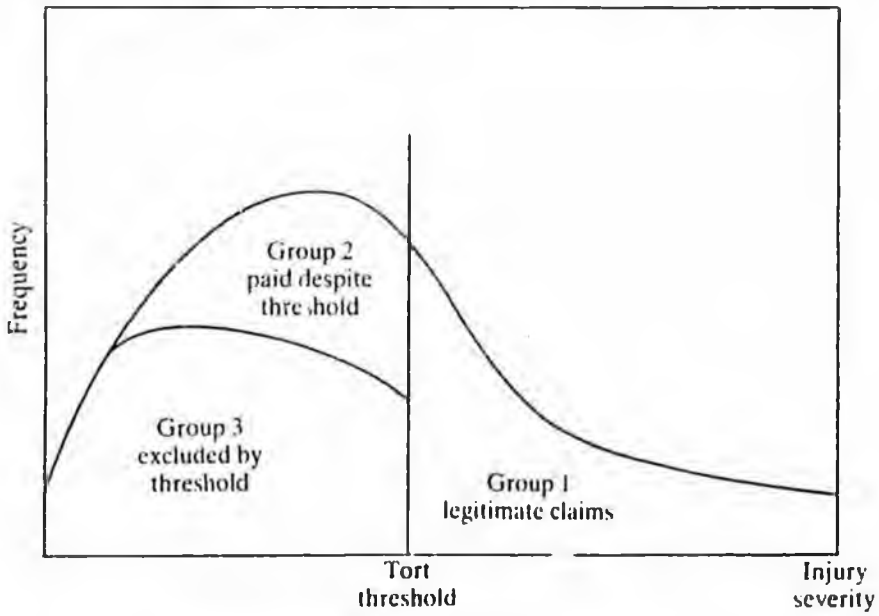

Figure 1. BI Claims Excluded by the Tort Thresholds

and 3 claimants in these states. If the populations of potential claimants are distributed similarly in the no-fault and reference states, the ratio of the number of successful no-fault-state claimants whose injuries exceed the threshold (Group 1) to the total number of potential no-fault-state claimants (all three groups) is equal to the corresponding ratio in the reference state. We use this relationship to derive our estimate of the size of Group 3, the claimants excluded by the threshold.

Table 2 above presents our estimates of the proportion of all potential no-fault state claimants (Groups 1, 2 and 3) that are excluded by the tort threshold (Group 3). We calculate these estimates as follows. Let r be the proportion of paid reference-state claimants whose injuries exceed the no-fault state's tort threshold r is equal to the ratio of the number of Group 1 claimants to the total number in Groups 1, 2 and 3 in the reference state). Similarly, let p be the proportion of no-fault-state claimants in our data whose injuries exceed the tort threshold p is equal to the number of Group 1 claimants divided by the number of Group 1 and Group 2 claimants in the no-fault state). Let x be the unknown ratio of the number of Group 3 claimants to the number of paid (Groups 1 and 2) no-fault state claimants. We wish to estimate ß, the proportion of all potential claimants excluded by the threshold (the ratio of the number of Group 3 claimants to the total number in all three groups), where

$$\beta = \frac{x}{1+x}. \qquad (1)$$

We assume that the distribution of injuries in the no-fault and reference states is the same, or, more specifically, that the proportion of potential

claimants in each state whose injuries exceed the no-fault state's threshold is the same,

$$r = \frac{p}{1 + x}. \tag{2}$$

Combining equations (1) and (2), we obtain our estimate

$$\beta = \frac{x}{1 + x} = 1 - \frac{r}{p}.$$

As shown in Table 2, the estimates using different reference states differ by as much as 27 percent, reflecting differences between the potential-claimant populations in the different states. These differences arise for various reasons, including differences between states in the mix of accident types, victim characteristics, and the cost of medical care. In addition, potential BI claimants may be less likely to file BI claims in a state such as Maryland where PIP insurance is required if they can more easily obtain compensation from their PIP coverage. If this effect were large, it could affect the estimates of tort-threshold effects that use Maryland as the reference state. As Hammitt (1985) reports, however, comparisons between BI-claimant populations do not provide any evidence that the availability of PIP benefits in Maryland reduces the number of BI claimants in that state, and the tort-threshold estimates that use Maryland as the reference state are comparable to those derived using other reference states.

In addition to differences between accident-victim populations in different states, our BI-file estimates are affected by the difficulty of determining which reference-state claimants would have satisfied a particular tort threshold, that is, distinguishing Group 1 claimants from the others. For the no-fault-state claimants, the survey forms record whether the tort threshold was exceeded, allowing us to distinguish between Group 1 and Group 2 claimants. But for the tort state claimants we had to estimate, using reported medical expenses and injury severity, whether the claimant's injuries would have exceeded the no-fault state's tort threshold. In order to make the comparison between tort and no-fault states consistent, we considered claimants in both states to have exceeded the threshold (Group 1) only if their recorded injuries exceeded the threshold.

We could not determine unambiguously whether a claimant exceeded the tort threshold from the recorded injury descriptions. For example, the Massachusetts threshold is exceeded if the claimant suffers permanent and serious disfigurement, but the questionnaire we used does not ask about the severity of a permanent disfigurement. Somewhat arbitrarily, we define all claimants with permanent disfigurement to have exceeded the threshold.[16]

We check the accuracy of this classification procedure by comparing the proportions of no-fault-state claimants recorded as having exceeded the threshold to the proportions estimated by our method of classifying claimants using their reported injuries; this is presented in Table 3. Our classification procedure labels more claimants as being over the threshold in both

Table 3. Percentage of All Paid BI Claims that Exceed the Tort Threshold

	NJ	MA
Recorded over threshold	88%	76%
Classified over threshold	89%	80%
Either recorded or classified over threshold	97%	88%

New Jersey and Massachusetts. However, the differences between proportions are small—at most 4 percent. The discrepancies probably result from two factors. First, our classification procedure counts too many claimants over the threshold because of the ambiguity in the injury descriptions (some of the permanently disfigured claimants were not sufficiently disfigured to exceed the threshold). Second, the proportion recorded in the questionnaire as having exceeded the threshold is probably too small. The multiple-choice question from which this proportion is derived asks how the claimant exceeded the threshold but does not ask whether he did so. We assume that all claimants for whom no answer was given (and whose medical expenses did not exceed the dollar threshold) did not exceed the tort threshold, but there are surely some claimants who exceeded the threshold but for whom, for whatever reason, the question was not answered.

Although our classification procedure is not perfect, the effect of the imperfections on our estimate of the proportion of claimants excluded by the tort thresholds is unclear. Since we use the same classification method for both no-fault and reference states the errors should be offsetting. The similarity of the BI-file and PIP-file estimates suggests that the effect of the classification errors is not large, relative to the other inaccuracies of the procedure.

CIRCUMVENTING THE TORT THRESHOLD

Do claimants in some no-fault states inflate their medical expenses, either by incurring needless treatment or by claiming (perhaps with the assistance of an unscrupulous doctor) to have incurred such treatment? We find no evidence of such padding in our data.

Claimants face a strong incentive to breach the threshold because doing so enhances the possibility of their receiving payments for general damages, which are not covered by PIP insurance. Moreover, by breaching the threshold, claimants may be able to recover for their economic losses twice: once from their PIP insurers, and once under their BI claims. This double recovery may be possible if the PIP insurer does not require reimbursement from the BI payment, or if the insurer fails to enforce the reimbursement provision.

If a significant number of claimants whose injuries do not exceed the threshold manage to obtain BI payment by "padding" their claims, we would expect to find a "hump" in the distribution of medical losses—a dis-

proportionately large number of claimants whose reported medical expenses exceed the tort threshold by only a little. To assess how many Massachusetts and New Jersey claimants overcome the tort thresholds by padding their medical expenses, we compare the proportion of claimants whose injuries exceed the dollar threshold by no more than $100 and $500 to the proportion predicted in each of the four states without thresholds. In total, we make sixteen comparisons (two no-fault states times two medical expense intervals times four reference states). In twelve of the sixteen cases, fewer claimants have recorded medical expenses in the interval just above the threshold than predicted. In the other four cases, using the above method, the estimate of the number of paid claimants who exaggerate their injuries in order to breach the threshold is between 2 and 16 percent of all claimants who appear to exceed the threshold.[17]

Because twelve of our sixteen comparisons provide no evidence of padding, we conclude that the data give little support to the notion that claims are systematically padded to circumvent tort thresholds. Further, since these states are more litigious than most, as discussed above, we would expect to find more evidence of padding claims here than in most other no-fault states. Alternatively, the effect of any padding that does occur may be offset by other factors such as other claimants' reluctance to file BI claims when they have already been compensated under PIP, or their uncertainty about the definition of the tort threshold and whether they are eligible to make BI claims.

SUMMARY

Contrary to what one might expect, modest tort thresholds appear to have a substantial effect on the number of accident victims who obtain compensation from liability insurance, at least in the states we studied. The availability of first-party insurance benefits probably contributes to this reduction, but our data do not allow us to estimate this effect separately in the four no-fault states.[18] Stringent tort thresholds, like the Michigan verbal threshold, deny tort compensation and, with it, compensation for pain and suffering to nine out of ten automobile accident victims. Also, contrary to some reports, we find little evidence in the states studied to support the view that many accident victims incur unnecessary medical treatment as a means of circumventing the tort threshold. The thresholds appear to serve their purpose of acting as gates to limit the number of automobile accident victims who enter the tort system and they thereby defeat the no-fault reforms.

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NOTES

1. States are classified as tort, add-on, and no-fault. No-fault insurance is not sold in tort states. In add-on states, insurers are required to offer and motorists may be required to buy no-fault coverage. In no-fault states, motorists are required to buy no-fault insurance and accident victims are not entitled to tort compensation unless their injuries exceed the tort threshold.
2. In 1983 New Jersey adopted a law allowing automobile insurance buyers to choose the threshold to which they will be subject if injured. Buyers can elect either the $200 threshold which applied to all motorists from 1973 to 1983, or a new, higher threshold of $1500 in medical expenses, net of hospital, x-ray and other diagnostic expenses, to be adjusted annually in accordance with the Consumer Price Index. The verbal portion of the new threshold is also stricter than the old. Under the old threshold, a victim could sue for tort compensation if his injuries were not confined to "soft tissue," but this language has been omitted from the new threshold.
3. Most no-fault plans further limit compensation for each type of loss. Maximum policy limits on medical benefits range from $2,000 to unlimited, while wage-loss policy limits on benefits are often 75 or 85 percent of lost wages, up to only $100 or $200 per week.
4. An accident victim may file a claim directly with another party's liability insurer, may file a lawsuit against the other party and/or his insurer, or do both. Because of filing fees and other costs, only about one-fifth of those who file liability claims (primarily those with larger claims) also file suit (see Hammitt, 1985).
5. The proportion of claimants denied BI compensation in a claims-conscious state will be a lower bound for the proportion that would be denied in a less claims-conscious state if claims-consciousness disproportionately increases the number of claims filed by victims with relatively mild injuries, that is, if severely injured victims in the less litigious state are as likely to file claims as those in the more litigious state.
6. Using a similar method, we estimate that the availability of no-fault insurance alone has little effect on the number of liability claims filed in Maryland, an add-on state that requires motorists to carry no-fault insurance (see Hammitt, 1985).
7. As reference states, we used the four other states—California, Washington, North Carolina, and Maryland—that we had selected for our larger study (Hammitt, 1985). The first three are tort states, while Maryland is a mandatory add-on state, meaning that motorists are required to carry PIP insurance.
8. Landes (1982) analyzed fatal accident rates across states and years. She asserts that, after controlling for other factors, fatalities are more numerous in states with higher thresholds, and that comparatively strict thresholds may increase the fatal-accident rate by 10 to 15 percent.
9. The New Jersey tort threshold was $200 at the time the claims data were collected, but was changed in 1983. See note 2 *supra*.
10. The tort thresholds are defined as follows:
    New Jersey: (1) $200 medical expenses net of hospital and diagnostic expenses, (2) death, (3) permanent disability, (4) permanent significant disfigurement, (5) partial or total loss of body member, (6) any injuries not confined to soft tissue.
    Massachusetts: (1) $500 medical expense, (2) death, (3) loss of body member, (4) permanent serious disfigurement, (5) loss of sight or hearing, (6) any fracture.
    Pennsylvania: (1) $750 medical expense net of diagnostic x-ray and rehabilitation costs in excess of $100, (2) death, (3) serious permanent injury, (4)

permanent, irreparable, severe cosmetic disfigurement, (5) total disability exceeding 60 days.
Michigan: (1) death, (2) serious impairment of bodily function, (3) permanent, serious disfigurement.

11. Our estimates are consistent with those available from other sources. According to a study by Thomas Jones, then Michigan Insurance Commissioner, BI claims in that state declined 87 percent after no-fault insurance was adopted. It is not clear whether this figure refers to claims filed or paid (see Widiss et al., 1977: 383). The U.S. Department of Transportation published ratios of paid BI claims to insured cars for fourteen no-fault states covering the years 1969 to 1975. These data were obtained from the State Farm Insurance Companies, which had a 14 percent national market share at the time. By comparing the average paid claim frequencies for all reported years before and after no-fault was adopted, we calculate that BI claims declined 62 percent in New Jersey, 82 percent in Pennsylvania, and 88 percent in Michigan (see U.S. Department of Transportation, 1977: 26–28).
12. The share of total BI payments made to claimants whose injuries do not exceed the New Jersey tort threshold is 7 percent in California, 8 percent in Maryland, 9 percent in Washington, and 16 percent in North Carolina. The share of payments to claimants whose injuries do not exceed the Massachusetts threshold is 15 percent in California, 18 percent in Washington, 25 percent in North Carolina, and 31 percent in Maryland. These estimates assume that none of the claimants whose injuries do not exceed the threshold would be paid, and that they consequently overstate the reduction in claims payments. In contrast, our procedure for estimating the number of claimants that are excluded because of the threshold accounts for the fact that some are paid, even though their injuries do not exceed the threshold (see the "BI-File Estimates" subsection). As shown by Table 3 *infra*, as many as one-quarter of paid claimants in the no-fault states may have injuries that do not exceed the threshold.
13. See AIRAC (1979) for the actual questionnaire. Although all claimants would "qualify" before the threshold was established, in the sense that they were not barred from filing a claim because of a tort threshold, only those to whom another motorist was likely to be liable were described as qualifying for recovery. Thus drivers in single-car accidents were not included in this definition. Because PIP compensation is available to nearly all accident victims the proportion of PIP claimants who would have qualified for BI compensation prior to the imposition of the tort threshold is an estimate of the proportion of accident victims who are injured in circumstances that allow compensation under tort liability. The proportion is close to two-thirds in each of our four no-fault states: Michigan—56 percent, Pennsylvania—64 percent, Massachusetts—65 percent, New Jersey—69 percent.
14. Filing a BI claim will not affect one's own insurance rates, as filing a PIP claim might, and the victim may file a BI claim as retribution. On the other hand, a victim may feel that he must retain an attorney to handle a BI claim, he may find it more unpleasant to negotiate with an adversary insurance firm, or he may pity the at-fault driver.
15. There is also a fourth group—accident victims whose injuries exceed the threshold but who do not file BI claims, or whose claims are denied for other reasons. Because we are interested in the number of potential claimants excluded by the threshold, this group does not concern us. We assume that the number of eligible claimants who do not file claims, or whose claims are incorrectly denied, is the same fraction of claims that are properly paid in each state. That is, we assume that no claims are incorrectly denied for not exceeding the threshold when the claimant's injuries do exceed the threshold.

16. The tort thresholds are reported at note 10 *supra* We assume that the claimant exceeded the Massachusetts threshold if his medical expenses exceeded $500, he died, or he suffered permanent disability or a fracture. The New Jersey threshold is deemed to be satisfied if medical expenses net of hospital and x-ray expenses exceeded $200, the claimant suffered permanent disability or a fracture, or he died.
17. More precisely these are estimates of the percentages of "excess" claimants—the data do not indicate the reasons. In Massachusetts, the estimates of the percentage of "excess" claimants between the dollar threshold ($500) and $100 higher ($600) is 13, 2 and 2 percent using California, Washington and Maryland respectively as reference states. In New Jersey the corresponding percentage is 16 percent using a $500 range and California as the reference state.
18. As described at note 6 *supra*, using our BI-file method we found little evidence that the availability of PIP benefits alone significantly reduces the number of BI claims in Maryland.

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