No-Fault Insurance — Are Section B Benefits a Viable Alternative?

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The caption at page 10 of the 4 September 1987 issue of *The Lawyers Weekly* read, "Lawyers should help lower costs, [and] delay for real court reform." In his address to the Canadian Bar Association annual meeting the Chief Justice of Canada is reported as having said that "Reorganization, rationalization, co-ordination and 'real creative thinking' - rather than more laws, more judges or more courthouses - are the ways to achieve that reform." At the same conference Gordon Henderson raised the question "What's to be done about the litigation explosion?" His suggestions varied from more mediation services in family disputes to constitutional amendments to permit provincially appointed judges to hear landlord and tenant cases.[1] While neither of these suggestions addressed specifically the matter of personal injury cases resulting from automobile accidents, it is clear that they have occupied a substantial portion of the time of those involved in the legal system, the cost of which has been borne, at least in part, by the litigants.

The Chief Justice and Henderson are not alone in thinking that the methods of resolving disputes in our society is in need of an overhaul. Some of the rules in our society are perceived as being so inherently bad that radical surgery is thought to be necessary to save parts of our legal system. This is particularly true in the case of compensation of automobile accident victims. The perception of what is wrong with the present tort system in automobile accidents has two elements. First, compensation (without accident insurance) is dependent on proving fault of another and subsidiary to that, quantifying the personal injury claim. The requirement of establishing fault means that failure to do so leaves some victims uncompensated. This, in turn, means that society generally (if not the victim himself) will bear the cost of the accident by providing the necessary medical services, if not also long term care. The second concern is the cost

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[1]G.F. Henderson, "What's to be Done About the Litigation Explosion?" *The Lawyers Weekly* (11 September 1987) 4.

(mostly legal) of proving, first, fault, and then, the damages. For some, the legal costs have far exceeded a reasonable portion of the total claim. For others, the awards themselves are perceived as exorbitant. As Professor Fleming summed it up, "public sentiment will not in the long run condone the heavy expenditures of adversary litigation or indeed protracted settlement negotiation".[2] In summary, to some, the system appears to be rotten.

The core of the disease has thus been identified, in general terms, as a problem with the method by which we resolve disputes. One proposed cure, which has been implemented in some jurisdictions, has been to try to eliminate the dispute itself rather than merely change the dispute resolution procedure. The no-fault approach is intended not only to address the problem of dispute resolution, but also to eliminate the fault issue. In addition, if proving damages is costly and the results erratic, standardized compensation schedules should eliminate the quantification issue. In "No-Fault Utopia," after an accident, the victim is compensated regardless of fault in a predetermined amount and there is no dispute to be resolved. In addition, elimination of the fault principle will lead to the compensation of a greater number of victims. No-fault insurance from the viewpoint of dispute resolution is an example of the medium becoming the message. If it is too costly to administer a tort compensation system and the results are erratic anyway, then why not replace the system with a less costly one? The major question left for consideration is whether or not a no-fault system is indeed a better system. The answer has yet to be conclusively determined.

The difficulty occurs in trying to weigh the administrative savings and broader coverage of a no-fault system against a policy to award smaller payments and a system that may tend towards more accidents. Dispute resolution systems cannot be analyzed only from an administrative viewpoint. Administrative procedures are intended to facilitate the achievement of primary goals. Both no-fault and tort systems have as their primary goal the compensation of accident victims. The no-fault system has a broader objective than the tort system in that it tries to compensate more victims, but broader compensation means the resources available are divided between more victims. This reduces the amount of compensation that any one victim would receive under a tort system.

The no-fault system may introduce some unwanted disadvantages by compensating regardless of fault. For example, legal-economic analysis might lead one to conclude that the traditional tort system discourages careless driving. If the driver knows he pays if he is at fault, there is an added incentive on him to drive more carefully. Payment may take the form of satisfying a judgment or, more subtly, the insured driver may experience an increase in his insurance premiums. Either way, the fault system introduces what has been called a "general deterrence" factor that arguably does not exist in a no-fault system. Thus, it is theoretically possible that one might experience more accidents in a no-fault jurisdiction. The evidence, however, is inconclusive. In one study it was estimated that states that introduced partial no-fault plans have experienced an increase in the number of fatal accidents of between 376 and 1009 per

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[2]J. G. Fleming, "Drug Injury Compensation Plans" (1983) 32 *UNB LJ* at 10.

year. The author of the study suggests that a partial no-fault system with a $1500 threshold on medical claims would increase fatalities by 10%.[3] That study has not been universally accepted.[4] It was reported that accidents decreased at the time of the introduction of a partial no-fault scheme in Massachusetts, but on the other hand, they increased in Manitoba.[5] A Québec model suggests a 14.4% increase in accidents because of the change in the insurance laws and an additional one hundred persons killed per year.[6] There may, however, be a tendency to report accidents when compensation is more likely. In summary, a no-fault system may lead to more accidents but will compensate more victims; the first point has not been conclusively proved.

If there are more accidents and more victims compensated, these two increases must be accounted for in any no-fault compensation plan. These costs are generally offset in two ways. First, the administrative costs are thought to be lower (experience to date would appear to support this) and, second, recovery is restricted to amounts set out in standard schedules. Regarding first point, the matter of administrative costs, Professor Fleming states that for every $1.00 received by the victim in an automobile accident in the United States, another $1.07 goes towards the expenses of operating the fault system. The plaintiff's legal expenses are cited as constituting 23% of this amount and the insurer's attorney fees 25%.[7] By comparison, the cost of handling workman's compensation claims in Ontario amounts to eight percent.[8]

The second popular method to reduce no-fault compensation costs is to restrict benefits. First, non-economic losses (i.e., general damages) are often left uncompensated or severely curtailed. Professor Atiyah sets out the rationale:

> Most of these schemes provide for compensation for pecuniary loss only. The American schemes cover medical costs and wage losses up to a given maximum, but the Canadian schemes... include some cover for non-economic loss. It is, however, widely assumed that the cost of such a scheme cannot be kept sufficiently low to make it a practical proposition unless compensation for non-economic loss is either cut out altogether, or at least is kept down much below the level of common law damages. The reason for this is obvious: if everybody injured in a road accident is to get compensation at the levels now awarded in damages, the total cost of the compensation paid out must inevitably greatly exceed the total amounts now paid out in damages. It is true that a first party scheme can be administered at much lower cost than tort liability insurance, and that these savings can be utilized to cover the cost of compensating those who now receive no damages, but it is unlikely that these savings alone would enable all road accident victims to be compensated at common law levels.[9]

[3] See S.A. Rea Jr., "Economic Analysis of Fault and No-Fault Liability Systems" (1987) 12 *Can. Bus. L. J.* 444 at 462.

[4] *Ibid.* at 462.

[5] *Ibid.* at 465.

[6] *Ibid.* at 467.

[7] *Supra*, note 2 at 26.

[8] *Ibid.* at 27.

[9] P.S. Atiyah, *Accidents, Compensation and the Law*, 3d ed. (London: Weidenfeld, 1980) at 618-19.

Let us compare what a victim of an automobile accident might receive under a traditional tort system and Québec's no-fault system. The upper limit for non-pecuniary loss in a common law action in 1986 has been estimated at $189,300.[10] Under Québec's no-fault system the maximum benefit was approximately $37,000.[11] It should be obvious that while dispute resolution problems are often cited as one of the reasons for the movement towards no-fault systems, delivery of those systems at lower cost (i.e., lower insurance premiums) is at least partially accomplished by the payment of smaller benefits but more of them. In summary, no-fault has come to mean smaller benefits, but compensation of more victims, at lower administrative costs and hopefully without a greater number of accidents. Or, as Professor Rea put it, "A no-fault system is said to be in balance if the extra benefits paid under the first-party insurance are offset by reductions in categories of third-party claims such as pain and suffering. This guarantees that premiums will not rise if the administrative costs are lower under no-fault."[12]

The shifting of the cost of accident compensation from the tortfeasor to the victim has a number of other consequences. For example, a no-fault system should encourage the manufacture and purchase of safer cars. And, the safer the car, the lower the premium the victim should have to pay. Again citing Professor Rea:

> Insurance companies would be expected to charge lower rates for those with cars that offer more protection for the occupants. A third-party system would lead to higher rates for vehicles that present a greater threat to others on the road. This difference is most obvious for collisions between passenger automobiles and trucks. The introduction of a no-fault system would raise auto insurance rates and lower truck insurance rates because trucks are relatively safe for the truck driver but can cause serious injury to an automobile driver. Many no-fault states have excluded trucks from the program for this reason.[13]

The matter of safer vehicles is not solely an influence in no-fault jurisdictions. If the insurance industry in fault jurisdictions determine premiums in part by classifying the safety of the vehicle, premiums for the collision and accident benefits portions of the policy should decrease for safer types of vehicles. The Québec study found that design modifications were made in Sweden to attract lower premium classification by manufacturers. The problem, however, may be more one of communication of information between insureds, insurers and manufacturers than a problem with the basic fault system.

The analysis provides some obvious caveats about no-fault plans in the more general dispute resolution forum. First, it should be obvious that although no-fault

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[10] *Waterhouse* v. *Fedor* (1986), 34 D.L.R. (4th) 566 (B.C. Sup. Ct.).

[11] B. Parnega, "Québec & Michigan Insurance Plans: How They Affect Ontario Actions" (1987) 5 *Can. J. of Ins. L.* 2.

[12] *Supra*, note 3 at 464.

[13] *Supra*, note 3 at 456.

schemes may have been originally conceived as an alternative to litigation, it was soon realized that the issues were much broader and any conclusions that might be drawn, much more complicated. In fact, the questions of administrative and litigation costs of a tort system in comparison to a no-fault system have been overtaken by issues of total coverage versus fault coverage and the effect any system has on individual conduct. In summary, the method of dispute resolution proved not to be the primary issue. The search for lower insurance premiums led to an examination of alternatives to going to court and resulted in a fundamental re-examination of the theory of liability and accident compensation. Much of that re-examination had little to do with the matter of resolution of disputes, but more with the consequential costs of trying to eliminate disputes.

In a number of jurisdictions the consequences of a pure no-fault system have been avoided and its perceived advantages gained by the introduction of partial no-fault plans. Under such schemes, basic losses are covered by no-fault rules while top losses (i.e., general damages for personal injury) are still subject to tort actions. A bill to this effect was introduced in the New Brunswick Legislature in 1975. It would have abolished tort claims for damage to automobiles but retained tort principles for personal injury claims. The bill was the object of a substantial (and successful) insurance industry lobby. A partial no-fault system is thought to cut down the administrative cost where it is most burdensome and at the same time maintains the advantages perceived to be associated with tort systems. In part, the reasons for its existence and its effect are analogous to the existence and impact of small claims courts; that being the elimination of costly proceedings for small claims without having a major impact on the legal system. The Manitoba and Saskatchewan systems were models for that which was proposed for New Brunswick.

Québec is one of the few jurisdictions that has a pure no-fault system for personal injuries and death. Its unpopularity with victims who might have received compensation at common law is probably best illustrated by the number of reported cases where a victim tries to bring an action that occurred in Québec outside Québec.[14]

The debate on the merits of no-fault and common law tort liability debate has taught us a number of things about dispute resolution. One begins to understand why the law is sometimes slow to change. Change often brings unintended consequences. In Québec no-fault insurance was intended not merely as a solution to a problem of dispute resolution but also to compensate more victims. If this was the primary objective, one can then ask, does it deliver compensation better than that which is now provided for in the standard automobile policy in New Brunswick?

In New Brunswick most victims of automobile accidents are covered by Section B of a standard automobile insurance policy regardless of fault. As in Québec, the victim need not prove fault to collect under the driver's policy and similarly the driver is covered. My personal policy differs from the Québec scheme in two important preliminary details. First, I have a maximum coverage of $25,000 versus $37,000 in

[14]See C. Walsh, "'Stranger in the Promised Land?' The Non-resident Accident Victim and the Québec No-fault Plan" in this issue at 172.

Québec and loss of earnings are only insured for two years instead of being unlimited. These are, however, relatively minor matters with regard to the principle. More important are the consequences of the availability of Section B coverage. While the Québec system bans actions against the tortfeasor, the New Brunswick system allows the victim to "top up" his compensation by suing the tortfeasor for any damages he has incurred in excess of the Section B coverage. Thus, if I am injured in an accident where my damages total $100,000, I will collect a maximum of $25,000 from my own insurer and may sue the tortfeasor for the remaining $75,000. It should be obvious that the Section B approach is designed to obtain the best features of a tort and no-fault system as far as the victim is concerned. Obviously, if the limits purchased in Section B were the same as in Québec, New Brunswick would be providing their victims with more coverage than that available in Québec.

There is one other aspect of the present system in New Brunswick that might surprise some. Professor Rea poses the following proposition in his article, "Fault and No-Fault Liability Systems";

> A rational person would choose to insure himself against economic loss regardless of the cause, whether it be a negligent driver, a dangerous condition at the work place, a risky product, a risky leisure activity, or illness. In a world without information costs he would fully insure himself against all possible losses, and the premium would reflect the care that he takes and the kinds of activities that he engages in. Before relaxing these assumptions, it is necessary to appreciate an important difference between the amount one would insure for and the amount that would compensate for a loss. Consider an accident that would cause the loss of a toe. The victim might experience great pain at the time of the accident and might be willing to pay to avoid the loss of his toe, but he would not rationally insure for the loss of a toe. The reasoning goes as follows. The decision to insure involves a transfer of income between two states of the world, one with a toe and one without. The insured person pays a premium if he does not lose a toe and receives a benefit if he loses a toe. If the insurance is fair, insurance will be purchased until the marginal utility of a dollar is equated across all states of the world. If the loss of a toe does not affect the marginal utility of income, there is no reason to transfer income from the state of the world with a toe to the state of the world without a toe. To do so would lower expected utility. The person might require a large sum to be indifferent between these two states of the world, but he would not insure for the loss of the toe. More generally, we expect rational individuals to insure for pecuniary losses only. For example, a disability might result in loss of earnings, expenses for care, and considerable discomfort. It would not be rational to insure for the discomfort portion of the loss.[15]

It is interesting that subsection 3 of Section B benefits is intended to cover victims

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[15] *Supra*, note 3 at 451-52.

for such non-pecuniary losses. This coverage provides coverage to victims for losses (including non-economic losses) where the tortfeasor is underinsured. In economic theory, all of us who have purchased this coverage are irrational. However, it is clear that an attempt is being made by potential victims in fault jurisdictions to gain access to compensation far beyond what either traditional tort and no-fault systems provide. It is doubtful that one could argue today that the Québec no-fault system should replace our present system on the basis that our compensation of victims is clearly inadequate for those who have the greatest need.

It should be obvious that since our present system provides more benefits, it is going to cost more. The assessment of damages has been eliminated only for personal injuries below $25,000, so costs for determining fault in larger claims continue. Furthermore, the question of fault still arises in the determination the property damage issue. Thus the costs of dispute resolution can be expected to be higher in New Brunswick. It is still unclear whether the accident rate in New Brunswick has already increased as a result of the introduction of the compulsory Section B coverage, as has been alleged in the United States. If it has, we may now be operating one of the most costly systems, delivering maximum coverage with high accident costs and considerable dispute resolution costs.