

Justice culture?

Tony Silverman revisits the debate on compensation culture in the UK.

LAST YEAR A GIRO WORKING PARTY published a research paper entitled 'The Cost Of Compensation Culture'. The paper generated enormous media interest, including national newspaper coverage. There was a leader article in the *Financial Times* commenting on the paper, which started with 'Britain's actuaries ...'. The attempt by the GIRO working party to engage with a pivotal issue for non-life insurance is welcome, but how representative was the picture painted?

The United States comparison

The '2% ... but coming down' figure for the US comes from a 2002 Tillinghast study, referring to 2000, while the UK number of '1% ... rising at over 10% per year' is derived in the paper. I must admit to some surprise on first reading the paper that the UK number could be remotely in the same ballpark as the US number, given that the



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Some quotations from the front page of the paper

'The ball park' cost of compensation' is roughly £10bn per year, over 1% of [UK] GDP. This cost has been increasing at 15% per year recently and is set to continue rising at over 10% per year'

'The majority of the 'public' believe attitudes to compensation have changed in the last five years and that this is a bad thing'

'There are some fundamental differences between UK and US which we think will stop costs spiralling to the dizzy heights achieved in the US (over 2% of GDP in recent years but coming down)'

differences between the UK and US civil justice systems are so big. The comparison of these two numbers on the front page surely made many readers sit up and think 'I didn't realise we were already that close to the US'. This was an important part of the paper's message.

A closer look revealed the following factors, which suggest that the real picture is somewhat different:

- Perhaps most importantly, the UK number includes employers' liability claims. These types of claim are usually part of the workers' compensation insurance in the US, which is not included in the Tillinghast numbers.
- The UK number includes several government-paid schemes (for example compensation to farmers for BSE), which are an important part of the UK total. The Tillinghast US study is restricted to private insurance (and self-insurance) costs.
- After publication of the 2002 paper, Tillinghast's 2003 paper showed that US tort costs in 2001 increased, rather than decreased, as a percentage of GDP.
- The Tillinghast US study excludes punitive dam-

ages, which you cannot legally insure against in most US states. Yet the working party's paper relies heavily on punitive damages to paint a picture of a supposedly dysfunctional US system. This dovetails nicely with a commonly held UK picture of the US system deeply affected by reports of verdicts that include punitive damages. The misleading implication is that the UK (1% ... rising at over 10%) is close to a US-type outcome (2% but coming down) characterised by the cases quoted. In reality the damages in such cases are mostly excluded from the 2% number, so it is likely to be higher in reality.

What of the UK system?

A major plank of the paper concerns the UK conditional fee agreements (CFAs) originally introduced in 1995, intended to increase the proportion of legally valid potential claims entering the UK legal system.

Under this system there was still a liability for the defendant's corporate lawyers' fees if a claimant lost. There was also the cost of the success fee to be paid if a claimant won, which was not recoverable from the defendant. In 2000, the rules were amended to make defendants and their insurers, if they lost, liable for any after the event (ATE) insurance purchased by the claimant to cover liability for defendant's legal fees, and for the success fee element of a CFA. At this point the original intention of increased access to justice began to take effect, as is described in the paper.

At the same time, the gap between the lower proportion of potential claims handled by the old legal aid system and the higher level appropriate to the new system, was filled by the claims management



Tony Silverman works for PricewaterhouseCoopers

companies (CMCs), some of which developed questionable business practices. The UK public is still less likely to pursue a claim than might ideally be necessary for the new system to work efficiently, and arguably this has provided the CMCs with a role.

What happened next?

What the paper does not do is offer any real evidence that the UK system is awash with frivolous or invalid claims. The attempt to do this by proxy, using a comparison with the US, is flawed, as detailed above. According to a 2002 Datamonitor report, the number of personal injury claims in 2001 had reduced by 7.4% since 2000 and serious injury road traffic accident claims had decreased by 2.6% over the same period. The CBI-PricewaterhouseCoopers Financial Services Survey showed that by September 2002 the balance of insurance industry opinion was that the value of claims would actually reduce over the following three months, though this did change in later surveys. So what was really happening?

The UK system, rather than producing an avalanche of flimsy claims, soon began to grind ever slower following legal challenges by insurers to the CFA system and to its accompanying ATE insurance system. These tied up the pipeline of cases in court and have produced a stream of judicial decisions. In the meantime there have been some well-publicised insolvencies among the CMCs.

Assumptions about the US

The first case listed in Appendix IV of the working party's paper under the heading 'It couldn't happen here, could it?' heading is perhaps emblematic of the paper's view of the US system. The single sentence description reads: '81-year-old Mrs Liebeck won \$3m in damages against McDonald's after spilling coffee on her lap.' This case is cited so often, and in such similar terms, that some people may be surprised by the facts of the case.

In 1992, 79-year-old Stella Liebeck spilled coffee on her lap. The coffee was so hot she received third-degree burns over 16% of her body, necessitating eight days' hospital treatment and, according to the evidence before the court, permanent disfigurement, and extreme pain. Liebeck offered to settle in return for payment of her medical bills, approximately \$20,000, but McDonald's refused her settlement offer. The court heard that McDonald's coffee was heated to 180°–190° degrees Fahrenheit (84°C) – not necessary for taste, but helpful in creating a pleasant aroma in the area. McDonald's had been aware of the dangers for more than ten years through 700 similar cases and admitted its coffee was 'not fit for consumption' when sold because of the burns risk. The temperature at sale has now been reduced as a result of the *Liebeck* verdict. The jury assessed compensatory damages at \$200,000, but found Liebeck 20% at fault and so awarded her \$160,000. The jury then decided punitive damages were appropriate and initially awarded \$2.7m, but the trial judge reduced this to \$480,000.

The role of punitive damages in the US is sometimes not well understood. Although space does not permit here, there is a deep-rooted and coherent framework for the system. Of course the US system is likely to evolve over the coming years, as all systems will. Pressure for tort reform is continual and, while probably part of an ongoing balance of forces in the US, may result in some reduction in the general level of punitive damages awards in the future.

All in all, the UK is most likely further behind the US in terms of total claims handled by the civil justice system than the paper suggests. It is possible the difference will narrow in the years ahead and there may be some substantial further increases in UK claim levels. Insurers need to consider how they can play a profitable part in the expansion of the industry that such a scenario would entail. □

A response from Julian Lowe, one of the authors of 'The Cost of Compensation Culture'

I'm grateful for the opportunity to respond immediately to this article, as someone who hadn't read the original paper might get a misleading impression of its content and of any 'view' the working party is implied as having about the US legal system.

First and foremost, the paper does not set out any 'view' or 'message'. Because the phrase 'compensation culture' was topical, we felt the need for a paper that looked beyond the normal areas of actuarial involvement (insurance). The paper considers what 'compensation culture' might mean, looks at UK developments, and quantifies the UK cost (both financial and non-financial), as well as the benefits. We also considered some scenarios for how the compensation regime might develop, compared the UK with other countries, and surveyed general insurance practitioners and the public. The paper was presented as a debate in October 2002 at GIRO.

Much of the article above relates to the cost of the US tort system and a Tillinghast study. Reference to the Tillinghast study was a small part of the paper. The paper discusses the differences in quantifying compensation costs between the two approaches and points out that next year's US costs were likely to rise, owing largely to September 11 and asbestos claims. The paper's summary explicitly states 'there are some fundamental differences between the UK and US', and notes that US costs are more than twice the UK costs. Most readers would draw the conclusion that the UK is pretty different from the US, not surprisingly close.

Our brief light-hearted reference to some silly or infamous compensation claims is not 'emblematic' of our view of the US system – we don't have a 'view!' Nor do we make any 'assumptions about the US'. What we did do is ask a lawyer, with experience both sides of the pond, to summarise how each stage of the legal system works in both countries. He pointed out, among other things, the significant role played by punitive damages in the US, where the fear of crippling damages leads to a desire to settle out of court, encouraging claims, and settlements, for smaller amounts.

Don't take my word for any of these things – go and have a look at the paper yourself on the profession's website. We do show, based on a range of public sources, that compensation costs have increased at double-digit inflation for the past five years, and observe that the consensus amongst practitioners is that this trend will continue. The recently published third IUA survey of UK bodily injury claims by English, Matthews & Brockman confirms the double-digit inflation of injury claims over the past decade. It also notes the frequency of claims in the £5,000–£15,000 size band (the typical size of claims made via accident management companies) has increased by 100% in the past five years. I wonder what could be causing that?