



Center for Justice & Democracy
90 Broad Street, Suite 401
New York, NY 10004
Tel: 212.267.2801
centerjd@centerjd.org
<http://centerjd.org>

MYTHBUSTER!

DEBUNKING MYTHS ABOUT TORT SYSTEM COSTS

Every year, an insurance industry-consulting firm, Tillinghast–Towers Perrin, issues a report that claims to estimate what it calls the overall annual “cost” of the U.S. tort system, most recently \$261 billion. On the basis of this figure, it then calculates a so-called “tort tax,” supposedly representing tort system costs to each individual.¹

These figures are bogus and its annual release is little more than a public relations gimmick used by the special interests behind the national “tort reform” movement. In fact, true tort system costs are likely impossible to honestly calculate because court systems do not accurately track such costs. Tillinghast does not even attempt to examine them, as explained below.

But taking one aspect of costs that has received some attention in recent years – total payouts in medical malpractice cases – it is clear how misleading Tillinghast’s figures can be. Medical malpractice payouts, for injuries and deaths caused by medical negligence in the nation, have recently hovered between \$5 billion and \$6 billion annually.² *This is less than half of what Americans pay for dog and cat food each year.*³

BY ITS OWN ADMISSION, TILLINGHAST’S FIGURES HAVE NO RELATION TO THE COSTS OF THE LEGAL SYSTEM.

- **Tillinghast admits that it does not examine jury verdicts, settlements, lawyers’ fees, court costs or any actual costs of what might generally be considered “tort costs.”** In 2006, Tillinghast acknowledged that its evaluation of the tort system does not include “costs incurred by federal and state court systems” and incredulously states these costs are not even relevant to its estimates.⁴ That admission is similar to one made by Tillinghast in its 2005 study stating, “the costs tabulated in this study are not a reflection of litigated claims or of the legal system.”⁵
- **Tillinghast’s definition of “tort system costs,” from which the “tort tax” figure is derived, is vastly larger than the actual tort system.**
 - Included in Tillinghast’s definition of “tort costs” is the immense costs of operating the wasteful and inefficient insurance industry.⁶ Fully 22 percent of Tillinghast’s “tort costs” are what it calls insurance industry “administrative expenses,”⁷ (e.g., salaries of executives, rent and utilities for insurance company headquarters, commission paid to agents, advertising and other acquisition costs).

- Tillinghast’s numbers are calculated from the most exaggerated possible source: insurance industry “incurred losses,”⁸ which are not really “losses” at all. They are mostly estimates - not actual costs - that insurers make in rate filings and have in the past proved to be wildly overstated.⁹
- On top of that, a huge percentage of “tort costs” identified by Tillinghast concern personal auto insurance, including liability claims for fender benders, for which policyholders pay insurance premiums. The vast majority of these claims are settled without any attorneys being hired or anyone being sued. Identifying these figures as “tort costs” is a huge error.
- Tillinghast admits that it does not factor in the benefits or cost-savings from the tort system. In its 2006 report, Tillinghast notes, “ this study does not attempt to quantify the benefits of the tort system. Such benefits include a systematic resolution of disputes, thereby reducing conflict, possibly including violence. Another indirect benefit is that the tort system may act as a deterrent to unsafe practices and products. From this perspective, compensation for pain and suffering is seen as beneficial to society as a whole.”¹⁰

TILLINGHAST FIGURES HAVE BEEN CONSISTENTLY DEBUNKED BY EXPERTS.

- **Economic Policy Institute.** In 2005, the Economic Policy Institute (“EPI”) released a definitive study debunking common myths about the costs of the legal system and its burden on consumers.¹¹ According to EPI:
 - Half of 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 victim.
 - EPI also noted, “There is no historical correlation between the inflated estimates of the costs of the tort system and corporate profits, product quality, productivity, or research and development (R&D) spending. Evidence suggests that the tort system, without the proposed restrictions, has actually been beneficial to the economy in all these areas.”
- **Business and News Publications.**
 - *Business Week* called the 2005 Tillinghast report a “wild exaggeration,” stating that it “includes everything from payouts for fender-benders to the salaries of insurance industry CEOs.”¹²
 - *The Wall Street Journal* said in an article, “...critics of past years’ studies – and there are many – say the number and the projections that come with it are deeply flawed. For instance, they include payments that don’t involve the legal system at all. Say somebody smashes his car into the back of your new SUV and his insurance company sends you a \$5,000 check to fix the damage. That gets counted as a tort cost in Tillinghast’s number. Critics say it’s just a transfer payment from somebody who wasn’t driving carefully to somebody who has been legitimately wronged. How is that evidence of a system run amok?”¹³
 - *Congressional Quarterly*: “Nearly all the assertions about the growing cost of the tort system are based on the figures from just one actuarial and management consulting firm, Tillinghast Towers-Perrin, that works for the insurance industry, which has a stake in limiting lawsuits ... The company’s estimates of tort costs include the insurance industry’s administrative expenses and payments on claims that never involve courts or lawyers, such as auto collisions.”¹⁴

- **Washington Monthly:** Tillinghast “includes in its definition of the ‘tort system’ insurance company administrative costs and overhead and the salaries of highly paid insurance company CEOs ... One thing TTP doesn’t include: court budgets, which makes its study seem a lot more like an assessment of the insurance industry than of the legal system.”¹⁵
- **Capra Report.** In a January 29, 1999 independent study prepared for the New York State Bar Association, Daniel Capra, Philip Reed Professor of Civil Justice Reform at Fordham University School of Law, said, “[A]ny cries about a ‘tort tax’ are nothing but absurd and self-serving overkill.”¹⁶ Professor Capra also found:
 - “The analysis of the costs of the tort system creates the unfair inference that the cost is caused solely by plaintiffs lawyers and frivolous litigation -- when in fact most of the cost of the system is the result of corporate wrongdoing causing injury, and ‘hardball’ litigation tactics of insurance companies that deny legitimate claims.”
 - “[T]he quasi-statistical analysis about the costs of the tort system fails to mention that the system provides the essential benefits of victim compensation and product safety. Any focus on costs without consideration of countervailing benefits is completely irresponsible.”
 - The “tort tax” figure “is particularly disingenuous given the record profits of insurance companies and their executives.”
 - “[T]he cost of the tort system to business is remarkably low when compared to business income and profits.”

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NOTES

¹ In its *2006 Update on U.S. Tort Cost Trends* released in December 2006 (the second report issued in 2006), Tillinghast says that even by its own bogus analysis, *this “tort tax” figure is dropping*. Specifically, “The U.S. tort system cost \$261 billion in 2005, which translates to \$880 per person, or \$4 per person less than in 2004.” Tillinghast also says, “U.S. tort costs grew by 0.5% in 2005 ... This was much lower than the growth rate of 5.7% in 2004, and was the smallest increase in tort costs since 1997.... The 0.5% rate of growth in tort costs in 2005 was less than overall economic growth of 6.3%. Since 1950, growth in tort costs has exceeded growth in GDP by an average of two to three percentage points. However, ... the ratio of tort costs to GDP decreased in 2005 compared to 2003 and 2004.”

² See, Americans for Insurance Reform, *Stable Losses/Unstable Rates, 2004*, <http://www.insurance-reform.org/StableLosses04.pdf>.

³ The Pet Food Institute puts these figures at \$13 to \$14 billion annually over the past few years. See http://www.petfoodinstitute.org/reference_pet_data.cfm

⁴ *2006 Update on U.S. Tort Cost Trends* at 10.

⁵ *U.S. Tort Costs: 2004 Update*, at 4.

⁶ *2006 Update on U.S. Tort Cost Trends* at 7.

⁷ *Ibid.*

⁸ Tillinghast admits, “[W]e recognize that more estimates of costs must be used when measuring on an incurred basis than when measuring on a paid basis. Our use of incurred losses instead of paid losses has resulted in higher increases in tort costs in recent years.” *Ibid* at 7.

⁹ See, e.g., Jay Angoff, *Falling Claims and Rising Premiums in the Medical Malpractice Insurance Industry*, July 2005, <http://www.centerjd.org/ANGOFFReport.pdf>; Americans for Insurance Reform, *Stable Losses/Unstable Rates, 2004*, <http://www.insurance-reform.org/StableLosses04.pdf>. Despite this evidence, Tillinghast says “use of incurred costs does not overstate tort costs. To argue this, one would have to hypothesize that insurers knowingly set reserves too high. We do not believe this is the case.” In fact, over reserving is a significant and well-documented problem. For example, according to a June 24, 2002, *Wall Street Journal* front page investigative article, St. Paul, which until 2001 had 20 percent of the national med mal market, pulled out of the market after mismanaging its reserves. The company set aside too much money in reserves to cover malpractice claims in the

1980s, so it “released” \$1.1 billion in reserves, which flowed through its income statements and appeared as profits. Seeing these profits, many new, smaller carriers came into the market. Everyone started slashing prices to attract customers. From 1995 to 2000, rates fell so low that they became inadequate to cover malpractice claims. Many companies collapsed as a result. St. Paul eventually pulled out, creating huge supply and demand problems for doctors in many states. Christopher Oster and Rachel Zimmerman, “Insurers’ Missteps Helped Provoke Malpractice ‘Crisis,’” *Wall Street Journal*, June 24, 2002.

¹⁰ *2006 Update on U.S. Tort Cost Trends* at 10.

¹¹ See, Economic Policy Institute, “The Frivolous Case for Tort Law Change,”

<http://www.epi.org/content.cfm/bp157>.

¹² “How Partisanship Puts Big Solutions Out of Reach,” *Business Week* editorial, March 14, 2005.

¹³ “Math Divides Critics as Startling Toll of Torts is Added Up,” *Wall Street Journal*, March 13, 2006.

¹⁴ “‘Tort Reform’ Battle: A Simple Case of Complexity,” *Congressional Quarterly Weekly*, Jan. 29, 2005.

¹⁵ Stephanie Mencimer, “False Alarm,” *Washington Monthly*, October 2004.

¹⁶ See, Daniel Capra, “An Accident and a Dream: Problems With the Latest Attack on the Civil Justice System,” 20 *Pace L.Rev.* 339 (2000). Capra’s original report seems based on a 1998 publication entitled “An Accident and a Nightmare,” by Joanne Doroshow, Citizens for Corporate Accountability & Individual Rights (predecessor to Center for Justice & Democracy), on file with the Center for Justice & Democracy.