

HARNESSING THE LIABILITY LOTTERY: ELECTIVE FIRST-PARTY NO-FAULT INSURANCE FINANCED BY THIRD-PARTY TORT CLAIMS*

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The classic virtue of the market system is its flexibility. Let things get bad enough—let a need become obvious enough—and there is a corresponding incentive, primarily but not exclusively financial, for entrepreneurs to devise alternatives to current malfunctioning offerings. Of course, the system does not always work that smoothly, but as Adam Smith pointed out 200 years ago, the almost hydraulic force with which brains and energy and, not the least, capital is inclined to flow to those attempting to right the market's wrongs is a very healthy influence.¹

Right now it is difficult to imagine anything functioning more inefficiently than the legal liability system, especially as it applies to personal injury. Insurance overhead and legal fees require billions of dollars, in constantly spiraling amounts, to produce a trickle of benefits disproportionately paid to a "lucky" few, but then only after years of delay. Why? Because determining who or what was at fault in an accident and the pecuniary value of nonpecuniary pain and suffering—both of which the common law requires in every case—are very cumbersome criteria for payment.

The picture is the same for all kinds of accidents including those from automobiles,² medical treatment,³ malfunctioning consumer and

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1. See *generally* 1 & 2 A. SMITH, *AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS* (1776).

2. For a description of the tort system in the context of auto accidents, see J. O'CONNELL, *THE INJURY INDUSTRY AND THE REMEDY OF NO-FAULT INSURANCE* 1-93 (1971); J. O'CONNELL

industrial products,⁴ and slips-and-falls.⁵ For example, a recent government study of products liability found that the average personal injury claim took nineteen months to close, and larger claims took much longer. The average payment dollar was for a claim that took sixty-nine months to close!⁶ And this included out-of-court settlements as well as cases going to trial. Out of the medical malpractice insurance dollar, only twenty-eight cents ever reaches injured victims; the remainder goes to pay lawyers on both sides and other insurance costs.⁷ What can be done about it?

Sixteen states have passed no-fault automobile insurance laws restricting the right to sue for pain and suffering based on the other driver's fault, in return for automatic payment, regardless of fault, for one's own out-of-pocket loss from one's own insurer.⁸ Although their performance has been the subject of some controversy, it has shown that Daniel Patrick Moynihan was essentially right when he said in 1975 that no-fault automobile insurance was "the one incontestably successful reform [proposed in] the 1960's."⁹ Consider the situation in Michigan: Coverage under their no-fault statute pays unlimited medical expenses plus over \$58,000 of wage loss in addition to \$20,000 for those fault-based claims that are preserved. (One who suffers "substantial bodily impairment" can still sue the other driver.)¹⁰ All this insurance is provided at a cost no greater, and apparently less, than the costs

& R. HENDERSON, TORT LAW, NO-FAULT AND BEYOND: TEACHING MATERIALS ON COMPENSATION FOR ACCIDENTS AND AILMENTS IN MODERN SOCIETY 99-221 (1975).

3. See J. O'CONNELL, ENDING INSULT TO INJURY: NO-FAULT INSURANCE FOR PRODUCTS AND SERVICES ch. 3 (1975).

4. See O'Connell, *Supplementing Workers' Compensation Benefits in Return for an Assignment of Third-Party Tort Claims—Without an Enabling Statute*, 56 TEX. L. REV. 537, 537-41 (1978) [hereinafter cited as *Supplementing*]; O'Connell, *Transferring Injured Victims' Tort Rights to No-Fault Insurers: New "Sole Remedy" Approaches to Cure Liability Insurance Ills*, 1977 U. ILL. L.F. 749, 749-53 [hereinafter cited as *Transferring*].

5. See J. O'CONNELL, *supra* note 3, at 48.

6. INSURANCE SERVICES OFFICE (ISO), 1976 PRODUCT LIABILITY CLOSED CLAIM SURVEY, PRELIMINARY ANALYSIS OF SURVEY RESULTS 50 (1976).

7. See O'Connell, *An Alternative to Abandoning Tort Liability: Elective No-Fault Insurance for Many Kinds of Injuries*, 60 MINN. L. REV. 501, 506-09 (1976).

8. For the statutes of those sixteen states and citations to the statutes of the eight other states providing no-fault benefits but not eliminating tort suits for pain and suffering, see O'Connell, *Operation of No-Fault Auto Laws: A Survey of the Surveys*, 56 NEB. L. REV. 23, 26-27 (1977).

9. Moynihan, *Foreword to J. O'CONNELL, supra* note 3, at xi. See also Note, *No-Fault Automobile Insurance: An Evaluative Survey*, 30 RUTGERS L. REV. 909 (1977).

10. MICH. COMP. LAWS ANN. §§ 500.3101-3179 (Supp. 1978). Under the Michigan law, wage loss is tied to inflation. Originally pegged at \$1,000 per month (for three years), the maximum payment for lost wages is now approximately \$1,600. See *id.* § 500.3107(b) (Supp. 1978).

of only \$20,000 of conventional fault-based liability insurance, under which relatively few seriously injured victims were adequately compensated.¹¹ Consider too the situation in New Jersey where the no-fault statute pays unlimited medical benefits plus \$5,200 of wage loss. At the same time, due to the pressures exerted by the trial bar, the statute preserves the right to sue the other driver when medical expenses exceed the ludicrously low amount of \$200.¹² According to a recent New Jersey legislative report, the average cost per car for the generous no-fault benefits is \$40.92; the average cost per car for \$15,000 of fault-based liability insurance covering personal injury—which, once again, pays relatively few seriously injured parties—is \$70.18 or almost twice as much.¹³

And yet no-fault reform is stuck. No state has enacted a new law since 1975, and many states that have laws that provide notoriously low benefits and that preserve far too many fault-based claims resist amendment.¹⁴ A federal bill has failed to pass,¹⁵ perhaps because the Government has been preoccupied with trying to unsteal the Panama Canal, creating an energy policy, and easing tensions in the Middle East, leaving little time for a paltry issue like auto insurance, especially given the awesome lobbying power of the trial bar,¹⁶ which operates as effectively in Washington¹⁷ as it traditionally has in the states.¹⁸

11. INSURANCE BUREAU, MICHIGAN DEPARTMENT OF COMMERCE, NO-FAULT INSURANCE IN MICHIGAN: CONSUMER ATTITUDES AND PERFORMANCE 42, 54 (1978).

12. The tort exemption is rendered at least slightly more realistic by precluding tort actions "if the bodily injury is confined solely to the soft tissue of the body and the medical expenses incurred or to be incurred by such injured person . . . for the reasonable and necessary treatment of such bodily injury, is less than \$200.00 exclusive of hospital expenses, x-rays and other diagnostic medical expenses." N.J. STAT. ANN. § 39:6A-8 (1978). Thus, hospital expenses, x-rays, and other diagnostic expenses do not count in reaching the \$200 threshold when the injury is confined to soft tissue.

13. NEW JERSEY LEGISLATURE STUDY COMMITTEE, NO-FAULT AUTOMOBILE INSURANCE REFORM IN NEW JERSEY 71 (1977).

14. See O'Connell, *supra* note 8, at 26-27.

15. See *House Unit Rejects Bill for a No-Fault Auto Insurance Plan*, Wall St. J., Aug. 2, 1978, at 4, col. 1.

16. For a general view of the increasing power of lobbying groups to block legislation, see TIME, Aug. 7, 1978, at 14-22.

17. Since 1975, the American Trial Lawyers Association (ATLA), a group composed largely of plaintiffs' personal injury lawyers, has raised and spent over one million dollars, with about two-thirds of the funds going to congressional candidates. Half of these contributions were made in 1978 alone. According to Lynn Sutcliffe, a Washington lawyer and supporter of no-fault, the ATLA contributions show "a clear pattern of trial lawyers' campaign spending which rewards those who oppose no-fault and punishes those who favor it." Fred Wertheimer, Senior Vice-President of Common Cause, the public interest lobbying group, said that, "ATLA did not run a

One must keep in mind the enormous income that personal injury litigation has provided for claimants' lawyers in recent years, and their resultant investment in the status quo. Personal injury work has become the most lucrative area of practice in the United States. Whereas senior partners in Wall Street law firms normally earn \$250 thousand to \$300 thousand annually, personal injury lawyers throughout the country, in small towns as well as big cities, often earn far more.¹⁹ A recent report on a three-partner firm in Marshall, Texas (population 29,000) indicated that a casual and by no means complete check of their 1975 earnings showed fees of at least \$1.6 million on personal injury settlements and verdicts of \$4.5 million.²⁰

Why such riches for personal injury lawyers? Because, unique among lawyers, they are paid not by the hour—"tied to their time sheets," as lawyers put it—but rather with an equity interest of one-third to one-half²¹ of the recovery. And even if contingent fees were reduced, injured parties might just end up with less competent lawyers and yet face all the same impediments to payment that they face under cumbersome common law liability.²²

campaign fund, it ran an investment fund." News Release, Common Cause, *Trial Lawyers Group Contributes Almost Quarter of a Million Dollars to 1976 Congressional Candidates* (Feb. 28, 1978). As just one of many examples, the ATLA fund contributed \$5,000 to the primary opponent of Rep. Bob Eckhardt (D. Tex.), the chief sponsor of the federal no-fault bill in the House. The ATLA fund was organized in 1975 after no-fault was passed in the Senate. In 1977 the 34,000 member ATLA moved its headquarters from Boston to Washington, D.C. in order to better fight federal no-fault legislation. News Release, Committee for Consumers No-Fault, *Trial Lawyer Opponents of No-Fault Raise and Spend \$1 Million in Political Fund* (Nov. 5, 1978).

18. See O'Connell, *supra* note 8, at 34.

19. See N.Y. Times, May 16, 1977, at 35, col. 3.

20. J. GOULDEN, *THE MILLION DOLLAR LAWYERS* 64-65 (1978).

21. See *Standards for No-Fault Motor Vehicle Accident Benefits Act: Hearings on S. 1381 Before the Senate Comm. on Commerce, Science, and Transportation*, 95th Cong., 1st Sess. 209 (1977).

A . . . suggestion [often made] is that limits be placed on *contingent fees* that can be charged by plaintiffs' lawyers. Curiously enough, nothing is concomitantly said about curbing defense lawyers' fees. Since the problem [of tort litigation] stems from litigation between two sides, why is an equitable solution to limit what one side can spend on litigation while ignoring the other? As long as we keep a system—like the fault system—that depends on litigation, how much sense does it make to limit by statute either side's (or both sides') access to litigation?

O'Connell, *supra* note 7, at 514 (emphasis in original).

22. "In all lines [studied—product liability, auto, workers' compensation, and medical malpractice], the defense spends more on litigation than does the plaintiff . . ." P. MUNCH, *COSTS AND BENEFITS OF THE TORT SYSTEM IF VIEWED AS A COMPENSATION SYSTEM* ix, 21-29, 42-52, 62-76, 82-90 (Rand Corp. 1977). See also CALIFORNIA CITIZENS' COMMISSION ON TORT REFORM, *RIGHTING THE LIABILITY BALANCE* 159-61 (1977).

With so many lawyers throughout the United States having such high stakes in the personal injury system, perhaps the difficulty of achieving reform by legislation should not surprise us. Trial lawyers exist in every community of any size. As one insurance official says: "They're affluent, active, and articulate. Also, in terms of relative zeal they have something now that [no-fault reform] would take away, and that gives them a whole different mental set than the rest of us."²³

It must also be kept in mind that even if state or federal no-fault laws do pass in the foreseeable future, they will still apply only to auto accident victims, providing no relief for other accident victims. This gets us back to the market. If things are so rotten—and legislative change seems blocked by the trial bar—can the market correct the situation the way Adam Smith told us it ought to?²⁴ It might. Consider the possibility of elective first-party no-fault insurance.

Before proceeding, some clarification of the terminology is in order. First-party insurance is coverage under which the policyholder collects payments for his losses from his own insurance company rather than from the insurer of the other person who caused the accident. The latter is known as third-party insurance: the prototypical example being tort liability insurance.²⁵

Elective first-party no-fault insurance might work like this: An insurer could offer no-fault coverages in increments of \$10,000, up to any amount,²⁶ payable for economic loss consisting principally of medical expenses (including rehabilitation) and wage loss stemming from personal injury or death. In return, the insurer would receive an absolute assignment of the insured's tort claim (for both economic and noneconomic loss) against third-parties causing injury or death. The insurer would then use the recoveries on those tort claims to help pay

23. Demkovich, *It's Time for Another Battle on No-Fault Insurance*, NAT'L J., Oct. 8, 1977, at 1572-73.

24. See note 1 *supra* and accompanying text.

25. See O'Connell, *Transferring*, *supra* note 4, at 775-76. The following proposal of first-party no-fault insurance was outlined in summary form in O'Connell, *Financing First-Party No-Fault Insurance by Assignment of Third-Party Tort Claims*, 1978 INS. L.J. 207. The proposal advanced in this article has changed in important particulars (but not in essential outline) from the proposal for first-party insurance with transfer of third-party tort claims outlined in O'Connell, *Transferring*, *supra* note 4, and O'Connell, *Supplementing*, *supra* note 4.

My discussions with Robert Martin of the Wichita, Kansas Bar have been very fruitful in the development of my later ideas.

26. Concerning the fears of many insurers of unlimited coverage or even coverage with extremely high dollar limits, see O'Connell, *supra* note 25, at 217; O'Connell, *Transferring*, *supra* note 4, at 786.

no-fault benefits to *all* insureds. To prevent adverse selection, the parties would have to transfer the tort claim prior to any injury, *i.e.*, at the time the agreement for future payment of no-fault benefits is consummated. Otherwise, if a victim could choose after an accident whether to press a fault-based or a no-fault claim, those with valid fault-based claims would press them while others would collect no-fault benefits, leaving an insurer without fault-based claims to provide income to pay no-fault benefits.

The no-fault insurer would agree that upon injury to a no-fault insured the no-fault insurer would pay no-fault benefits periodically as economic losses accrue.²⁷ Furthermore, the insurer would agree to pay the injured insured the equivalent of any amount in excess of the no-fault benefits recovered as economic losses in the tort action against third-parties without reduction for expenses incurred in recovering. This device guarantees that the insured will receive whatever level of no-fault benefits he wishes to purchase plus whatever amount of economic loss in excess of that limit he is eligible to recover in tort.²⁸ But he would have assigned to the no-fault insurer any tort right that had accrued to him as a result of the injury.

This provision distributing the tort recovery, however, could cause conflict of interest problems between the insurer and the no-fault insured unless corrective devices are employed. Consider the following hypothetical: *A* buys \$10,000 worth of no-fault coverage from *B*, an insurance company. *A* is injured in an accident with *C* and suffers \$30,000 in economic loss. *B*, of course, must pay *A*, pursuant to the no-fault contract, up to \$10,000 in no-fault benefits as losses accrue. When *B* proceeds to settle *A*'s tort claim with *C* (or *D*, *C*'s insurer), *B* may

27. The insurer could also offer optional first-party no-fault benefits for "pain and inconvenience" in scheduled amounts to avoid evaluation problems. For one such scheme, see R. KEETON & J. O'CONNELL, BASIC PROTECTION FOR THE TRAFFIC VICTIM 420-22 (1965). Concerning a survey of consumers' receptivity to such coverage, see J. O'CONNELL & R. SIMON, PAYMENT FOR PAIN & SUFFERING: WHO WANTS WHAT, WHEN & WHY? 32-34, 49-50 (1972), also published in 1972 U. ILL. L.F. 1, 32-34, 49-50. For a survey of insurance personnel concerning such coverage, see Brainard & Lord, *First-Party Pain and Suffering Coverage: A New Direction for No-Fault?*, 1978 INS. L.J. 319. The optional first-party coverage for "pain and inconvenience" could be limited to claimants with valid tort claims as determined in the arbitration proceedings described in text accompanying note 32 *infra*. See also note 28 *infra*.

28. To avoid having the first-party insurer pay amounts theoretically recoverable in tort against a judgment-proof, uninsured, or under-insured third-party, the first-party insurance contract could limit the amount recoverable in excess of no-fault benefits to the amount a successful tort claimant would have been able to actually recover. For a suggested use of this device in a different context, see Schwartz, *Statutory Strict Liability for an Insurer's Failure to Settle: A Balanced Plan for an Unresolved Problem*, 1975 DUKE L.J. 901, 913-14.

wish to settle the case expeditiously for, say, \$15,000 rather than litigate extensively for a potentially greater recovery. *B* may believe, for example, that in the event of actual litigation, *C* may not be held liable or that *A* may be held contributorily or comparatively negligent. Another possibility is that *B*, at year's end, may have, for example, five claims against *D*, and *D* six against *B*, which they settle altogether.²⁹ Even if *B* and *D* individually settle the case for \$15,000, *B* might find it difficult to agree with *A* on the allocation of the \$15,000 between economic and noneconomic damages, especially if the lump sum had been discounted for reasons of doubtful liability. Obviously, then, the way *B* efficiently disposes of *A*'s tort claim could lead to conflicts of interest or disputes or, at the least, disappointment and misunderstanding. But unless *B* has the power to dispose absolutely of *A*'s claim without *A*'s intervention, some of the effectiveness of first-party no-fault insurance is lost.

The solution to this dilemma is for *B* to retain the power to dispose absolutely of *A*'s tort claim, but nonetheless to retain an obligation to pay *A* at the level of no-fault benefits purchased plus the equivalent of whatever amount of economic loss in excess of the no-fault limit that *A* is eligible for under tort liability. But the amount, if any, of *B*'s obligation to pay *A*'s tort recovery for economic loss will be determinable ultimately by *A*'s having a right to request arbitration, in a procedure solely between *A* and *B*, on the issues of the fact and amount of *C*'s tort liability to *A* for economic loss. Thus *B* will agree, quite apart from any settlement it makes with *C* or *D*, to allow *A* to arbitrate the amount of *C*'s tort liability to *A* for economic loss. *B*, therefore, gets untrammelled control of *A*'s tort claim, but *A* is assured of not only whatever level of no-fault benefits he has purchased, but also of whatever economic loss in excess of that limit he is eligible for under tort liability.³⁰

29. It is, after all, the possibility of such expeditious settlement of claims between insurers and self-insurers that is one of the virtues of first-party no-fault insurance.

30. Arbitration of the amount due from the tortfeasor also solves the problem of conflict of interest when an insurer insures both the injured first-party and the third-party tortfeasor. The injured first-party is guaranteed an independent forum to determine the tortfeasor's liability, notwithstanding the identity of the tortfeasor's insurer.

A first-party insurer may find it distasteful to assert a tort claim against one of its own insureds. For example, *A*, who is paying first-party no-fault benefits to *B*, is later in the position of asserting *B*'s tort claim against *C*, whom *A* either is insuring for tort liability or for other coverage. The problem is scarcely unique to this proposal of elective first-party no-fault insurance; indeed it arises frequently today, without presenting insuperable problems, when an insurer is subrogated to claims against one of its own insureds.

Let us return to hypothetical cases: Assume *A* again elected \$10,000 of no-fault benefits, but now he suffers \$8,000 of economic loss and \$12,000 of noneconomic loss. *A* receives \$8,000 in no-fault benefits from *B* who, in turn, succeeds to *A*'s entire \$20,000 tort claim against *C*.³¹ *B* will use the \$12,000 recovered for *A*'s noneconomic loss to fund payment of the noneconomic loss of its insureds without tort claims. Note that where *A* has insured himself for as much or more in no-fault benefits as he suffers in economic loss, there is no problem in distributing the tort proceeds to *A* except in exceptional cases.

This brings us back to our hypothetical where *A* elected \$10,000 of no-fault benefits and suffered \$30,000 of economic loss. Further assume that *A* incurs \$25,000 of noneconomic loss, and *B* pays *A* \$10,000 in no-fault benefits as the loss accrues. *B* also files a claim against *C* (or *D*, *C*'s liability insurer). As suggested above, *B* may settle the claim individually with *D*, or *B* and *D* may, at year's end, negotiate a bulk settlement of all mutual claims. This gives rise to various possibilities as *B* deals with *C* or *D*.

First, *B* may not be able to extract a settlement from *C* (e.g., due to doubtful liability), or *B* may settle with *C* for an amount that includes a figure (assume \$7,000) allocable to *A*'s economic loss that is less than *A*'s no-fault limit (\$10,000). In either event, *B* would not make an offer to *A* in excess of the no-fault benefits. But *A* would have the right to arbitrate with *B* whether he is entitled to payment for amounts due in tort from *C* for his economic loss above the no-fault limits. *A*, however, would be obliged to pay his own lawyer if he wished to retain one for such a proceeding.

Second, *B* may settle with *C* for an amount in excess of *B*'s no-fault obligation to *A* and then offer *A* the amount *B* thinks represents *A*'s share of the settlement allocable to *A*'s economic loss above the no-fault limits. Assume in this regard that *B* settles with *C* for \$18,000 and then offers *A* \$8,000, representing the amount of the settlement in excess of the no-fault limits (\$10,000). *A* can either accept the \$8,000 or demand a separate arbitration with *B* over the fair evaluation of *A*'s

31. The first-party no-fault contract should probably be written as excess insurance, *i.e.*, payable only to the extent that collateral sources such as health insurance and sick leave are not payable. To that extent, the collateral sources would be eligible to share in *A*'s tort recovery, as they would have had no assignment to *B* been made.

If *A* has no-fault insurance on his wage loss for less than his actual wages—*e.g.*, insurance for \$200 a week when he actually loses \$360—he should be entitled to the difference, if recoverable in tort. See J. O'CONNELL & R. HENDERSON, *supra* note 2, at 318-20.

claim for more. Such an arbitration proceeding would be very similar to those routinely held under uninsured motorist coverage where a first-party insurer and its insured arbitrate the value of the insured's tort claim against a third-party, with the first-party insurer in effect assuming the role of the third-party's liability insurer. The main difference is that only a portion of the insured's economic loss due from the third-party, not his entire economic and noneconomic loss, is assessable against the first-party insurer. Note again that *A* (as with uninsured motorist coverage) must pay for his own lawyer if he wishes to retain one in this proceeding,³² and that any amounts payable in excess of the no-fault limits, whether payable pursuant to arbitration or not, could be payable periodically as losses accrue (as with the no-fault benefits).

Third, *B* can litigate against *C* (either pursuant to arbitration or otherwise). Either *A* or *B* can then insist that *A* join the litigation, in which event *A* will be bound by the findings as to his losses. *A* may secure and pay for his own counsel or rely on *B*'s counsel. In the proceeding, whether by arbitration or otherwise, *A* and *B* will request that the trier of fact, in a special verdict, separate economic from noneconomic damages.³³ Note that because *A* stands to gain from a finding of economic loss in excess of the no-fault limits and because the finding of noneconomic loss (which accrues to *B*) will normally vary positively with the finding of economic loss, there is a confluence of interest between *A* and *B*, making it less likely and necessary that *A* retain separate counsel in litigation against *C*.

Note also that in such a proceeding there is nothing to flag to the trier of fact—whether judge, juror, or arbitrator—that to any abnormal extent *B* is a party in interest. Thus the case will be tried exactly like a case where *A* is claiming for both his economic and noneconomic loss and *B* is subrogated to the extent of any first-party payment to *A*. But there is no reason why, if necessary, a court could not take steps to shield a jury from knowledge of *B*'s interest as plaintiff, just as a jury is normally shielded from knowledge of an insurer's interest as defendant or as subrogee.³⁴

32. For a device whereby the insurer and claimant could each pay one-half of the claimant's legal fees, see R. KEETON & J. O'CONNELL, *supra* note 27, at 324, 438.

33. For a proposed statutory provision for such a separation, see *id.* at 324, 446; UNIFORM PERIODIC PAYMENTS ACT § 3 (Tent. Draft 1978).

34. See R. KEETON, BASIC TEXT ON INSURANCE LAW § 3.10(c)(1) (1971). Note that the contract can require the insured to cooperate in the prosecution of a claim, as he must under present law when the insurer is a subrogee or when he is required to cooperate in the defense of an action

B will retain control of the handling of the claim against *C* throughout the case, including retaining the right to settle at any point, subject once again to *A*'s right to arbitration of the amount due from *B* based on *A*'s tort claim for his economic loss above the no-fault limits.

Assume that *A* (who, it will be recalled, has purchased \$10,000 of no-fault coverage) has a total claim against *C*, which is arbitrated to a liability finding of \$30,000 in economic loss and \$25,000 in noneconomic loss. The parties could structure the arrangement so that: (1) the entire verdict is payable to *B*, with *B* then obligated to continue to pay no-fault benefits to *A* periodically as losses accrue until the \$30,000 limit is reached; or (2) *B* pays the \$20,000, representing *A*'s economic loss above the no-fault limits, directly to *A* in lump sum, thereby extinguishing any further obligation except to continue periodic payment of no-fault benefits until the \$10,000 limit is reached; or (3) *B* pays *A* in lump sum the entire amount of *A*'s economic loss above amounts already paid in no-fault benefits. The first arrangement seems preferable.

Note the advantages to a no-fault insured under first-party no-fault insurance. He is assured of automatic payment of economic loss at whatever level he chooses in the event of accidental personal injury and of payment of whatever tort damages he would have received for his economic loss without the necessity of incurring attorneys' fees or other litigation expenses for either no-fault or fault-based payment.³⁵ His net payment, therefore, will often be almost as great as, and sometimes greater than, the payment he would have received at common law, while suffering much less uncertainty and anxiety. To take our hypothetical case again: If *A* had a valid tort claim against *C* and recovered his entire loss of \$55,000 (\$30,000 economic loss plus \$25,000 noneconomic loss), he would normally pay at least one-third to a lawyer (or \$18,333), leaving him with a net of \$36,667. Under the elective first-party no-fault plan he receives a net of \$30,000 with \$10,000 (the amount he chose) payable automatically without the uncertainty and angst of tort litigation. Assuming litigation expenses of fifty per-

against himself that is covered by insurance. See O'Connell, *Transferring*, *supra* note 4, at 777 n.98. See also text accompanying note 48 *infra*.

35. On the possible use of deductibles—in addition to the built-in deductible of structuring first-party no-fault as excess insurance, see note 31 *supra*—as a means of controlling costs, especially due to increased claim frequency, see O'Connell, *supra* note 25, at 217-18; O'Connell, *Transferring*, *supra* note 4, at 787-89.

cent,³⁶ A would have received net payment of \$27,500 from tort liability insurance versus \$30,000 under elective first-party no-fault insurance.

Admittedly, the no-fault insurer and the insurer of the third-party who injured the no-fault insured would still have to settle the complex questions of fault and the value of pain and suffering. But those issues would now arise between two insurance companies, who would in all likelihood settle the matter expeditiously by informal means and without the expensive litigation that now occurs with many intercompany claims.³⁷ And regardless of whether litigation results, an insurance company would not pay its lawyer a third or more of any recovery, as individual injury victims must do. Casualty insurance companies instead pay their lawyers the same way they pay their salaried executives—well, but not well enough to make them quick millionaires.³⁸

Of course, one might argue that placing tort claims completely in the hands of insurance companies—who are presumably less risk averse than individual claimants—would result in an increase in personal injury litigation with its attendant cost to society. As one person wrote to me after considering my proposal:

Suppose, by illustration, that potential litigation between two insurance companies is perceived by both parties to offer the plaintiff insurance company a 50% chance of winning \$100,000, and that counsel fees for each side would be \$5,000 independent of the outcome. If both companies were risk neutral, plaintiff company would value the suit at \$45,000 (half of \$100,000 less \$5,000) while defendant insurance company would value the suit at -\$55,000 (half of \$100,000 minus \$5,000). There would thus be a settlement range of \$45,000 to \$55,000. A risk averse individual plaintiff, in contrast, would value the suit at less than \$45,000; such a plaintiff would rather be paid a fixed sum less than \$45,000 than gamble for the expected value of \$45,000. This produces a greater settlement range when an individual plaintiff faces a defendant insurance company than when two insurance companies face each other. Unless individual plaintiffs are more likely than insurance companies to misperceive their chances in the tort suit, one might expect the litigation by companies would be more likely than litigation by individuals.

36. See note 21 *supra* and accompanying text.

37. For example, elaborate intercompany arbitration is used expeditiously to deal with collision insurers' claims against property damage liability insurers for auto damage.

38. *But see* note 21 *supra*. Although in the aggregate defense lawyers are paid more than plaintiffs' lawyers, the main reason cited is that "[t]he defense expenditure on litigation is much greater, relative to the plaintiff's, on less serious cases." P. MUNCH, *supra* note 22, at ix. See also O'Connell, *Transferring*, *supra* note 4, at 750 n.9. When insurers negotiate with each other, such expenditures in smaller cases might decline. See note 37 *supra* and accompanying text.

The consequences of contingent fees for lawyers should also be explored: Isn't it probable that a contingent fee lawyer representing an individual plaintiff would be even more risk averse than the flat-fee lawyer of the insurance company?

The consequences of variation in risk aversion, perceptions of probabilities of success and the resulting settlement ranges must be evaluated to test the claim of reduced administrative costs under [elective first-party no-fault insurance].³⁹

There are several pertinent comments to these observations. First, as the writer suggests, the lack of expertise on the part of many claimants and their lawyers in appraising the value of personal injury claims may lead to more litigation than would result if experienced parties on both sides were negotiating over the matter.⁴⁰ Second, unlike plaintiffs' lawyers, who on the whole deal with clients who are at their mercy, insurance company lawyers and claimsmen are subject to the discipline of a commercially astute organization that will be inclined to eliminate needless litigation. Third, even if the total amount of litigation increases, that is not necessarily a bad thing. The greatest evil of the present system is the existence of a vast pool of insurance dollars that is paid out either not at all or in such a dilatory, haphazard manner to needy claimants, while others, usually less needy, are overpaid. It is not necessarily a condemnation of elective first-party no-fault insurance to assert that such insurance will result in more claims and litigation if that litigation is between sophisticated commercial parties shrewdly asserting arguably valid claims against each other (with the concomitant benefit of internalization of costs),⁴¹ while needy accident

39. Private correspondence with the author, May 26, 1978.

40. One of the most respected federal trial judges in the country—formerly a leading trial lawyer as well as a law school professor—commented to me recently on Chief Justice Burger's estimate that one-third to one-half of American lawyers are not properly qualified for trial advocacy. See Burger, *The Special Skills of Advocacy: Are Specialized Training and Certification of Advocates Essential to Our System of Justice?*, 42 *FORDHAM L. REV.* 227 (1973). But see *N.Y. Times*, Feb. 11, 1978, at 1, col. 3. This trial judge said:

The biggest cause of inept trial lawyering is the non-personal injury lawyer who reads in the *Jury Verdict Reporter Newsletter* that some big-name lawyer . . . has won a \$450,000 verdict for a broken leg. The kid next door then breaks his leg on a skateboard and such a lawyer thinks it is worth \$450,000, out of which he is going to net, say, \$150,000 (that's a lot of real estate closings!). But his case is not a \$450,000 case—it is a \$1,500 case at best. But with stars in his eyes he refuses a reasonable settlement. In fact, professionally and temperamentally he is totally inadequate for trial work. He hates the combat and is completely out of his element. But, not being willing to settle, he comes to court along with his client, and they both take an awful beating. That's where your inadequate trial work stems from.

41. The costs of its accidents that are properly reflected in an enterprise's costs are, in the

victims are promptly paid for their real losses. Thus first-party no-fault insurance focuses on the needy accident victim to whom it is preeminently fair. He gives up—as he does under statutory workers' compensation or statutory no-fault automobile insurance—all, or the bulk of, his fault-based claim in return for guaranteed no-fault payment.⁴²

This plan for no-fault benefits will not be mandatory.⁴³ Rather, it will be elective, allowing, but not compelling, any insurer to offer it by contract and similarly allowing any potential accident victim to refuse it.⁴⁴ Given the apparent public preference, evidenced by many polls, for certainty of payment versus the gamble of a lawsuit, one can expect widespread acceptance of no-fault.⁴⁵ Thus an automobile insurer could offer no-fault insurance benefits for accidents to its insureds in states without, or with inadequate, no-fault automobile insurance laws.

economists' argot, "internalized"; costs that are not thus reflected are "externalized." The virtues of internalization have been crisply summarized by former Professor Leonard Ross of the Columbia Law School:

[Market] deterrence operates by placing the costs of accidents on the activities which cause them; for example, by making power lawn mower manufacturers liable for all damage caused by malfunctions of their mowers. In theory, mower prices would then rise and sales fall; some families would be induced to shift to manual mowers, the total amount of power mowing would be reduced, and the level of accidents would abate. Moreover, manufacturers might become choosy about customers, raising prices to non-institutional buyers or perhaps simply to obvious schlemiels. Finally, they would have an incentive to redesign mowers to improve safety features. A variety of market forces would be set in motion to lower the total loss through accidents.

Ross, Book Review, 84 HARV. L. REV. 1322, 1323 (1971).

42. Essentially the same bargain with potential accident victims is struck under first-party no-fault insurance as under workers' compensation, auto no-fault statutes, and other plans and proposals for no-fault insurance both here and abroad. See O'Connell, *supra* note 25, at 213-16; O'Connell, *Transferring*, *supra* note 4, at 779-86.

43. Concerning the virtues of voluntary market solutions versus mandatory governmental solutions, see O'Connell, *supra* note 25, at 221.

44. For an indication that when employees have an election, they do not choose to preserve their tort rights as opposed to accepting no-fault coverage under workers' compensation acts, see Horowitz & Bear, *Would a Compulsory Workman's Compensation Act Without Trial by Jury Be Constitutional in Massachusetts?*, 18 B.U.L. REV. 1, 35-36 (1938).

45. J. O'CONNELL & W. WILSON, CAR INSURANCE AND CONSUMER DESIRES 4-5 (1960); O'Connell & Simon, *Payment for Pain & Suffering: Who Wants What, When & Why?*, 1972 U. ILL. L.F. 1. For a comprehensive review of the public opinion surveys on no-fault versus tort liability insurance, see O'Connell & Wilson, *The Department of Transportation and Market Facts Public Opinion Polls on No-Fault Auto Insurance*, 1971 INS. L.J. 239; O'Connell & Wilson, *Public Opinion on No-Fault Auto Insurance: A Survey of the Surveys*, 1970 U. ILL. L.F. 307, also published in O'Connell & Wilson, *Public Opinion Polls on the Fault System: State Farm Versus Other Surveys*, 1970 INS. L.J. 261. Although these studies apply to auto accidents, the public aversion to the tort liability process would seem to apply to other accidents as well. See A. CONARD, J. MORGAN, R. PRATT, C. VOLZ, & R. BOMBAUGH, AUTOMOBILE ACCIDENT COSTS AND PAYMENTS: STUDIES IN THE ECONOMICS OF INJURY REPARATION 280, 287-89 (1964); J. O'CONNELL, *supra* note 3, at 112-15.

Workers' compensation insurers could offer employees—pursuant to collective bargaining⁴⁶—benefits supplementing inadequate workers' compensation benefits for all injuries in the course of employment and no-fault benefits to employees and their families for off-the-job accidents. Health and disability insurers, either writing individual or group policies, or casualty companies writing homeowners' coverage, could offer no-fault coverage for all kinds of accidents. Professional trade associations could offer similar coverage to their members.

Insureds should assign their claims for punitive damages as well as compensatory loss. The main purpose of punitive damages, after all, is to punish the wrongdoer and to deter such conduct by him and others. So long as the damages fall on the tortfeasor, that purpose is served regardless of who actually receives payment. Thus, inclusion of punitive damages in the third-party tort suit by the assignee does not subvert the policy behind such damages. In point of fact, the proceeds of these damages will be better used if they help fund first-party no-fault benefits. In addition, if the injured party retains the right to punitive damages, the power of the assignee to settle the claim expeditiously is hindered. On balance, then, the assignment of the punitive damages portion of the claim, in addition to other portions, seems preferable.⁴⁷

Would allowing pursuit of the claim primarily or solely in the interest of an insurer deflate jury verdicts for pain and suffering and thereby also reduce the funds available to pay no-fault claims? Several factors militate against the likelihood of this occurring: The jury need not be informed that the plaintiff is an insurer any more than it is now told in personal injury cases that the defendant is an insurer. Moreover, at least initially, such lawsuits by insurers will be relatively rare; juries, therefore, probably will not suspect who is the real party in interest.⁴⁸ To the extent also that the accident victim retains an interest in the claim, the problem is lessened. But even assuming transfer of the entire fault-based claim and the widespread practice of no-fault insurers pressing such claims, lower pain and suffering verdicts, while perhaps more likely, need not be substantial. A University of Chicago jury

46. Concerning related collective bargaining matters, see O'Connell, *Bargaining for Waivers of Third-Party Tort Claims: An Answer to Product Liability Woes for Employers and Their Employees and Suppliers*, 1976 U. ILL. L.F. 435, 462-67. Concerning the possibility of a union binding its members to the acceptance of no-fault benefits in return for assignment of tort claims, see O'Connell, *Supplementing*, *supra* note 4, at 548-49.

47. See O'Connell, *Supplementing*, *supra* note 4, at 545-48 n.42.

48. See note 34 *supra* and accompanying text.

study found jurors conscientiously follow the law, as opposed to their subjective prejudices, including feelings for or against insurance companies.⁴⁹ Finally, if and when no-fault insurers press their insureds' fault-based claims to the point that it affects the size of jury verdicts, insurers (who are, after all, often defendants in such suits) will benefit from the new climate. And it certainly seems unlikely that the proceeds from fault-based claims will be so reduced that they cause abandonment of a no-fault coverage that has become so widespread.

This plan for elective no-fault insurance permits the insurance industry to harness liability insurance both for its own and the public's advantage. Insurers seem almost panicked over current trends in personal injury liability and their inability to control them through legislation or otherwise. But far from requiring vast, revolutionary and unpredictable changes dictated by often hostile or uninformed legislatures, elective contracts for no-fault insurance with a corresponding purchase of the payees' fault-based claims need not await statutory authorization. Further, the insurance industry can structure these contracts itself subject, of course, to input in the public interest through regulatory approval by insurance commissioners.⁵⁰

It is true that there are legal rules that at first blush might seem to inhibit the implementation of such elective no-fault insurance, *e.g.*, rules prohibiting the sale of personal injury claims and rules against maintenance and champerty, which supposedly prohibit lawyers from sharing in the proceeds of a suit.⁵¹ But these rules were instituted to prevent the use of unfair advantage against injured victims and "offi-

49. See Kalven, *The Dignity of the Civil Jury*, 50 VA. L. REV. 1055, 1065, 1072 (1964).

50. Several insurance commissioners have indicated to me informally that they would approve first-party elective no-fault insurance contracts calling for the assignment of third-party tort claims. As to the arguable necessity of an insurance commissioner's approval, see R. KEETON, *supra* note 34, at 71-72, 543-45, 550-53. Although a legislature could ban such contracts, the burden on any party trying to pass legislation to stifle innovation in this field would be heavy, just as the burden of trying to pass legislation requiring no-fault insurance has been heavy. See text accompanying note 14 *supra*.

51. See notes 52-53 *infra*.

Concerning binding members of the insured's family, other adults in the family could voluntarily become first-party insureds. As to binding minor members of the family, see O'Connell, *supra* note 25, at 220 n.36; O'Connell, *Transferring*, *supra* note 4, at 790-91 n.136.

As to the out-of-state validity of first-party no-fault insurance contracts in return for assignments of the payees' entire tort claim, one should note the willingness of courts to honor out-of-state barriers to the tort rights of injured employees where relatively generous workers' compensation benefits supply the quid pro quo for surrender of the tort claims. See 4 A. LARSON, *THE LAW OF WORKMEN'S COMPENSATION* §§ 88.10-.23 (1978). One should also note the willingness of courts in third-party suits to honor out-of-state employers' subrogation rights different from subrogation rights in the forum state. *Id.* § 88.23.

cious intermeddling," neither of which is threatened when an insurance company promises to pay promptly the out-of-pocket losses of accident victims in return for the right to press their claims against third-parties causing injury.⁵² Note that the law already allows the accident victim to, in effect, sell a third of his claim to his lawyer in the form of a contingent fee. Why not go a step further and allow the equally voluntary transfer of the whole claim (or the bulk of it) to a highly regulated, financially stable entity like an insurance company, thereby removing almost all the risk of uncompensated accident loss.⁵³

Fears about the propriety and legality of insurers actually prosecuting others' personal injury claims may, however, thwart the implementation of my proposal. In that event, the first-party no-fault insurer could contract only for the right to waive its insureds' third-party tort claims. Thus, a first-party no-fault insurer would gain from its policyholders (at their individual option) the right to waive, but not actually prosecute, the policyholders' third-party tort claims (or those of their survivors) in return for the prompt payment of first-party no-fault insurance plus a guarantee of the equivalent of whatever amount of economic loss is payable by any third-party tortfeasor to the no-fault insured. The first-party no-fault insurer would use that power of waiver of the entire third-party tort claim as leverage to negotiate with third-parties for payment to the first-party insurer up to the amount of the first-party insurers' obligation to its payees. And any amount in excess of its obligation to its insured received from the third-party by the first-party insurer would be payable to the no-fault insured. If, within a period defined in the policy, the alleged third-party tortfeasor or its insurer has not settled with the first-party no-fault insurer, the latter could assign the third-party tort claim back to the injured party (subject to a right of subrogation in favor of the first-party insurer to the extent of its payment to the injured party). At that point the injured party will be free to assert his third-party tort claim in a normal fashion, while retaining, or continuing to receive, first-party no-fault benefits.

Under this arrangement, the first-party insurer will not be in a position to recover amounts paid for its payees' pain and suffering to help fund no-fault payments. But at least the first-party insurers will have

52. See also O'Connell, *supra* note 25, at 224-25; O'Connell, *Supplementing*, *supra* note 4, at 552; O'Connell, *Transferring*, *supra* note 4, at 807-09.

53. See O'Connell, *The Interlocking Death and Rebirth of Contract and Tort*, 75 MICH. L. REV. 659, 681-83 (1977), reprinted in *abridged form* in 1977 INS. L.J. 734, 745-47.

an effective lever to obtain reimbursement of its no-fault payments from any apparent tortfeasor without resort to litigation. Clearly, if the apparent tortfeasor wants to litigate the liability issue, the first-party insurer will be inclined to send the claim back to its insured-payee. But to avoid that exposure to much greater liability, the third-party will be under great pressure at least to make a substantial contribution to the no-fault payment and perhaps to cover it completely. Thus the savings in litigation costs could be very substantial.

This device will be particularly attractive to a first-party insurer limiting its insurance to accidents, such as airplane disasters, where the likelihood of litigation and liability on the part of the defendants is great. Thus to the extent that the number of cases where the first-party insurer would make no-fault payments and have no third-party tortfeasor to collect from is relatively small, this device becomes more attractive, given the inability of the first-party insurer to recoup payments for pain and suffering to cover no-fault payments to many accident victims without viable tort claims. For airplane accidents and other similar mishaps, however, the discrepancy between the number of victims being paid no-fault benefits and the number with potentially valid third-party tort claims would be relatively small. In addition, since over ninety percent of injuries in airplane accidents result in death, for which little if any noneconomic loss has traditionally been recoverable,⁵⁴ the inability to recover for these items will mean relatively little disadvantage. Assume, for example, that a first-party insurer agrees to pay victims of airplane accidents under policies automatically activated by the purchase of an airline ticket with a selected credit card. The insurer would pay without regard to the culpability of the airlines or manufacturers of the aircraft and component parts. Prior to the occurrence of any accidents, the first-party insurer conceivably could negotiate with those potential third-party defendants to contribute to the no-fault pool in return for surrender of the potential accident victims' tort claims.

Except for the fact that the first-party insurer gains only the right to waive—not actually prosecute—its insureds' third-party tort claims, this plan would work almost identically to the proposal outlined earlier. Thus, in addition to the level of no-fault benefits purchased, the no-fault insurer would guarantee payment to the victim or his survivors of whatever amount is recoverable as economic loss in a tort action against any third-party without reduction for the expenses of recovery. In return, the insured would assign to the no-fault insurer the right to

54. See W. PROSSER, *HANDBOOK OF THE LAW OF TORTS* § 127, at 907-08 (4th ed. 1971).

waive the insured's tort rights against third-parties for both economic and noneconomic loss and the concomitant right of the insured (or his survivors) to arbitrate whether there is due from any tortfeasor economic loss in excess of the no-fault limit.

In every case where the insured had purchased enough no-fault insurance to cover all economic loss accruing to him or his survivors, there would be the problem of distributing any further amounts recoverable in tort. But assume a hypothetical case where *A*'s husband elected \$100,000 of no-fault benefits, and *A* suffered, from the death of her husband in an aircraft accident, \$200,000 of economic loss and \$50,000 of noneconomic loss. *B* pays *A* \$100,000 in no-fault benefits. *B* also proceeds against *C* (or *D*, *C*'s liability insurer) armed with the right to waive, but not actually prosecute, *A*'s tort claim against *C*. If, for example, *C* is an airline, *B* may have made arrangements with *C* at the start of, or during, the insurance year to have *C* contribute to *B*'s no-fault pool in return for a waiver of all *B*'s insureds' tort claims against *C*. *C* would thereby get a lower liability insurance rate from *D*. Indeed, it is the prospect of lower rates that enables *C* to finance its contribution to *B*'s no-fault pool. Or, as also suggested above, *B* may settle the claims individually with *D*. Various possibilities can occur here too as *B* deals with *C* or *D*. First, *B* may not be able to extract any payment from *C* (e.g., due to doubtful liability). In that event, *B* would simply assign the (presumably worthless) tort claim back to *A*, relieving *B* of the obligation to pay any amount in excess of the no-fault limits.

Second, *B* may settle with *C* for an amount that includes a figure allocable to *A*'s economic loss (assume \$80,000) that is less than *A*'s no-fault limits (\$100,000). In that event, *B* would not offer *A* any amount in excess of the no-fault benefits. But *A* would have the right to arbitrate whether she is entitled to additional payment from *B* for her economic loss above the no-fault limits due in tort from *C*. *A*, however, would be obliged to pay for her own lawyer if she wishes to retain one for this proceeding.

Third, *B* may settle with *C* for an amount in excess of *B*'s no-fault obligation to *A* and then offer *A* the amount *B* estimates as the share allocable to *A*'s economic loss above the no-fault limits. Assume that *B* settles with *C* for \$130,000 and then offers *A* \$25,000, representing the

amount of the settlement in excess of the no-fault limits (\$100,000) due *A* (*B* has allocated \$5,000 to *A*'s noneconomic loss). *A* can either accept the \$25,000 or demand a separate arbitration with *B* to determine the fair evaluation of *A*'s claim for more.

Finally, *B* may wish to arbitrate with *C* the questions whether and in what amount *C* is liable in tort to *A*, with any payment from *C* limited to *A*'s economic loss. This, however, is unlikely because if *C* is inclined to force *B* to litigate, *B* will be inclined to assign *A*'s claim back to *A* subject to *B*'s right of subrogation to the extent of *B*'s no-fault payments to *A*. Thus, if *C* wants to litigate, *B* would have little incentive to waive any part of *A*'s tort claim. Nonetheless, *B* could retain the right, short of assigning *A*'s claim back to *A*, to litigate *C*'s liability for *A*'s economic loss with the concomitant right to force *A* to cooperate in the prosecution of the claim and to be bound by the finding as to *C*'s liability for the economic loss. Note that here too *A* will be prompted to cooperate because she will stand to gain in that proceeding to the extent there is a finding of economic loss in excess of the no-fault limits. Here too the confluence of interest between *A* and *B* will make it less important for *A* to retain and pay her own lawyer in the proceeding against *C*. But to the extent that *A*'s noneconomic loss is greater than the applicable no-fault limits, *A* will have an incentive to waive *B*'s obligation to pay *A* in excess of her no-fault limits and will simply assert her tort claim against *C* on her own. She should probably be allowed to do so. Whether *B* should have the right to refuse to accept the waiver could be handled either way.

The immediately preceding discussion raises another point: Whenever noneconomic loss is greatly in excess of economic loss (which is more likely in cases of personal injury than in cases of death), there may be an incentive to "bribe" *B* (in the economist's nonpejorative sense) not to waive the tort claim in return for payment of economic loss. Rather one may find it advantageous to encourage *B* to cede back the tort claim, perhaps by agreeing to waive any right to receive no-fault benefits. Whether the no-fault contract should allow this is perhaps debatable.

In sum, courts should welcome, not strike down, contracts for elective no-fault benefits. By such devices the market can attempt to correct many of the evils and abuses of the present liability insurance

system. A succeeding article⁵⁵ will explain how such approval of first-party no-fault contracts is consistent with a long history of judicial efforts to free the law from restraints on the transfer of interests in personal injury tort claims.

55. O'Connell, *Overcoming Legal Barriers to the Transfer of Third-Party Tort Claims as a Means of Financing First-Party No-Fault Insurance*, 1979 WASH. U.L.Q. —.