Tort Costs in America

An Empirical Analysis of Costs and Compensation of the U.S. Tort System

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Contents

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Executive Summary

Chapter

01

The American legal system is lauded for its underlying principles of due process and equal justice under the law. But the costs of the legal system and the efficiency with which it delivers compensation to injured parties have not been routinely measured.[1] This study seeks to address that issue by providing an estimate of the costs and compensation paid in the U.S. tort system (hereafter referred to as "tort costs"[2]) using insurance data and estimated self-insured costs.

The costs included in this study are only those that are insurable, which will understate tort costs to the extent that they are uninsurable. These national and state-specific tort cost estimates provide a foundation for analysis of the effect of legislative reforms on the cost and efficiency of the tort system, the variation in liability costs across states, and the economic impact of potential excesses in the tort system. A detailed description of the data and methodology used in this study is included in the appendices.

We find that in 2020 (the latest year for which full data is available), tort costs amounted to $443 billion, or 2.1 percent of U.S. gross domestic product (GDP). These tort costs include:

- $229 billion in general and commercial liabilities, which cover a broad range of personal injury, consumer, and other claims;
- $196.5 billion in automobile accident claims; and
- $17.5 billion in medical liability claims.

Tort Costs Over Time

To provide comparative context, we extend our analysis from 2020 back to 2016 and explore the development of tort costs throughout that period. Overall, the direct economic costs of the tort system have grown at an annual rate of six percent a year over the period 2016 to 2020, with commercial liability growing at a faster rate than personal

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or medical professional liability. This rate exceeds both the growth in inflation, which averaged 1.9 percent, and GDP, which grew at 2.8 percent over the same period. Because growth in the tort system has outpaced GDP, tort costs as a percentage of GDP grew from 1.88 percent to 2.13 percent. This result has been exacerbated by the contraction in GDP in 2020 caused by COVID-related shutdowns, but even through 2019 tort costs grew at a faster rate than GDP.

Table 1 summarizes total direct economic tort costs for businesses and individuals over time.

Tort Costs per Household

We estimate that U.S. tort costs in 2020 equate to $3,621 per household. As illustrated in Figure 1 below, this per-household figure has grown consistently since 2016.

Tort Costs Across States

The results reveal significant variations across states.

- Tort system costs in the most expensive states are up to 2.7 times larger than in the least expensive states. For example, Florida has the highest tort costs as a percentage of state GDP (3.6 percent), while Nebraska, New Hampshire and South Dakota have

Table 1: Direct Economic Tort Costs By Category of Tort ($ Billions) (2016-2020)

	2016	2017	2018	2019	2020	Average Annual Growth
Commercial Liability	222	220	248	264	291	7%
Personal Liability	128	138	149	153	152	4%
Total Tort Costs	**350**	**358**	**396**	**418**	**443**	**6%**
National GDP	18,586	19,370	20,402	21,243	20,760	3%
Consumer Price Index	240	245	251	256	259	2%
Total Costs as % of GDP	**1.88%**	**1.85%**	**1.94%**	**1.97%**	**2.13%**	**3.15%**

See Table 3 for full results, explanation of calculations, and sources.
Differences in totals are the result of rounding.

Figure 1: Change in Tort Costs Over Time (2016-2020)

Sources: Bureau of Economic Analysis; United States Census Bureau.

among the lowest (less than 1.5 percent).

- Tort system costs per household are about $2,000 in states such as Maine, New Hampshire, South Dakota, and West Virginia, but over $4,500 in states such as California, Florida, and New Jersey, and as high as $5,408 in New York.

Efficiency of the Tort System

Finally, we estimate that the tort system is relatively inefficient at delivering compensation to claimants. Compensation to claimants only represents 53 percent of the total size of the tort system, while the remaining 47 percent covers litigation costs and other expenses.

The following sections give context for and describe in detail the methodology, data, and results of this analysis, including summaries of recent trends in tort costs.

Introduction

Chapter

02

The legal system in the United States provides businesses and individuals with the means to obtain civil remedies for harm caused by others in the form of monetary damages and penalties. This legal system includes a variety of individuals and institutions (both public and private) that are involved in adjudicating tort claims in federal, state, and local courts; arbitrations and mediations; settlement negotiations; and other settings. We refer to these laws, institutions, and persons collectively as the "tort system."

The tort system may be described as playing two important economic roles in society: to compensate for harm actually incurred, and to prevent future harm by encouraging responsible behavior.

The U.S. Tort System

The cost and efficiency of the tort system has been the subject of public policy debate, and the United States has been found to have significantly higher liability costs than other developed countries.[3] Factors contributing to differences in liability costs across countries include: the comprehensiveness of the social safety net, the availability of no-fault compensation schemes, the existence of loser-pays rules for attorneys' fees in certain jurisdictions, the extensiveness of private rights of action, the access to litigation funding (including contingency fees), and the availability and abuses of the class action mechanism.[4]

Excessive costs of the tort system can adversely affect businesses and individuals, and multiple studies have identified significant indirect costs and liability risks that are a result of the way the tort system works, sometimes referred to as "externalities." For example:

- The risk of litigation can discourage the development and sale of new products and can slow innovation.[5]
- The perceived liability risk of different litigation environments can influence where businesses choose to locate or do business.[6] In particular, liability costs in the U.S. decrease manufacturing cost

"… [T]he United States has been found to have significantly higher liability costs than other developed countries."

competitiveness by at least 3.2 percent[7] and could deter foreign direct investment.[8]

- Ultimately, excesses in the tort system have been linked to lower worker productivity and employment,[9] and these effects can be severe in industries subject to widespread litigation, such as asbestos-related personal injury litigation.[10]

Within the U.S., there are large variations in liability costs across states and they have been explained in part by differences in state legal environments, such as the number of lawyers, the perception of the competence of state judges, the strength of evidentiary rules, and the frequency of frivolous or abusive litigation.[11]

In addition to having a substantial aggregate cost on the economy, a large portion of the total tort-related expenditures go toward litigating and defending claims and lawsuits rather than compensating claimants.

> “[W]e find for every dollar paid in compensation to claimants, 88 cents were paid in legal and other costs.”

One study of insured personal injury claims in Texas found that for every dollar received by a claimant, an average of 75 cents was paid in legal and administrative costs.[12] Our own estimate developed in this study is similar; we find for every dollar paid in compensation to claimants, 88 cents were paid in legal and other costs.[13] This raises the important question of whether there are more efficient ways to adjudicate and compensate claimants.

A Consistent Measure of Tort Costs

In this study, we develop estimates of tort costs for the entire United States and for each state. This research is an update to our 2018 study with Lawrence Powell, which reported on the size of the U.S. tort system in 2016.[14] For purposes of this study, we[15] define tort costs as the aggregate amount of judgments, settlements, and legal and administrative costs to adjudicate private claims and enforcement actions. The costs of the tort system also include the market-determined gross profits for insurers, as policyholders are required to pay these costs to create a sufficient incentive for insurance companies to willingly bear the transferred liability risks.

Insured and Self-Insured Liabilities

We use data on liability insurance premiums in the United States to develop a consistent and transparent measure of tort costs. Tort liability is, however, not always insured in the commercial marketplace. It can be self-insured by businesses subject to tort liability. We include in our estimate of tort costs the liabilities of businesses that are self-insured, including businesses with explicit arrangements and risk management programs, as well as those that assume risk passively by choosing to be uninsured.[16] The liabilities included in this study are only those that are insurable, which will understate tort costs to the extent that certain tort claims are uninsurable.[17] While the tort costs computed in this study will necessarily exclude some costs, they are consistently estimated over time and geography, providing data to track trends and to compare tort costs across jurisdictions. An additional advantage of relying on insurance data is that our estimates incorporate the impact of private settlements on tort costs, which are missing from studies that rely only on public records of adjudicated cases.

The principal categories of insurable liability include:

- liability for personal injury, property damage, and in some cases consequential damages;
- liability related to commercial disputes based on tort claims, such as negligence, bad faith, misappropriation, or tortious interference;
- automobile accident liability;

- product liability and certain environmental liabilities;
- consumer protection liability;
- professional liability, including medical liability;
- investor protection liability;
- labor and employment liability;
- civil rights (including disability, privacy, and non-discrimination protections); and
- antitrust liability, such as for unfair competition.

Liability costs covered by the commercial insurance market can be directly estimated from the statutory reporting of insurance companies. Specifically, total earned premiums of liability insurance policies measure the size of the tort system for insured businesses and individuals. Earned premiums cover the aggregate amount of expected awards and settlements, the costs of administering and adjudicating claims, and insurers' gross profits.

For self-insured businesses, we rely on data from Verisk's MarketStance® business, a leading provider of market intelligence to the insurance industry. MarketStance estimates U.S. commercial liability exposures and premiums, including liability exposures for self-insured businesses.[18]

We apply loss ratios and loss adjustment expense ratios from the National Association of Insurance Commissioners (NAIC) to the estimated liability premiums to compute the amount of tort costs that are paid in compensation to injured parties, spent administering and defending claims, or paid to transfer liability to insurers.

An additional advantage of relying on insurance data is that our estimates incorporate the impact of private settlements on tort costs, which are missing from studies that rely only on public records of adjudicated cases.

Results

Chapter

03

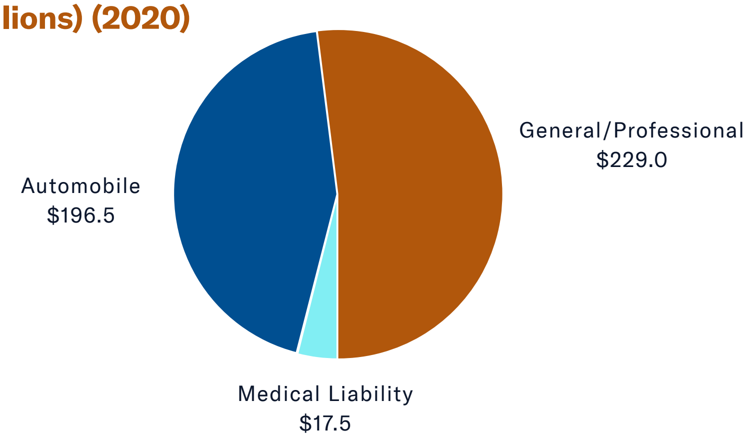
We estimate that the aggregate tort costs in the U.S. amounted to $443 billion in 2020. As shown in Figure 2, $229 billion in tort costs are attributable to general and professional liability claims; $196.5 billion to automobile claims; and $17.5 billion to medical liability claims.

Costs and Compensation of the U.S. Tort System

Insurance data are reported by line of coverage. For summary purposes we report three categories of tort costs that correspond to lines of insurance: automobile liability, medical professional liability, and all other commercial and personal liabilities. We report tort costs as either arising from personal or commercial sources of exposure. Commercial sources of exposure are further subdivided as arising from operating, professional, or self-insured liabilities. Table 2 summarizes U.S. tort costs across these dimensions

Of the $291 billion commercial liability, $225.6 billion relate to liabilities covered by operating

Figure 2: Direct Economic Tort Costs by Category of Tort ($ Billions) (2020)



Sources: MarketStance; NAIC.

Table 2: Summary of Tort Costs by Line of Exposure ($ Billions) (2020)

	Commercial/ Personal Liability [A]	Medical Liability [B]	Automobile [C]	Total [D]
Commercial Liability	**225.6**	**17.5**	**47.8**	**290.9**
Operating Liability	66.1	-	34.0	100.1
Professional Liability	30.2	11.3	-	41.5
Self-Insured	129.3	6.1	13.9	149.3
Personal Liability	**3.4**	**-**	**148.7**	**152.1**
Total	**229.0**	**17.5**	**196.5**	**443.0**

Sources and Notes:
Differences in totals are the result of rounding.
[A]: Includes general/professional liability and liability portion of individual homeowners' exposure. Operating, professional, and self-insured segments are from MarketStance, NAIC, and SERFF.
[B]: MarketStance, NAIC.
[C]: Includes personal and commercial auto liability.
[D] = [A] + [B] + [C]

liability and professional liability, while $17.5 billion relate to medical liability, and $47.8 billion to commercial automobile liability. Commercial liabilities include:

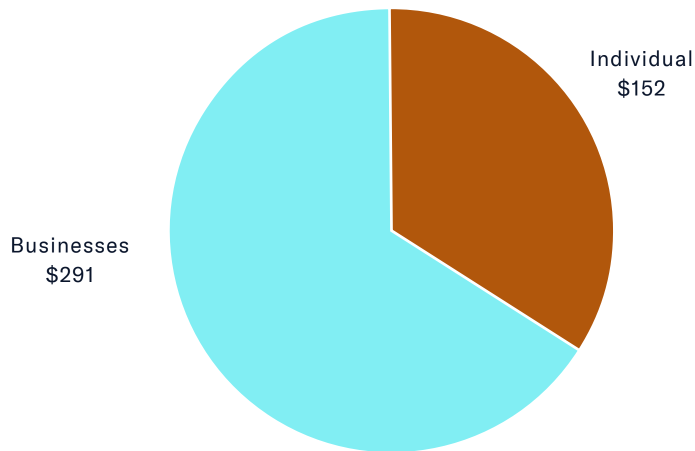
- $66.1 billion of operating liability, including coverages that relate to commercial property, commercial general liability, and product liability lines;
- $30.2 billion of professional liability, including directors and officers liability, employment practices liability, and professional errors and omissions liability; and
- $129.3 billion of self-insured exposures, which shows that many businesses choose not to purchase insurance.

Personal liabilities covered by homeowners', renters', and condominium insurance only account for $3.4 billion, a small fraction of the tort system. In contrast, personal auto liability accounts for $148.7 billion in total tort costs.

As shown in Figure 3, $291 billion relate to liability faced by businesses and $152 billion by individuals.

"We estimate that the aggregate tort costs in the U.S. amounted to $443 billion in 2020."

Figure 3: Direct Economic Tort Costs by Insured Type ($ Billions) (2020)



Tort Costs Over Time

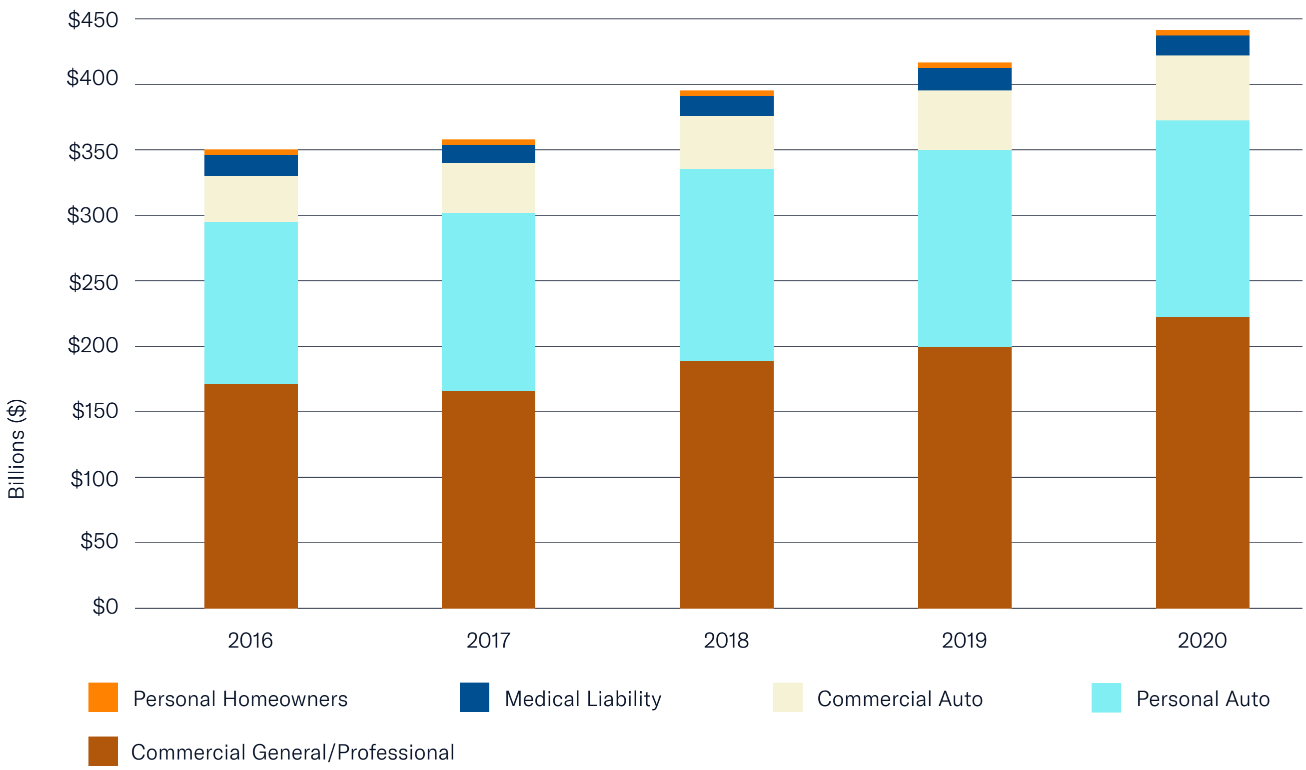
Using the methodology described in this paper, we estimate tort costs for the years 2016-2020. Total direct economic tort costs by insurance line of exposure are summarized in Table 3 and Figure 4.

Table 3: Direct Economic Tort Costs by Category of Tort ($ Billions) (2016-2020)

		2016	2017	2018	2019	2020	Average Annual Growth
Commercial Liability							
General/Professional	[1]	172.5	168.1	190.6	200.9	225.6	6.9%
Medical	[2]	15.2	14.8	15.2	16.6	17.5	3.5%
Automobile	[3]	34.7	37.4	41.7	47.0	47.8	8.4%
Commercial Liability Total	[4]	222.4	220.3	247.6	264.5	290.9	6.9%
Personal Liability							
Homeowners (liability portion)	[5]	3.0	2.9	3.1	3.1	3.4	3.3%
Automobile	[6]	124.9	135.1	145.5	150.2	148.7	4.4%
Personal Liability Total	[7]	127.9	138.1	148.6	153.3	152.1	4.4%
Total Tort Costs	[8]	**350.3**	**358.4**	**396.2**	**417.8**	**443.0**	**6.0%**
National GDP	[9]	18,586	19,370	20,402	21,243	20,760	2.8%
Consumer Price Index	[10]	240.0	245.1	251.1	255.7	258.8	1.9%
Total Costs as % of GDP	[11]	**1.9%**	**1.9%**	**1.9%**	**2.0%**	**2.1%**	**3.2%**

Sources and Notes:
MarketStance; NAIC; Bureau of Economic Analysis; Bureau of Labor Statistics.
Differences in totals are the result of rounding.
Tort economic costs include losses, direct defense costs and cost containment expenses, plaintiffs' legal costs, and cost of risk transfer. Average Annual Growth is the compound annual growth rate from 2016-2020: i.e., $(\text{value}_{2020}/\text{value}_{2016})^{1/4}$-1.
[4] = [1] + [2] + [3]
[7] = [5] + [6]
[8] = [4] + [7]
[10]: CPI is non-seasonally adjusted for all urban consumers; all items in U.S. city average. Base period: 1982-84=100.
[11] = [8] / [9]

Figure 4: Tort Costs by Category of Tort (2016-2020)



Sources and Notes: MarketStance; NAIC; Bureau of Economic Analysis; Bureau of Labor Statistics.

Overall, tort costs have grown at an annual rate of 6.0 percent a year over the period 2016 to 2020—with commercial liability growing at a faster rate than personal liability. This exceeds both the growth in inflation, which averaged 1.9 percent, and GDP, which grew at 2.8 percent over the same time period.[19] Because growth in the tort system has outpaced GDP, tort costs as a percentage of GDP grew from 1.9 percent to 2.1 percent.

The Impact of COVID

The high rate of tort cost growth compared to GDP persisted in 2020 despite the tremendous systemic disruptions caused by the pandemic. While COVID caused courts to shut down and greatly slowed the pace at which tort cases proceeded though the justice system, the insurance data on which this study relies capture the future expected costs of all tort liabilities that relate to either claims made

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or injuries occurring in the policy year.[20] Our estimates are based on insurance premiums earned and losses incurred in each year. This includes the expected losses and expenses for liabilities in the current year plus any unexpected developments in losses and expenses for unresolved liabilities from prior years. Therefore, even though the pace of adjudicating claims may have slowed down as a result of the COVID-related shutdowns, the liabilities were still incurred in 2020 and are captured in our insurance-based estimates.

Tort Costs per Household and Across States

We also compute the total costs of the tort system per household. The total national tort cost figure of $443 billion in 2020 amounts to $3,621 per household.[21]

Insurance companies allocate premiums and losses to each state or territory based on the physical location of the insured risk, but for some liability coverage where a single premium is determined for multiple locations, premiums and losses can be allocated to the location of the principal office of the insured.[22] MarketStance produces ground-up written premium estimates based on the location, class, size, and other characteristics of each operation. MarketStance adjusts these estimates to account for premiums that are reported where multistate businesses are headquartered and not where the risks are located. Accordingly, our estimates of tort costs across states capture liabilities that are incurred in each state.

Tort costs vary greatly across states, ranging from

“The total national tort cost figure of $443 billion in 2020 amounts to $3,621 per household.”

$593 million in Wyoming to over $60 billion in California, but this diversity is not entirely explained by the relative size of the states. For example, tort costs are over $5,000 per household in New York, while the tort costs in the least expensive states are under $2,200 per household. Table 4 reports our estimates of the annual tort costs in 2020 by state as a percentage of GDP and per household. Tort costs as a percentage of GDP are computed as the total tort costs in each state, or nationally, divided by the annual GDP in the same jurisdiction. Similarly, tort costs per household are computed as total tort costs in each state, or nationally, divided by the number of households in the same jurisdiction.

Table 4: Tort Costs by State ($ Millions) (2020)

State	General/ Commercial	Medical Liability	Automobile	Total Costs	Tort Costs as % of State GDP	Tort Costs per Household ($)
AK	$320	$30	$367	$717	1.44%	$2,810
AL	$2,682	$196	$2,744	$5,622	2.48%	$2,977
AR	$1,757	$94	$1,529	$3,380	2.59%	$2,888
AZ	$4,501	$313	$4,212	$9,026	2.42%	$3,414
CA	$35,350	$1,598	$23,316	$60,264	2.00%	$4,599
CO	$4,459	$207	$3,906	$8,573	2.24%	$4,011
CT	$3,103	$346	$2,468	$5,917	2.14%	$4,271
DC	$948	$54	$272	$1,275	0.88%	$4,422
DE	$1,161	$61	$811	$2,033	2.68%	$5,480
FL	$19,931	$1,146	$19,096	$40,173	3.63%	$5,065
GA	$6,867	$607	$8,447	$15,922	2.56%	$4,157
HI	$808	$53	$554	$1,415	1.71%	$3,023
IA	$1,519	$121	$1,301	$2,941	1.51%	$2,309
ID	$1,108	$50	$833	$1,991	2.38%	$3,067
IL	$10,573	$829	$6,129	$17,532	2.04%	$3,590
IN	$3,064	$370	$3,078	$6,511	1.73%	$2,502
KS	$1,481	$167	$1,342	$2,990	1.71%	$2,618
KY	$1,803	$169	$2,563	$4,535	2.13%	$2,594
LA	$2,714	$149	$4,177	$7,040	2.99%	$4,018
MA	$6,046	$590	$3,920	$10,556	1.81%	$3,988
MD	$2,750	$469	$3,888	$7,107	1.73%	$3,186

Table 4: (continued) ($ Millions) (2020)

State	General/ Commercial	Medical Liability	Automobile	Total Costs	Tort Costs as % of State GDP	Tort Costs per Household ($)
ME	$520	$65	$544	$1,129	1.63%	$1,982
MI	$3,963	$366	$7,167	$11,496	2.23%	$2,888
MN	$2,948	$138	$2,689	$5,774	1.55%	$2,615
MO	$3,587	$273	$3,087	$6,947	2.11%	$2,847
MS	$1,341	$96	$1,561	$2,998	2.63%	$2,685
MT	$740	$54	$563	$1,358	2.64%	$3,114
NC	$4,152	$284	$4,541	$8,978	1.52%	$2,227
ND	$441	$16	$351	$807	1.47%	$2,516
NE	$888	$72	$960	$1,920	1.44%	$2,504
NH	$497	$88	$596	$1,181	1.35%	$2,190
NJ	$8,523	$724	$7,306	$16,552	2.68%	$5,059
NM	$1,365	$170	$1,209	$2,745	2.79%	$3,462
NV	$1,535	$120	$2,590	$4,246	2.48%	$3,757
NY	$25,097	$2,695	$12,323	$40,115	2.33%	$5,408
OH	$5,399	$374	$4,923	$10,696	1.58%	$2,267
OK	$1,789	$155	$2,045	$3,990	2.12%	$2,671
OR	$2,343	$165	$2,544	$5,052	2.07%	$3,075
PA	$8,894	$1,418	$6,620	$16,932	2.19%	$3,316
RI	$710	$60	$762	$1,532	2.53%	$3,695
SC	$2,529	$172	$3,539	$6,239	2.55%	$3,181
SD	$319	$32	$374	$726	1.32%	$2,086
TN	$3,596	$448	$3,214	$7,258	1.96%	$2,750
TX	$19,959	$858	$17,858	$38,676	2.18%	$3,904
UT	$1,832	$106	$1,817	$3,754	1.90%	$3,742
VA	$4,283	$296	$4,134	$8,713	1.59%	$2,737
VT	$451	$29	$245	$725	2.17%	$2,759
WA	$4,390	$299	$4,519	$9,208	1.52%	$3,169
WI	$3,043	$130	$2,345	$5,519	1.63%	$2,321
WV	$653	$105	$860	$1,618	2.13%	$2,204
WY	$294	$23	$276	$593	1.63%	$2,542
National	**$229,026**	**$17,452**	**$196,518**	**$442,996**	**2.13%**	**$3,621**

Note: Homeowner (liability portion) is included under General/Commercial Liability.

Table 5 shows the 10 most expensive states in terms of tort costs as a percentage of GDP. Tort costs in the 10 most expensive states, as measured by costs as a percentage of GDP, were $98.4 billion. This amounts to 2.98 percent of the total GDP in these states.

Table 6 shows the 10 most expensive states in terms of tort costs per household. Tort costs in the 10 most expensive states, as measured by cost per household, were $207.1 billion. This amounts to $4,724 per household for each of the 43.8 million households in these states.

Table 5: States With Highest Tort Costs as % of State GDP (2020)

State	Total Tort Costs [1]	State GDP [2]	Tort Costs as % of State GDP [3]
FL	$40,173	$1,106,036	3.63%
LA	$7,040	$235,437	2.99%
NM	$2,745	$98,472	2.79%
DE	$2,033	$75,787	2.68%
NJ	$16,552	$618,579	2.68%
MT	$1,358	$51,509	2.64%
MS	$2,998	$113,846	2.63%
AR	$3,380	$130,751	2.59%
GA	$15,922	$622,628	2.56%
SC	$6,239	$244,882	2.55%
Top 10 States	**$98,439**	**$3,297,926**	**2.98%**

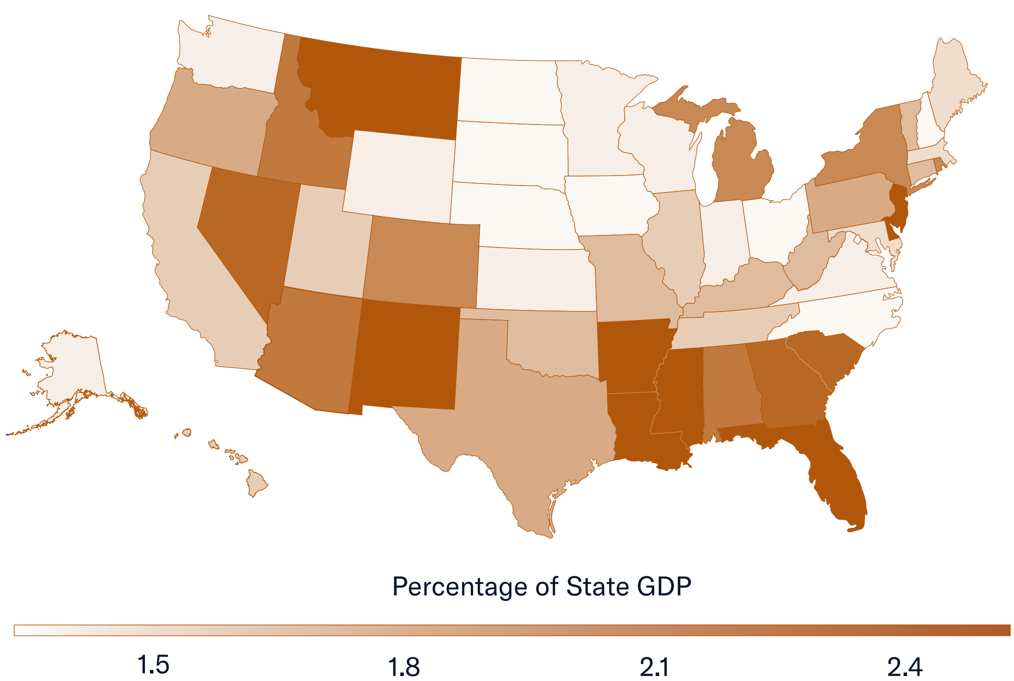
Sources and Notes:
[2]: Bureau of Economic Analysis, Gross Domestic Product by state: All industry total. Last updated: March 31, 2022.
[3] = [1] / [2].

Table 6: States With Highest per-Household Tort Costs (2020)

State	Total Tort Costs ($ millions) [1]	Number of Households [2]	Tort Costs per Household ($) [3]
DE	$2,033	370,953	$5,480
NY	$40,115	7,417,224	$5,408
FL	$40,173	7,931,313	$5,065
NJ	$16,552	3,272,054	$5,059
CA	$60,264	13,103,114	$4,599
CT	$5,917	1,385,437	$4,271
GA	$15,922	3,830,264	$4,157
LA	$7,040	1,751,956	$4,018
CO	$8,573	2,137,402	$4,011
MA	$10,556	2,646,980	$3,988
Top 10 States	**$207,145**	**43,846,697**	**$4,724**

Sources and Notes:
Washington D.C. had the sixth largest tort costs per household but is excluded.
[2]: U.S. Census.
[3] = [1] / [2].

Figure 5: Tort Costs as a Percentage of GDP by State (2020)

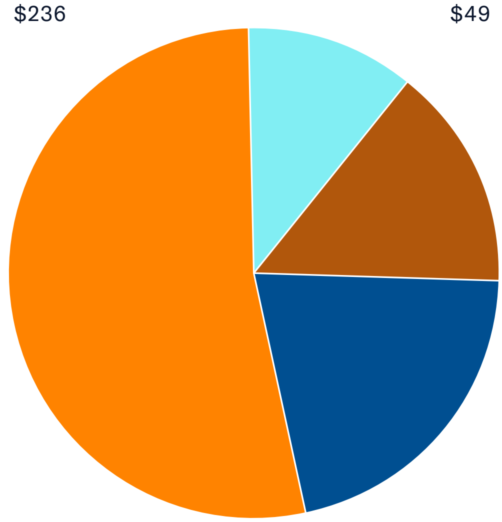


Efficiency of the Tort System

We define efficiency as the extent to which the tort system minimizes the costs of adjudicating and administering claims, relative to the net compensation received by claimants. By assuming similar levels of efficiency for insured and self-insured costs, we estimate that only $236 billion out of $443 billion, or 53 percent of the total expenditures, go toward compensating claimants. The remaining 47 percent go toward the payment of legal costs of claimants and defendants, and the cost of risk transfer.[23] The cost of risk transfer represents 21 percent of the aggregate tort costs. Figure 6 summarizes how tort costs are allocated between claimants, lawyers, and insurers.

"... [W]e estimate that only $236 billion out of $443 billion, or 53 percent of the total expenditures, go toward compensating claimants."

Figure 6: Source of Tort Costs ($ Billions) (2020)



Insurance data provide not just an estimate of the cost of the tort system, but also offer a basis to assess its relative efficiency in terms of the portions of total expenditures that are used to compensate injured parties. In addition to premiums, insurance companies report losses and loss adjustment expenses. In the tort system, claimants' legal fees are typically paid on a contingent fee basis out of the award received by the claimants.[24] Accordingly, insurance losses include both the claimants' legal costs as well as the compensation that claimants receive for their claims. Loss adjustment expenses include defendants' legal costs, including all of the costs of investigating, defending, and adjusting claims.[25]

Most tort cases are financed by claimants' lawyers, or litigation funders, through contingency fees charged as a percentage of any monetary awards that are paid to claimants. In a contingency fee arrangement, the financer of the litigation assumes the litigation risk but is compensated by receiving a large portion of any award. The success of the plaintiffs' bar in prosecuting tort claims has led to a high effective hourly wage of claimants' attorneys.[26] We estimate the portion of losses that are used to pay claimants' legal costs based on a prior study that found that the costs to bring claims, including contingency fees, are approximately 33 percent larger than the costs of defending those claims.[27] Accordingly, we compute that claimants' legal costs are a third larger than the loss adjustment expenses.

Table 7 summarizes our estimation methodology for assessing the efficiency of the tort system. Using data from the NAIC statutory filings, we compute losses and loss adjustment expenses for the relevant lines of insurance. Defendants' legal costs are equal to loss adjustment expenses. Claimants' legal costs are estimated to be 33 percent higher than the loss adjustment expenses. Claimant compensation is computed as the difference between the total losses and the claimants' legal costs. The remaining category is the cost of risk transfer, which includes insurer profits and operating costs.

Table 7: Sources of Tort Costs ($ Billions) (2020)

	Losses			Loss Adjustment Expense	Insurer Margin	
	Plaintiffs' Compensation	Plaintiffs' Legal Costs	Total Award	Defendants' Legal Costs	Cost of Risk Transfer	Total
	[1]	[2]	[3]	[4]	[5]	[6]
Commercial/ Personal Liability	**123.1**	**46.4**	**169.5**	**34.8**	**24.8**	**229.0**
Insured	43.4	16.7	60.1	12.5	23.7	96.3
Self-Insured (commercial)	77.5	29.6	107.1	22.2	0.0	129.3
Homeowners (liability portion)	2.2	0.1	2.3	0.1	1.1	3.4
Automobile	**107.9**	**12.5**	**120.4**	**9.4**	**66.7**	**196.5**
Commercial Auto (insured)	19.9	3.3	23.2	2.5	8.3	34.0
Commercial Auto (self-insured)	10.7	1.8	12.5	1.3	0.0	13.9
Personal Auto	77.3	7.4	84.7	5.6	58.5	148.7
Medical Liability	**4.8**	**5.9**	**10.7**	**4.4**	**2.3**	**17.5**
Total	**235.7** 53%	**64.8** 15%	**300.6** 68%	**48.6** 11%	**93.8** 21%	**443.0** 100%

Notes:
Differences in totals are the result of rounding.
[1] = [3] - [2]
[2] = [4] x (4/3)
[3] = [6] × (Incurred Losses / Earned Premiums)
[4] = [6] × (Incurred Losses / Earned Premiums)
[5] = [6] - [4] - [3]
[6]: Total estimated cost and compensation.

Conclusion

Chapter

04

The aggregate amount of tort costs is large and accounts for a significant portion of the GDP in the U.S. We estimate that in 2020, tort costs amounted to $443 billion, or 2.1 percent of U.S. gross domestic product. The tort system has grown at an average annual rate of six percent a year—faster than both inflation and GDP.

These tort costs exhibit significant variations across states, ranging from over $5,000 per household in New York to approximately $2,000 per household in the least expensive states. Similarly, tort costs as a percentage of state GDP are considerably higher than the national average in some states.

The tort system is relatively inefficient in delivering compensation to claimants. We estimate that only 53 percent of the expenditures in the tort system are paid to compensate claimants, while 47 percent go to cover the cost of litigation and risk transfer costs.

We hope that this objective, clear definition of tort costs and transparent cost estimation methodology will provide a basis for future research and policy debate.

Included Categories of Tort Claims

Appendix

A

This study provides a consistent and transparent estimate of tort costs for the entire United States and for each state. These estimates provide a foundation for research into the variation in liability costs across states; the effectiveness of legislative reforms in reducing costs and increasing the efficiency of the tort system; and the economic impact of potential excesses in the tort system.

Categories of Tort Liability

The tort system allows an individual who has been wronged or injured to seek compensation from the person or entity that caused the harm. For practical reasons, our definition of the tort system includes only categories of liability that are insurable.[28] This definition of the tort system excludes some tort liabilities. For example, harms caused by intentional actions are typically uninsurable but would be considered torts within the legal system.[29, 30] While this definition does not overlap exactly with any formal legal definition, it makes it possible to estimate the size of the tort system using insurance data.

The legal system in the United States provides businesses and individuals with the means to obtain civil remedies for harm caused by others in the form of monetary damages and penalties. The legal basis for seeking damages arises from two principal sources of legal liability:

1. the common law, or court-made law, of torts, such as negligence and product liability; and

2. statutory protections established through legislation, such as consumer protection acts, labor and employment laws, and securities laws.

Publicly available insurance data are reported by line of business or industry. They do not distinguish between claims based on common law liability and statutory liability. Accordingly, we do not separately estimate the liability costs arising from common law claims and statutory law claims. To the extent that both are insurable, they are included in our estimates.

"For practical reasons, our definition of the tort system includes only categories of liability that are insurable."

Compensation for Common Law Torts

Common law torts are causes of action to redress harm caused by others due to a negligent or careless act or omission, or other wrongful conduct.[31] Compensation for damages in the tort system depends on the type of claim. For example, in personal injury cases damages may cover economic losses (such as medical expenses and lost wages) as well as non-economic damages (such as pain and suffering).[32] In other litigation, claimants may seek compensation for property damages, financial losses, or punitive damages. This study includes six main categories of insurable common law tort claims, as listed below.

- Automobile accidents: The largest category of insurable tort liability claims arises from automobile accidents.

- Commercial disputes based on tort claims, such as negligence, bad faith, misappropriation, or tortious interference: These are claims that arise from contract disputes concerning alleged failures to abide by the terms or fulfill obligations made in private agreements. While these are, by definition, not tort claims, in many instances claimants will invoke parallel common law tort claims in connection with the same conduct, such as allegations of bad faith and fair dealing, misrepresentation, or tortious interference.[33] Doing so allows claimants to benefit from the ability of defendants to draw on insurance policies that would not cover alleged intentional acts such as breach of contract.

- Personal injury or property damage:[34] Coverage for personal injury or property damage claims is available through general liability and umbrella policies.

- Product liability: Product liability-related insurance coverage is available both through general liability and umbrella policies, and through specialty coverage.

- Professional liability: Professional liabilities are covered by a number of lines of insurance that provide coverage for negligence in the provision of professional services, including medical liability insurance.

- Environmental toxic torts: Until 1985, the risk of products or industrial pollution causing bodily injury or property damage to others was widely covered by insurance. Thereafter, pollution and asbestos liabilities were generally excluded across the United States.[35] As a consequence, environmental toxic torts are now only covered by specialty environmental liability lines of insurance that offer limited coverage. These specialty lines are included in our estimates. Many environmental toxic torts arising from exposures after 1985—including asbestos—are uninsurable. While significant, these amounts are small relative to the total size of the tort system.[36]

Compensation for Statutory Liability

Civil liabilities can also be imposed by statute. Statutory liability claims can arise from a combination of federal, state, or local statutes that give rise to claims for compensation, remediation, injunctive relief, and penalty. Statutory liability claims can be brought either through private rights of action or regulatory enforcement proceedings. Some of these statutes also provide for criminal liability, but criminal liabilities are outside our definition of the tort system. Statutes that can give rise to insurable liability claims include:

- labor and employment laws;
- consumer protection laws, including general unfair and deceptive practices acts;
- civil rights laws, including disability, privacy and non-discrimination protections;
- antitrust laws;[37] and
- securities laws.

Statutory environmental protections, such as environmental clean-up costs and costs of compliance with emissions controls, are generally uninsurable and excluded from our definition of the tort system.[38] Workers' compensation liabilities are typically handled outside the tort system and consequently are excluded.

> "Statutory liability claims can arise from a combination of federal, state, or local statutes that give rise to claims for compensation, remediation, injunctive relief, and penalty."

Methodology

Appendix

B

Tort costs include (1) the compensation paid to claimants, whether through adjudicated judgments or settlements, (2) the costs of adjudication, and (3) the cost that policyholders pay to transfer tort liability risks to insurers (i.e., the cost of risk transfer).

Liability Insurance Premiums

We estimate tort costs based on the total premium expense that would be required to fully insure against all claims arising in the tort system, including actual premiums paid, and the estimated tort costs for self-insured risks.

Liability insurance premiums cover the expected amounts required to pay for:

(1) compensation paid to claimants (covered losses, including awards and settlements);

(2) the costs of adjudication (defense costs and cost containment expenses, including the costs to investigate and litigate claims); and

(3) the cost of risk transfer (claims administration costs, including the costs of operations, risk management, and profit required to compensate insurance companies for assuming the liability risks).

Since the price of liability insurance is set in a competitive marketplace,[39] premiums paid by policyholders reflect the market costs of obtaining and providing liability insurance. In particular, as the insurance premiums include insurers' operating costs and profit margins, our estimate of the tort costs includes the cost of risk transfer.

While premiums include insurer expenses and profits, insurance companies have several important advantages that allow them to administer and pay claims more efficiently than individual policyholders. Some of the advantages that insurance companies hold over individual policyholders include: the pooling of risks, the realization of economies of scale in defending and administering claims, and the beneficial tax treatment of expected future losses. For these reasons, it can be less expensive for a policyholder to pay a premium that includes the insurance company's expenses and profits than to be self-insured.[40]

Despite these advantages, some businesses self-insure by having high deductibles or exposures in excess of carried limits, or by choosing to not purchase any insurance at all. For liabilities that are self-insured, losses and defense costs are computed based on estimates of the size of the self-insured market. The cost of risk transfer is assumed to be avoided by self-insuring. This reduction in liability costs for self-insured businesses is a simplifying assumption. For example, captives operate similarly to carriers and often hire third parties to administer claims, and businesses that self-insure must reserve for expected losses and perform their own risk management functions. We do not account for these costs in our estimates, nor do we account for selection bias that could attract higher risk businesses to buy insurance.

This study does not capture certain direct and indirect costs of the tort system. First, our measure of the direct economic cost of the tort system does not include the cost of running and administering the institutions of the tort system, such as the cost of operating state and federal courts, the cost of regulatory enforcement staff, or the productivity and wages lost by individuals who serve on juries. We also do not quantify any of the negative externalities of the tort system, including the effects on innovation, the availability of products or services, foreign direct investment, and the economy as a whole. Similarly, we do not quantify any positive effects that the tort system may have in preventing and deterring harms, and in providing just outcomes for injured parties. Non-economic costs of the tort system, including the psychological costs and stresses of legal disputes, are also outside of the scope of this study.

Since insurance premiums are reported by insurance lines of business, we group them into the following broad segments:

(1) commercial liability and medical professional liability,

(2) personal liability, and

(3) automobile liability.

We discuss the estimation of tort costs for each of these segments below.

"For liabilities that are self-insured, losses and defense costs are computed based on estimates of the size of the self-insured market."

Commercial and Medical Professional Liability

The largest components of U.S. liability costs are covered by commercial liability insurance. We rely on estimates of the size of the market for liability insurance developed by MarketStance to compute the tort costs for commercial and medical professional liability. MarketStance uses data on the cost of liability insurance from insurance companies' rate filings, and detailed information about the number and size of businesses from the Economic Census and other sources to compute the exposure base for risks by size, industry, and location of businesses.

Based in part on survey data, MarketStance estimates the percentage of exposures that are retained either by businesses choosing to self-insure, or through deductibles and exposures in excess of carried limits. MarketStance scales the estimated insured exposures (for the largest liability insurance lines) to match total premiums written into each state by domestic and alien insurance companies using data collected by the National Association of Insurance Commissioners (NAIC) and other sources. The same scaling factor is then used to develop estimates of self-insured premium liabilities (described in more detail below).

This methodology is described in more detail in the following pages.

Table 8: Lines of Insurance Included in Commercial Liability Estimates

Type of Insurance	NAIC Line	Related MarketStance Line	Tort Category
Commercial Multiple Peril (Liability)	5.2	Premises and Operations Liability Umbrella Liability Excess Liability BOP	General/ Professional
Other Liability - Occurrence	17.1	Premises and Operations Liability Umbrella Liability Excess Liability Cyber Liability D&O Liability BOP	General/ Professional
Other Liability - Claims Made	17.2	E&O/Prof Liability EPLI Fiduciary Liability Cyber Liability D&O Liability	General/ Professional
Products Liability	18	Products Liability	General/ Professional

***Notes:**

1. The NAIC insurance lines in this table include the following types of insurance: 5.0002 Business Owners, 5.0003 Commercial Package Policy, 5.0006 Commercial Farm and Ranch, 5.0007 Other CMP Policies, 17.0001 Commercial General Liability, 17.0002 Completed Operations, 17.0003 Comprehensive Personal Liability, 17.0004 Contractual Liability, 17.0005 Day Care Centers, 17.0006 Directors and Officers Liability, 17.0007 Elevators and Escalators Liability, 17.0008 Employee Benefit Liability, 17.0009 Employers Liability, 17.001 Employment Practices Liability, 17.0011 Environmental Pollution Liability, 17.0012 Fire Legal Liability, 17.0013 Kidnap and Ransom Liability, 17.0014 Liquor Liability, 17.0015 Municipal Liability, 17.0016 Nuclear Energy Liability, 17.0017 Personal Injury Liability, 17.0018 Premises and Operations (OL&T and M&C), 17.0019 Professional Errors and Omissions Liability, 17.002 Umbrella and Excess (Commercial), 17.0021 Umbrella and Excess (Personal), 17.0022 Other, 17.0023 Veterinarian, 17.0024 Internet Liability, 17.0025 Provider Excess Stop Loss, 17.0026 Excess Stop Loss, 17.0027 Other Excess Stop Loss, 17.0028 Cyber Liability, 18.0001 Occurrence, and 18.0002 Claims Made.
2. While aviation, ocean, and marine policies provide some liability coverage, they are relatively small lines and predominantly cover property losses. Since NAIC data do not separately report the cost of liability coverage included in other lines, these liability costs are excluded from our estimates.

Insured Commercial Liability Costs

Commercial liability costs can be either insured or self-insured. All insurance companies are required to report financial data, including premiums, to state and federal regulators, and this information is widely available. These data are aggregated and reported by a number of data providers, including NAIC.[41] Table 8 shows the specific lines of insurance included in MarketStance's estimates.

Medical liability insurance protects doctors and hospitals from liability arising from allegations of negligence, purportedly resulting in the injury or death of patients.[42] MarketStance separately analyzes medical professional liability insurance, which is reported separately by NAIC under line 11.

For purposes of estimating tort costs in 2020, we are interested in direct premiums earned, which include the portion of premiums that relate to coverage for the 2020 calendar year.[43] However, MarketStance computes direct premiums written in its estimates of insurance liability exposure. On average, earned commercial liability premiums were five percent lower than written premiums in 2020. Accordingly, we scale down the estimates of commercial written premiums by five percent. Similarly, we scale down medical professional liability written premiums by two percent.

"For purposes of estimating tort costs in 2020, we are interested in direct premiums earned, which include the portion of premiums that relate to coverage for the 2020 calendar year."

Self-Insured Liability Costs

We also estimate the fraction of tort costs not covered by insurance and price this self-insured liability cost using insurance rates.[44] Aggregate premium data provide an estimate of tort costs for those businesses and individuals that purchase insurance. However, not all businesses and individuals purchase insurance, and not all losses are covered. At the smaller end of the market, many individuals and businesses retain a significant amount of risk by not purchasing insurance or having low limits. At the other end of the market, many larger businesses self-insure by choosing high deductibles, or by setting aside funds and developing their own risk management programs. Similarly, in the medical liability insurance segment, many physician groups and hospital systems are largely or fully self-insured.[45]

These self-insured liabilities are not tracked by NAIC but are a significant part of the market. We rely on data and the methodology developed by MarketStance—a leading provider of market intelligence to the insurance industry—to develop estimates of the self-insured commercial and medical professional liability costs. We do not estimate self-insured costs of individuals, since we assess these to be immaterial to tort costs in aggregate (as discussed further below). The key steps in the methodology for self-insured liability lines are as follows:

(1) computing the total liability exposure using rate filings and business demographic data;

(2) estimating the percentage of the exposure that is insured and self-insured; and

(3) determining the premium cost of insuring the exposure based on total reported insured premiums.

These steps are discussed under the following sub-headings.

Computing Total Exposure

In addition to statutory financial data, insurance companies are required to submit rate filings with their regulators, which describe how their premiums are set. Many of these rate filings are available from NAIC's System for Electronic Rates and Forms Filing (SERFF). Rate filings provide valuable information on the cost of liability insurance within each state and identify the risk factors that insurance companies use to price liability insurance. These risk factors and the associated pricing, combined with estimates of the size of each industry sector, provide a measure of the total liability exposure for each business, doctor, or hospital.

MarketStance estimates exposure based on rate filings, business demographic data reported by the U.S. Census, and other federal government sources for each state. Business demographic data that affects liability costs include: the location of the business operations, the industry in which the business operates, the number of employees, amount of sales, total payroll, or square footage of business operations. Risk factors for medical professional liability also include other factors such as the number of physicians or hospital beds covered.

Included in these estimates are exposures for employee businesses, non-employee businesses, hospitals, individual physicians and practices, and state and local governments. MarketStance models exposures and premiums for the following liability lines of coverage ("modeled categories of exposure"):

- Premises and Operations
- Products Liability
- Umbrella and Excess (Commercial)
- Business Owners (Liability Portion)[46]
- Professional Errors and Omissions Liability

- Directors and Officers Liability
- Employment Practices Liability
- Fiduciary Liability
- Cyber Liability
- Medical Professional Liability

Estimating the Percentage of Exposure That Is Self-Insured

The percentage of exposure that is self-insured varies greatly across businesses with different demographic characteristics. For instance, larger businesses are more likely to retain risk through formal risk management programs, whereas smaller businesses are more likely to be entirely uninsured. In addition, businesses in different industries are exposed to different types of risk, which can greatly affect which lines of insurance they purchase and which risks they retain. Many physician groups and hospital systems are largely or fully self-insured. As noted above, this limits the usefulness of aggregate statistics on medical liability insurance premiums reported in NAIC statutory filings.[47]

MarketStance estimates the percentage of the total exposure that is insured based on surveys of companies' propensity to purchase insurance.

Determining the Cost of Self-Insured Exposure

MarketStance calibrates its estimates of self-insured exposure by matching the corresponding estimated insured fraction of exposure to the reported values. MarketStance combines its estimates of premiums written and the premium equivalent values for self-insured risks. For each modeled category of liability exposure,[48] MarketStance scales estimated premiums to equal the liability premiums reported in the related annual statement lines, with adjustments, applying the self-insured factor to derive the written premium equivalents for that part of the market.

Personal Liability Insurance

Personal liability exposure is estimated from the costs of homeowners' (private homes and condominiums) or renters' insurance policies.

Most individuals only carry general liability insurance as a part of homeowners' or renters' insurance policies. Using rate filings from SERFF that separately report liability premiums, we estimate the fraction of homeowners', condominium owners', and renters' insurance premiums that are for liability coverage.

As shown in Table 9, most of the home and condominium owners' insurance premiums are for property damage, and only three to five percent of the premiums go to cover personal liability exposure. In contrast, for renters' and tenants' insurance policies, where the value of the insured property is much less, liability coverage accounts for 19 percent of the total premiums.

We apply these percentages to total homeowners', renters', and condominium owners' insurance premiums reported by NAIC to estimate personal liability insurance premiums. While a number of individuals do not carry homeowners' or renters' liability insurance, they are the most likely not to possess the wealth necessary to make payments, and so be judgment proof. Therefore, we assume that uninsured personal liability costs are not material.

Table 9: Estimated Portion of Homeowners' Insurance That Relates to Liability Coverages

	Average Portion of Premium for Liability Coverage	Range Across States
Homeowners	3.1%	1.3% - 11.5%
Renters/Tenants	19.2%	8.3% - 72%
Condominium/ Unit Owner	5.4%	2.4% - 21.1%

Source: SERFF Filings.

Auto Liability

We assume that all personal automobile liability is insured either directly or through uninsured/underinsured insurance.[49] Individuals are required to carry automobile liability insurance, and liability from drivers that are uninsured or underinsured is covered by uninsured/underinsured motorist coverage (a form of first party insurance that covers the insured's own losses) designed to fill that gap. NAIC reports the total earned liability premiums (including coverage for uninsured and underinsured motorists) in its Auto Insurance Database Reports.[50] The automobile liability premiums include the following coverages:

- bodily injury liability;
- property damage liability;
- BI/PD combined single limits;
- personal injury protection;
- uninsured/underinsured motorist;
- medical payments; and
- other liability.

Businesses are also required to carry commercial automobile liability insurance unless they are sufficiently large that they can be exempt and self-insure. This requirement means that most small businesses that own cars and trucks will carry commercial liability insurance. Larger businesses will frequently retain some or all of the commercial automobile liability risk. Total premiums earned for commercial automobile liability insurance are reported in NAIC statutory filings.

Self-insured costs are estimated based on the RIMS survey, which has information on the fraction of commercial automobile liability that is retained.[51]

Efficiency of the Tort System

We define the efficiency of the tort system to be the extent to which costs are paid to claimants as compensation instead of being paid to lawyers, insurers, or other parties to administer or adjudicate claims. To assess the efficiency of the tort system, we estimate how much of the total tort costs are paid as compensation, claimants' attorneys' fees, defense costs, and risk transfer costs.

"Insurance data provides estimates not only of the total premium costs but also of the amount of premiums that are used to pay out losses or defend and administer claims."

Insurance data provides estimates not only of the total premium costs but also of the amount of premiums that are used to pay out losses or defend and administer claims. Insurance losses include amounts that are paid to claimants to resolve their tort claims. In the U.S., claimants' legal fees are typically paid on a contingent fee basis out of the award received by claimants. Accordingly, to estimate the amount of tort costs that are retained by claimants as compensation for their alleged injuries, we need to deduct the claimants' attorneys' fees from the reported losses. We estimate claimants' attorneys' fees based on a RAND study that found that the costs to bring claims, including contingency fees, are approximately 33 percent larger than the costs of defending those claims.[52] The cost of defending claims is reported in insurers' loss adjustment expenses. Accordingly, we compute that claimants' attorneys' fees are a third larger than the reported loss adjustment expenses. Compensation is computed as total reported losses less claimants' attorneys' fees. The remaining tort costs are the cost of risk transfer, which as described above is assumed to be avoided for self-insured businesses. In summary:

- compensation is computed as losses less claimants' attorneys' fees;
- claimants' attorneys' fees are computed as loss adjustment expenses multiplied by 1.33;
- defense costs are computed as loss adjustment expenses; and
- cost of risk transfer is computed as insured premiums less insured losses and loss adjustment expenses.

Based on this methodology, we compute that about half of tort costs are paid as compensation to injured parties. While we do not have data to compare the efficiency of the U.S. tort system with that of other countries, the fact that nearly half of costs in the tort system are not going to claimants suggests that there is opportunity to greatly improve efficiency and lower costs.

Updates to 2018 Study

In addition to updating the analysis to include estimates from 2016 through 2020, this study makes several updates to our prior 2018 study to make use of the best available data sources. We have (1) updated the estimates of medical liability costs to rely on data from MarketStance,[53] (2) updated our analysis of commercial liability loss ratios to use data from NAIC,[54] and (3) updated our analysis of non-employee businesses to reflect the data more accurately.[55] The net result of these changes is that our estimate of the total tort costs in 2016 is lower than what we had previously estimated.

Important Caveats

Our estimated tort costs are understated for several reasons.

First, self-insured costs have omitted components:

- We do not include any estimate for self-insured costs for individuals.
- Self-insured businesses are assumed to avoid claims administration costs and the cost of risk transfer. This simplifying assumption underestimates costs for certain businesses. For example, captives operate similarly to carriers and may hire third parties to administer claims, and businesses that self-insure must reserve for expected losses and perform their own risk management functions.

Second, this study does not capture certain direct and indirect costs of the tort system:

- Our measure of the direct economic cost of the tort system does not include the cost of running and administering the institutions of the tort system, such as the cost of operating state and federal courts, the cost of regulatory enforcement staff, or the productivity and wages lost by individuals who serve on juries.
- We also do not quantify any of the negative externalities of the tort system, including the effects on innovation, the availability of products or services, foreign direct investment, and the economy as a whole.

Third, this study only captures tort liabilities that are insurable. This excludes torts relating to intentional acts, as well as certain torts that are excluded from coverage, including many pollution and toxic tort claims.

Finally, non-economic costs of the tort system, including the psychological costs and stresses of legal disputes, are outside of the scope of this study.

Endnotes

1 Past empirical analyses of cost and efficiency have been largely ad hoc and incomplete in terms of national aggregation and state-to-state comparisons. A valuable contribution that this study seeks to make is the ability to present comprehensive and consistent measures of tort liability costs that can be updated routinely and compared from year to year.

2 This phrase ("tort costs") reflects the costs of litigating and adjudicating claims, the compensation that is paid to injured parties, and the amounts that businesses and individuals pay to transfer tort liabilities to insurance companies.

3 David L. McKnight and Paul J. Hinton, *International Comparisons of Litigation Costs: Europe, the United States and Canada* (U.S. Chamber of Commerce Institute for Legal Reform) (2013).

4 *See generally*, Mark J. Browne and Joan T. Schmit, *Litigation Patterns in Automobile Bodily Injury Claims 1977-1997: Effects of Time and Tort Reforms*, 75 J. Risk and Ins., 83 (2008). We presented a review of the literature on the impact of tort reforms, much of which relies on insurance data, in our 2012 study on the determinants of tort costs across states. *See* Paul Hinton et al., *Determinants of State Tort Costs: The Predictive Power of the Harris State Liability Systems Ranking Study* (U.S. Chamber of Commerce Institute for Legal Reform) (Oct. 2011).

5 Alberto Galasso and Hong Luo, *Punishing Robots: Issues in the Economics of Tort Liability and Innovation in Artificial Intelligence.* In The Economics of Artificial Intelligence: An Agenda, pp. 493-504. University of Chicago Press, 2018.

6 "2019 Lawsuit Climate Survey – Ranking the States," U.S. Chamber of Commerce Institute for Legal Reform, 2019.

7 Jeremy A. Leonard, *How Structural Costs Imposed on U.S. Manufacturers Harm Workers and Threaten Competitiveness* 16 (prepared for The Manufacturing Institute of the National Association of Manufacturers) (2003).

8 *See* Robert E. Litan, *Through Their Eyes: How Foreign Investors View and React to the U.S. Legal System* (U.S. Chamber of Commerce Institute for Legal Reform) (2007); see also U.S. Department of Commerce, *The U.S. Litigation Environment and Foreign Direct Investment: Supporting U.S. Competitiveness by Reducing Legal Costs and Uncertainty* (Oct. 2008).

9 Thomas J. Campbell et al., *The Causes and Effects of Liability Reform: Some Empirical Evidence* (NBER Working Paper No. 4989) (1995).

10 Joseph E. Stiglitz, Jonathan M. Orszag and Peter R. Orszag, *The Impact of Asbestos Liabilities on Workers in Bankrupt Firms* (Sebago Associates) (Dec. 2002).

11 *See* Paul J. Hinton, David McKnight and Ronald I. Miller. *Determinants of State Tort Costs: The Predictive Power of the Harris State Liability Systems Ranking Study, available at* SSRN 2154124 (2012); *and* "2019 Lawsuit Climate Survey – Ranking the States," U.S. Chamber of Commerce Institute for Legal Reform, 2019. Research has also found that differences in legal environments can contribute to fraudulent or exaggerated automobile accident claims, which raises the cost of automobile insurance. *See* Stephen J. Carroll et al., *The Costs of Excess Medical Claims for Automobile Personal Injuries* (RAND Corporation) (1995).

12 Joni Hersch and Kip Viscusi, *Tort Liability Litigation Costs for Commercial Claims* 27, Vand. U. Law Sch., Law and Econ., Working Paper 07-16 (2007).

13 We estimate that only 53 percent of the total expenditures of the tort system were paid to claimants. *See* Figure 6. Equivalently, for every $1.00 received by claimants, $0.88 was paid in legal and other costs (i.e., 53% = 1.00/1.88).

14 Paul Hinton, David McKnight and Lawrence Powell, *Costs and Compensation of the U.S. Tort System*, (U.S. Chamber of Commerce Institute for Legal Reform) (October 2018).

15 Paul Hinton and David McKnight are Principals at The Brattle Group. This study was developed for the U.S. Chamber of Commerce Institute for Legal Reform (ILR). We would like to acknowledge the contributions of those who commented on earlier drafts, in particular Eric Price-Glynn, Senior Principal, at Verisk's MarketStance® business; and our colleague Bin Zhou. We would also like to acknowledge Lawrence Powell, the Director of the Alabama Center for Insurance Information and Research at the Culverhouse College of Business, and Judyth Pendell, an independent consultant, who helped develop the methodology and contributed to the first version of this study. Zain Ijaz, Caitlyn Louzado, and Olivia Wurgaft provided research assistance.

16 Self-insured costs include exposures that are uninsured, insurance deductibles or retentions, specific exposures excluded from policies, and exposures in excess of insured limits.

17 Awards, whether compensatory or punitive, arising from a finding of intentional wrongdoing are generally excluded from liability coverage. In addition, certain claims, such as claims relating to pollution and toxic torts, are excluded under most insurance policies.

18 MarketStance estimates premiums and liability exposure for the following lines of insurance: Business Owners, Premises and Operations, Products, D&O, E&O, Employment Practices, Fiduciary, Umbrella, Excess, Medical Professional, and Cyber.

19 U.S. Bureau of Labor Statistics.

[20] An occurrence policy has lifetime coverage for the incidents that occur during a policy period, regardless of when the claim is reported. A claims-made policy only covers incidents that happen and are reported within the policy's timeframe.

[21] The total number of households in 2020 is 122.4 million as per the U.S. Census Bureau American Community Survey 5-year estimates. $3,621 per household in tort costs is calculated by dividing $443 billion by 122.4 million.

[22] *See e.g.,* NAIC, Official Annual Statement Instructions, Property/Casualty, for the 2020 reporting year. Adopted by the NAIC as of June 2020, Schedule T – Exhibit of Premiums Written Allocated by States and Territories.

[23] Throughout this study, we refer to the "cost of risk transfer" – a term meant to fully describe what policyholders are paying for when they pay their insurance premiums. The cost of risk transfer is the market cost of transferring legal liability to an insurance company, after deducting the direct costs of paying and defending claims. It includes the money required to pay for the insurer's overhead and administrative expenses, and to provide profit to compensate for the risk the insurance company assumes.

[24] *See* James S. Kakalik and Nicholas Michael Pace, *Costs and Compensation Paid in Tort Litigation* 37 (RAND Institute for Civil Justice) (1986).

[25] *See e.g., Statutory Issue Paper No. 55 Unpaid Claims, Losses and Loss Adjustment Expenses* (National Association of Insurance Commissioners) (June 1998).

[26] Contingency fees have averaged about 33 percent since 1986. *See* Lester Brickman, *The Market for Contingent Fee Financed Tort Litigation: Is it Price Competitive?* 65, Cardozo L. Rev. 25 (2003); Eric Helland et al., *Contingent Fee Litigation in New York City* 1971, Vand. L. Rev. 20 (2017).

[27] *See* James S. Kakalik and Nicholas Michael Pace, *Costs and Compensation Paid in Tort Litigation* 37 (RAND Institute for Civil Justice) (1986). This study provides a comparison of the costs of prosecuting and defending a wide range of claims in the tort system. While this study is somewhat dated, loss adjustment expense ratios and contingency fee rates have been stable since 1986. Accordingly, we assume that the average cost of bringing claims relative to defending claims in 2020 is similar to what it was in 1986.

[28] Although state and federal governments enjoy sovereign immunity, the Federal Tort Claims Act and similar state laws allow lawsuits against them but with damage limits or higher evidentiary burdens than tort claims against private parties. These sources of liability, at least for states and municipalities, can be insured. We include government tort liabilities in our estimates and definition of the tort system to the extent they are commercially insurable.

[29] In some states, certain intentional torts and punitive damages are not insurable because shifting responsibility away from an individual for his or her own bad acts would create moral hazard (an incentive to act badly). Whether torts were committed deliberately is often in question, so insurance will often respond to a wider range of claimed torts because doing so does not involve admitting or denying wrongdoing. Furthermore, claimants typically include a negligence theory to ensure coverage, thus allowing them to draw on insurance resources. For example, a deliberate fraud allegedly committed by an employee may be restated as a failure to supervise.

[30] We note that although insurance coverage is not generally available for intentional torts, "there are an array of intentional torts for which insurance coverage is expressly provided under liability policies. For example, insurance coverage is available for defamation, disparagement, trademark infringement, misappropriation of style of doing business, unfair competition, infringement of copyright, title or slogan, false imprisonment, employment discrimination, wrongful termination, wrongful eviction, malicious prosecution, and invasion of privacy." See Christopher French, *Debunking the Myth that Insurance Coverage Is Not Available or Allowed for Intentional Torts or Damages*, 8 Hastings Bus. L.J. 65 (2012).

[31] Common law torts include: (1) intentional torts, such as assault, battery, trespass, conversion, and defamation; (2) negligent torts involving the violation of a duty of care; and (3) strict/product liability torts. *Tort*. Wex, Legal Information Institute. https://www.law.cornell.edu/wex/tort.

[32] 42 USC § 14505(1) and 42 USC § 247d-6d(e)(8). *Also see* Justia, *Non-Economic Damages in Personal Injury Cases.* https://www.justia.com/injury/negligence-theory/non-economic-damages/.

[33] Other sources of potential tort liability include slander and defamation.

[34] Bodily injury and property damage are the principal coverages in industry standard general liability policies. *Commercial general liability insurance*. Insurance Information Institute. https://www.iii.org/article/commercial-general-liability-insurance.

[35] Today, commercial general liability (CGL) policies contain a broad pollution exclusion that provides very little coverage for injury, remediation, or cleanup from pollutants. The clause excludes claims for "'bodily injury' or 'property damage' arising out of the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of 'pollutants.'" Examples of "pollutants" include asbestos, benzene, chemical

fumes, DDT, gasoline, heating oil, insecticide, lead paint, and TCE.

36 The impact of the asbestos exclusion can be assessed by considering the size of the aggregate loss payments on insured legacy (1985 and prior) asbestos exposures. In the United States in 2016, insured asbestos losses were $3.2 billion according to AM Best. Uninsured post-1985 exposures are excluded from this estimate but would be expected to be less costly than the claims arising from 1985 and prior exposures, which pre-dated occupational controls and the discontinuation of the use of asbestos. Relative to the estimated aggregate size of the tort system, this source of current liabilities is small. *See Asbestos Claims Payments Show No Sign of Slowing Down Despite Drop in Incurred Losses*, Best's Special Report (Nov. 2017).

37 Antitrust liabilities that arise in mergers and acquisitions are first party costs and would not be included in our insurance estimates based on third party liability coverage. Exclusion from coverage of intentional acts would also eliminate liability protection from proven actions of collusion.

38 Related private litigation, including class actions, can be brought to recover compensation for bodily injury and property value diminution associated with alleged violations of environmental laws. These costs are included in our tort cost estimates to the extent they are insurable under specialty environmental liability lines.

39 While there are differences across states and products, insurance markets are quite competitive by traditional measures and returns are lower than those of other industries. *See National Association of Insurance Commissioners, 2016 Competition Database Report* (2017), https://www.naic.org/prod_serv/ CLR-OPS-17.pdf; *see also Report on Profitability by Line by State in 2016* (National Association of Insurance Commissioners) (2017), https://www. naic.org/prod_serv/PBL-PB-17.pdf.

40 *See* Richard MacMinn and James Garven, *On the Demand for Corporate Insurance: Creating Value, Handbook of Insurance,* at 487-516 (July 2013).

41 *See e.g.,* "Statistical Compilation of Annual Statement Information for Property/Casualty Insurance Companies in 2019," National Association of Insurance Commissioners, 2020.

42 We note that one study of closed claims alleging medical malpractice found that in a large percentage of lawsuits filed, medical errors were not responsible for the claimed injuries. *See* David M. Studdert et al., *Claims, errors, and compensation payments in medical malpractice litigation 2024-2033*, 19 New England Journal of Medicine 345 (2006).

43 While premiums for annual policies are often paid in advance, those premiums are "earned" throughout the policy term.

44 We refer to uninsured exposures and exposures not covered by formal risk management programs as self-insured.

45 Eric Nordman et al., *Medical malpractice insurance report: A study of market conditions and potential solutions to the recent crisis*, Kansas City, MO: National Association of Insurance Commissioners (2004).

46 The liability portion can be broken out based on disclosures made in statutory filings.

47 Eric Nordman et al., *Medical malpractice insurance report: A study of market conditions and potential solutions to the recent crisis*, Kansas City, MO: National Association of Insurance Commissioners (2004).

48 There are over 30 different lines of liability insurance, including a number of specialty lines that MarketStance does not separately model.

49 Because of the mandatory coverage and inclusion of uninsured losses, we assume auto insurance premiums reported by NAIC represent 100 percent of personal automobile liability. In fact, uninsured motorists' coverage is not mandatory in most states, leaving some level of uninsured costs. Our estimate of tort costs will be understated as a result.

50 *Auto Insurance Database Report 2014/2015*, National Association of Insurance Commissioners (Dec. 2017), https://www.naic. org/prod_serv/AUT-PB-14.pdf.

51 The RIMS survey is focused on large and mid-market firms. We rely on the survey published for 2016.

52 *See* James S. Kakalik and Nicholas Michael Pace, *Costs and Compensation Paid in Tort Litigation* 37 (RAND Institute for Civil Justice) (1986).

53 In the prior study, we estimated the medical liability costs based on rate filings and estimates of the number of hospital beds and doctors in each state. We now source these estimates directly from MarketStance, which incorporates additional information on rate filings and data from the Economic Census in its estimates.

54 We have updated the analysis of commercial liabilities to use loss and loss adjustment expense ratios directly from NAIC, rather than computing them from company-level data sourced from SNL Financial.

55 We have updated our analysis of the MarketStance data for non-employee businesses. In the prior study, we had included premium estimates for non-employee businesses, but have since learned that those costs were separately included in the MarketStance data, which resulted in an over-estimate of the costs. We have updated this analysis of non-employee businesses to reflect the data more accurately.

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