



National News

Tillinghast Study: U.S. Tort Costs Reach a Record \$260 Billion

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U.S. tort costs reached a record \$260 billion in 2004, or approximately \$886 per person, according to the U.S. Tort Costs and Cross-Border Perspectives: 2005 Update from the Tillinghast business of Towers Perrin. This surpassed the previous record set in 2003 by \$16 billion. The 2005 Update analyzes U.S. tort costs from 1950 through 2004, with projections through 2007.

U.S. tort costs grew at a slightly faster pace in 2004 (5.9%) than in 2003 (5.5%), but still well below the high growth rates seen in 2001 and 2002, which averaged 14% each year. The 5.9% growth rate was less than the overall U.S. economic growth (as measured by gross domestic product -- GDP) of 6.6%. Since 1950, growth in tort costs has exceeded GDP growth by an average of 2% to 3%.

Asbestos claims contributed to the surge in tort costs earlier this decade, but were less of a factor in 2004. In fact, the impact of insured asbestos losses, which totaled approximately \$5 billion in 2004, was less than in each of the prior three years.

"There were several years when insurance companies were significantly increasing their cost estimates for asbestos-related liabilities," said Russ Sutter, principal. "Our study indicated that asbestos-related tort costs are still a major issue; however, there were fewer upward reevaluations during 2004."

U.S. tort cost growth since 1950 far exceeds U.S. population growth. Even after adjusting for inflation, tort costs per capita have risen by a factor of more than nine between 1950 and 2004.

International tort costs

The study also examined tort costs in several other industrialized nations and found that U.S. tort costs exceed other countries' by a sizeable margin, when measured as a ratio to economic output (measured by GDP). The U.S. had a 2.2% ratio of tort costs to GDP, compared with Germany (1.1%), Japan (0.8%) and the U.K. (0.7%). Aside from Italy (1.7%), the other countries examined in the study have tort costs comparable to historic levels observed in the U.S. in the 1960s and 1970s.

"Our comparison of international tort costs was somewhat surprising, since we had been hearing anecdotally that tort cost trends in the U.S. were making their way overseas. We saw a greater disparity in tort costs than we were expecting between the U.S. and other countries," said Steve Lowe, leader of the firm's global P/C insurance consulting practice. "Tort costs in the U.S. far surpass those of the other countries we examined, partly a result of different health care systems and legal systems. However, this difference may raise the issue of competitiveness of U.S. products in a global marketplace."

Medical Malpractice tort costs increase

Medical malpractice tort costs totaled \$28.7 billion in 2004, up from \$26.5 billion in 2003. Since 1975, medical malpractice costs have increased at an annual rate of 11.7% versus 9% for all other tort costs, according to Tillinghast.

"The growth rate for medical malpractice costs continues to lessen," Sutter said. "Some of the moderation may be attributable to various state tort reforms enacted during the past decade."

Commercial growth outpaces personal growth

Commercial tort costs have outpaced personal tort costs since 1990, according to Tillinghast. Personal tort costs have changed annually by an average of 3.7% since 1990 and 5.0% since 1999, while commercial cost changes have averaged 5.9% since 1990 and 11.6% since 1999. Even after removing insured asbestos losses, the growth rate for commercial tort costs over the last 13 years remains higher than the personal rate.

"The battle lines of the tort reform debate ebb and flow with changing patterns in tort costs each year; personal and commercial tort cost trends can point to where the next set of debates may lie," Sutter said. "In the near term, we expect commercial tort costs to continue growing at a faster rate than personal tort costs so the tort reform debate will likely consist of the business community on one side, countered by consumer advocates and the trial bar on the other side. Consumers will sit on the sidelines and may be confused by the whole matter. This is in direct contrast to past debates where personal lines costs were increasing rapidly."

Future implications

Given current trend patterns, Tillinghast expects U.S. tort costs to increase approximately 6.5% for the next three years.

A number of factors may influence the growth of tort costs in the near future, including:

- * Whether litigation related to directors and officers of publicly held companies has peaked;
- * How significant the costs from litigation pertaining to certain prescription drugs will be;
- * Whether the damages sustained from Hurricane Katrina -- and any future catastrophic events -- will lead to material tort litigation costs.

"There are a number of emerging issues that have the potential to impact tort costs going forward, such as recent lawsuits in the pharmaceuticals industry, the impact of class action reform passed by U.S. Congress in early 2005 and obesity-related litigation. There are also familiar culprits, like asbestos claims," said Sutter.

Methodology

The methodology used in Tillinghast's report incorporates three cost components: benefits paid or expected to be paid to third parties (losses), defense costs and administrative expenses. Administrative expenses are identified separately in the report. While Tillinghast outlines why these are a real cost of the tort system, it takes no position on the efficiency of the insurance industry's administrative expenses.

Tillinghast has not included costs incurred by federal and state court systems in administering actual suits. Certain indirect costs are also omitted, such as those associated with litigation avoidance.

U.S. Tort Costs and Cross-Border Perspectives: 2005 Update is the ninth study of U.S. tort costs published by the Tillinghast business of Towers Perrin. The first study was completed in 1985. The study examines only one side of the U.S. tort system: the costs. No attempt has been made to measure or quantify the benefits of the tort system, such as a systematic resolution of disputes, and the study makes no conclusion that the costs of the U.S. tort system outweigh the benefits, or vice versa. The report is conducted entirely by Tillinghast; it is not funded or subject to approval by any outside organization. The report is available at www.towersperrin.com/tillinghast.

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