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# Economic Policy Institute

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## REACTION AND RESPONSE: Answers to Towers Perrin's "Corrections and Clarifications"

On May 17, EPI released *The Frivolous Case for Tort Law Change*, by Lawrence Chimerine and Ross Eisenbrey, a report that is highly critical of the annual tort costs estimate produced by Tillinghast-Towers Perrin, a consultant to much of the insurance industry. EPI's report found that TTP's estimate is inflated by the inclusion of costs that have little or nothing to do with the legal system, and it describes the misuse of TTP's estimate by industry advocates who want to limit the rights of victims to recover damages when they are injured. In TTP's 11-point reaction to EPI's report, every one of the points it raises is inaccurate or irrelevant.

The following shows verbatim the 11 objections TTP raised in reaction to *The Frivolous Case for Tort Law Change* and EPI's point-by-point response.

#	EPI's tort report	TTP's objections	EPI's response
1	The EPI report states that <b>"the TTP reports are one-sided...TTP makes no attempt to measure the benefits of the tort system."</b> (page 2)	Tillinghast acknowledges this in its 2004 Update in the Introduction, Page 4. The objective of the 2004 Update is to measure the cost of torts in the U.S. We take no position as to whether tort costs are too high or too low, or whether the costs are high or low relative to the benefits of the tort system. Our purpose is merely to inform the policy debate with an objective factual cost estimate.	<p>TTP admits EPI's point that its approach is one-sided and makes no attempt to measure the benefits of the tort system. TTP claims it has no position on whether costs are too high, yet a heading in its Executive Summary labels the United States as a "litigious society" even though research shows that the United States is considerably less litigious than Germany, Sweden, Israel and Austria, and about the same as Denmark and England.</p> <p>TTP includes data in its updates for no purpose other than to create the impression that tort costs are too high. For example, its <i>2003 Update</i> warns that "at this rate of increase, tort costs could approach \$1,003 per U.S. citizen by 2005—representing a new quadruple-digit benchmark"—as if a figure that is not adjusted for inflation has any meaning or importance as an economic benchmark. A similar statement was made again in their <i>2004 Update</i>.</p> <p>TTP has also published a chart, cited by the Council of Economic Advisors in the <i>Economic Report of the President</i>, purporting to show that U.S. tort costs as a percent of gross domestic product are higher than every other major industrialized, first-world country, even though the chart fails to account for the fact that the other countries generally have national health care systems that remove most medical bills from the tort system and that they also have much more generous unemployment and disability systems that remove a significant share of tort-related wage loss from the system. By portraying U.S. tort costs as outliers (the highest in the world!), TTP creates the impression they are too high.</p>

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2	<p><b>“Half the ‘costs’ that Tillinghast-Towers Perrin attributes to the tort system are not costs in any real economic sense. They are transfer payments from wrongdoers to victims.”</b> (page 2)</p>	<p>As noted above, the purpose of the 2004 Update is to measure the cost of torts in the U.S. We think it is common sense to include in the costs the amounts paid to the alleged victims of the torts. The basis for our estimates are fully disclosed in the report, so that users of the report understand what we are measuring.</p>	<p>The costs that victims of torts have sustained are not created by the legal system and exist whether an insurance company or defendant pays for them or not. It is wrong for TTP to include them as costs of the legal system, even if TTP “fully discloses” what they are.</p> <p>TTP’s claims that only “sweeping reform” or “sweeping structural changes to the U.S. tort system” can slow the increases in tort costs show how wrong it is to include victims’ compensation in its calculation of tort costs. “Sweeping reform” of the tort system will do nothing to reduce the harm to victims caused by pharmaceutical companies that market deadly drugs, let alone the number of auto accidents and the resulting injuries and damage. Because legal changes won’t affect them, these damages should not be included in a calculation of the tort system’s costs.</p>
3	<p><b>“To arrive at numbers large enough (hundreds of billions of dollars) to scare the public about the size of what it erroneously calls a tort crisis ...”</b> (page 3)</p>	<p>The purpose of the 2004 Update is to inform, not to “scare” anyone. Moreover, the word “crisis” does not appear in the 2004 Update.</p>	<p>The word “crisis” does appear twice on page 4 of the <i>2003 Update</i>, which is the version the CEA relied on for its report on the tort system in the <i>2004 Economic Report of the President</i>. TTP compared the “double-digit increases in tort costs” of 2001 and 2002 with the “lawsuit crisis of the 1970s,” which was “the last period of sustained double-digit inflation.”</p>
4	<p><b>“TTP includes a number of costs that do not belong in an estimate of tort costs:... (self-insurance costs and deductibles paid by insureds... benefits paid for non-tort losses).”</b> (page 3)</p>	<p>The purpose of the study is to measure U.S. tort costs, whether insured or not. We see no reason why self-insured tort costs should be excluded. In addition, benefits paid for non-tort losses are not included in our study, as a close reading of Page 8 of the 2004 Update would show.</p>	<p>TTP’s calculation of uninsured and self-insured costs is an estimation of estimates multiplied by arbitrary factors and increased by non-tort costs that cannot be documented. In TTP’s own words, “no source of data exists that tabulates the losses incurred by all self-insured entities.... We have relied on the various estimates available, as well as Tillinghast’s experience in this field, in developing costs for this category.” Even though these costs are not covered by an insurance company, Tillinghast still applies all but 10% of the “administrative expense component” in reaching its \$45.3 billion self-insured cost estimate. It is not plausible—with all of the insurance industry’s costs for advertising, salaries, marketing, profits, etc.—that claim handling costs are only 10% lower when no insurance company is involved.</p> <p>TTP admits on page 10 of the <i>2004 Update</i> that costs from certain kinds of contract and shareholder litigation “may be included in the tort cost totals” and TTP is “unable to separately account for them.”</p>

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5	<p><b>"...with respect to medical malpractice, for instance, whereas A.M. Best reports incurred costs of liability insurance of less than \$8 billion in 2003..."</b> (page 4)</p>	<p>Actually, A.M. Best reports incurred <i>losses</i> of \$7.9 billion in 2003. A.M. Best also reports over \$3 billion in defense costs in 2003. In addition, as those familiar with medical malpractice are aware, most (if not all) major U.S. health systems self-insure a significant portion of their medical malpractice losses. Such self-insured losses are not included in the data reported by A.M. Best.</p>	<p>TTP makes no attempt to explain how it reconciles a \$27 billion cost estimate for medical malpractice with A.M. Best's report that there were \$7.9 billion in incurred losses in 2003 and approximately \$3 billion in defense costs.</p>
6	<p><b>"Use of this figure allows TTP to simply 'reassess' liabilities associated with claims."</b> (page 5)</p>	<p>This statement is in reference to asbestos costs. It insinuates that Tillinghast changed its assessment of asbestos losses. That is not the case. The reassessment is by the U.S. property/casualty insurance industry, not Tillinghast; the numbers in the 2004 Update reflect data drawn from insurance company statutory annual statements.</p>	<p>The problem with TTP's use of incurred losses, which are not actual losses or a measure of claims paid, is that it allows creative accounting on the part of the insurance industry, which TTP then parrots. Since they are merely informed guesses about what insurance companies will eventually have to pay, rather than a verifiable accounting of what they actually have paid, they are not stable; they can be "reassessed" when insurance companies decide it is advantageous.</p>
7	<p>1. The EPI paper criticizes the 2004 Update for including administrative expenses. (page 5)</p> <p>2. The EPI paper, related to administrative expenses, states, <b>"But it is impossible to analyze how TTP apportions such costs to what it calls the tort system..."</b> (page 6)</p>	<p>1. We believe such expenses should be included, and separately identify them so that users of our report can analyze the data with and without such costs. We include a chart on Page 7 of the 2004 Update that shows the relative share of total insured tort costs attributable to administrative expenses. The administrative expenses are created because businesses and individuals feel the need to transfer the risk of a tort exposure. Absent the tort exposure, liability insurance would not be necessary and the administrative costs would not be incurred.</p> <p>2. It's not Tillinghast that apportions these expenses. Rather, it's the insurance companies themselves who apportion their administrative expenses to each line of business as part of their annual filings with state insurance departments. The data tabulated by A.M. Best that we cite on Page 8 of the 2004 Update includes the apportionment of administrative expenses to line of business.</p>	<p>22% of TTP's tort cost estimate is insurance company overhead, including salaries, the costs of advertising, marketing, and selling insurance products, profits, etc. It argues that this \$54 billion should be included because, "Absent the tort exposure, liability insurance would not be necessary and the administrative costs would not be incurred." This is plainly false. As Prof. Theodore Eisenberg of Cornell University Law School points out, automobile cases account for 61% of all compensation paid for tort claims. Insurance for auto-related torts is not optional; states <i>require</i> that drivers be insured.</p>

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8	<b>“For example, no one denies that insurance companies should make good on the promises in their insurance contracts to pay the first- or third-party damages of their insureds, but it is misleading to treat these obligations as tort costs.”</b> (page 6)	As noted previously, benefits paid for non-tort, or first-party, coverages are not included in the 2004 Update. In addition, we believe payments for third-party damages of insureds should be included ? they reflect the payments made as a result of alleged torts, which is what the 2004 Update attempts to measure.	Claims paid pursuant to an insurance contract where no one has alleged a legal right to recover in court, no suit is filed, no lawyer hired by any party, and no tort is adjudicated should not be counted among tort costs—especially in the context of arguments about the legal system and the need for “sweeping structural changes.”
9	<b>“TTP cites a number of misleading numbers to support its claims that there is a crisis in the tort system. These include claims that...tort costs as a percentage of gross domestic product are too high...”</b> (page 6)	As noted previously, the word, “crisis” does not appear in the 2004 Update. Moreover, Page 4 of the 2004 Update states, “This study takes no position on whether tort costs are too high or too low.”	See EPI’s response to points #1 and #3.
10	<b>“TTP’s 2003 Update claimed that tort costs rose almost 30% from 2000 to 2002 and predicted that the trend would continue.”</b> (page 7)	The 2003 Update showed increases in tort costs of 14.4% in 2001 and 13.3% in 2002. We did not expect that trend to continue. As outlined on Page 20 of the 2003 Update, we anticipated an increase in costs of 8.5% in 2003, well below the rate of increase in 2001 and 2002, and even below the 52-year average annual increase of 9.8%.	In the lead paragraph, titled “Future Implications,” of the <i>2003 Update</i> , TTP did not suggest that tort costs were slowing or rising at less-than-normal rates. Rather, it suggested just the opposite: “The high tort cost growth experienced in 2001 and 2002 suggests another period of high tort cost growth in the U.S., akin to what was last experienced in the 1970s and 1980s.” In each of those decades, according to TTP, tort costs grew at an average annual rate of 11.7% or higher (TTP’s <i>2003 Update</i> , Appendix 1b).
11	<b>“But because TTP appears to measure ‘tort costs’ by the premiums paid for all insurance coverage rather than through an actual accounting of tort payouts...,”</b> and <b>“Using insurance premiums as a proxy for tort costs...”</b> (page 8)	The 2004 Update’s tabulation of tort costs does not include all insurance coverages, as noted previously. Moreover, premiums are not used as a proxy for tort costs. As stated on Pages 8 and 9 of the 2004 Update:	The source of TTP’s estimates is a matter of controversy. Many, most notably former Texas State Insurance Commissioner Robert Hunter, have noted that TTP’s cost estimates trend closely with insurance premiums and the performance of the insurance industry’s investments.