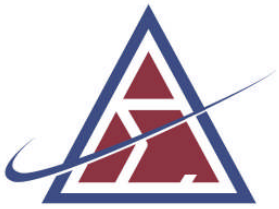

Institute of Actuaries of Australia

Fault versus No Fault
- Reviewing the International Evidence

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Introduction

Systems for meeting the cost of personal injury vary significantly around the world. This paper examines the costs, coverage and outcomes associated with different structures used to meet the cost of personal injury, comparing 'fault', 'no fault' and blended systems and, in particular, the insurance and compensation schemes which underpin them. At its heart, the issue of 'fault' versus 'no fault' is one of coverage. Those who can prove fault in a traditional tort system are covered; those who cannot are not covered and will need to fall back to their own resources and social welfare for support.

There are many arguments for and against fault-based systems; we summarise the key arguments below. Proponents of fault-based systems argue that those able to prove fault obtain fair compensation for their injuries and that tort acts as a deterrent to help reduce the risk of injury. No fault proponents argue that tort-law-based systems combine high cost with uncertain, inappropriate benefits, and that those who truly profit from it are the lawyers representing injured clients. The need to demonstrate fault (or liability) would also absorb resources that may be better used elsewhere and lead to inefficiency in the system.

Table 1 Arguments for and against Fault and No fault[1]

Arguments for fault-based systems (and against no fault)	Arguments for no fault system (and against fault-based)
Is inherently fair, as works on the premise that someone who injures another is responsible. Has flexibility to deal with different cases, whereas no fault schemes cannot provide true justice, as they are too formulaic and broad-brush. Can adapt to societal changes e.g.: New heads of damage Gives the genuinely aggrieved their day in court. Most matters don't actually go to court, but structure of court decisions and precedents is regular enough to allow informed settlements – surprises are rare. Does not necessarily lead to scheme cost blow-outs, if managed appropriately. Behavioural incentive to avoid injuries in the first place or to settle claims (the fear factor). Easier to avoid tricky entitlement issues, and lots of people on defined benefits who don't really need them might settle for a significantly lesser amount.	More transparent and more predictable Outcome in court is reliant on the quality of representation, not necessarily the merits of the case. Tort law can over or under compensate victims, therefore no fault is more likely to lead to a 'fairer' allocation of scarce resources. No fault schemes have had more stable costs, whereas common law access has been the cause of cost blow outs in many blended schemes. Tort reform has been needed to manage fault-scheme costs, but has been unsuccessful in the long term. There can be long delays between injury and settlement under a tort system. Tort system is expensive and inefficient The adversarial process creates a climate of hostility rather than focussing on rehabilitation of the injured, which can lead to poorer claimant outcomes. Systematic fines (e.g.; for OH&S breaches) are more effective than the threat of court action. As companies are typically fully insured, they often do not fully feel the impact of Tort systems anyway. Very definition of 'accident' suggests there may be little constructive scope for tort behavioural incentive. It may be too difficult to prove fault/negligence. There is a lack of coverage if there is no third party. It is easier for a no fault system to shift resources and focus onto rehabilitation and return to work.

In this paper, we review the international evidence in relation to the fault versus no fault debate. We focus on evidence in relation to injuries which in Australia are generally covered by motor injury

insurances, medical indemnity and where possible, public and products liability. Where necessary, we draw upon evidence from the workers' compensation sector, noting that outside the UK's Employers' Liability system, we are not aware of any other pure fault-based workers' compensation schemes.

The paper considers evidence from the US, where fault-based insurances dominate, although becoming more common are blended schemes offering a low level of 'no fault' benefits with restricted access to courts. In contrast, many European schemes have been able to offer both 'no fault' benefits and unrestricted access to the courts. Schemes such as Sweden's no fault patient insurance scheme for medical injuries, as well as Netherlands' and Switzerland's more comprehensive schemes covering any injury to workers are interesting cases. Experience from Canada as well as New Zealand's Accident Compensation Corporation is considered and compared, where possible, to Australian experience.

Political opinion around the world has shifted with fault and no fault schemes falling in and out of favour. We do not attempt to trace the historical development of the different scheme types – this is dealt with well in other papers.[2] Rather, we focus on the evidence available on the pros and cons of various scheme types and their features.

Meeting the Cost of Personal Injury around the world

The way in which countries meet the cost of injuries and sickness varies broadly by country. Table 2 provides a broad summary of the coverage most commonly available in selected countries. These personal injury compensation systems form part of broader systems in place in developed societies, including social welfare systems. The development and operation of both the personal injury compensation and broader systems are typically the result of numerous factors, including culture, population changes and other societal trends.

The following comments can be made about Table 2 below:

- Coverage for injured workers (including cover for occupational disease) is provided on a no fault basis in all countries except UK.
- Road and transport injuries typically have coverage via fault-based third party liability schemes.
- Injuries arising as a result of medical treatment (which we refer to in this paper as 'Treatment Injuries') typically have coverage via tort liability.
- Other injuries, (e.g. those caused during sport and recreational activities, in the home or in other public places) generally do not have any specific coverage. Coverage may be available via tort liability, or social welfare/public health, depending on circumstances.
- Sickness is almost universally covered by social welfare/public health and/or private insurance.
- New Zealand ACC's universal no fault coverage of injury contrasts the coverage provided in other countries.

Table 2 Coverage of injuries and sickness - comparison by country[3]

Country	Workplace Injuries	Road and Transport Injuries	Treatment Injuries	Other Injuries	Sickness & congenital disability
Australia	Predominantly no fault workers' compensation	Mix of mandatory fault and no fault schemes‡	Tort liability (with mandatory medical indemnity cover)	Mix of tort liability, (with liability insurance cover), social welfare, public health system or own resources	Social welfare, public health system and/or private insurance
New Zealand	No fault compensation	No fault compensation	No fault compensation	No fault compensation	Social welfare, public health system and/or private insurance
United States of America	Predominantly no fault workers' compensation	Mix of fault and no fault schemes	Tort liability (with mandatory medical indemnity cover)	Mix of tort liability, (with liability insurance cover), social welfare, public health system or own resources	Social welfare, public health system(partial) and/or private insurance
Canada	Predominantly no fault workers' compensation	Mix of fault and no fault schemes	Tort liability (with mandatory medical indemnity cover)	Mix of tort liability, (with liability insurance cover), social welfare, public health system or own resources	Social welfare, public health system and/or private insurance
European countries	Predominantly no fault workers' compensation (often linked to social welfare). UK: fault-based Employers' Liability	Third party liability schemes	Tort liability (with mandatory medical indemnity cover)‡‡	Mix of tort liability, (with liability insurance cover), social welfare, public health system or own resources ‡‡‡	Social welfare, public health system and/or private insurance‡‡‡‡

‡Three states and one Territory (Victoria, Tasmania, Northern Territory and NSW (serious injury only) have no fault schemes.

‡‡No fault compensation available in some countries (e.g. Sweden, the UK).

‡‡‡ Schemes in some countries (eg Switzerland) provide cover for employees injured outside of work.

‡‡‡‡ Special sickness benefits are available for employees in the Netherlands.

Key

No fault scheme
Tort Liability/Third Party Liability Scheme
Mix of fault and no fault schemes
Mix of Tort Liability, Social Welfare, Public Health or no cover available.
Social Welfare, Public Health and/or Private Insurance

Within countries too, there can be great variety in the way in which personal injuries are met. Table 3 below shows the example of motor injury (CTP) schemes in Australia.

Table 3 Comparison of motor injury schemes – Australia and New Zealand

	ACC	Vic	Tas	NT	NSW	Qld	SA	WA	ACT
No fault	✓	✓	✓	✓					
No fault for catastrophic injury	✓	✓	✓	✓	✓				
Common law access?	No	Access Limits	Yes	No	Yes - Benefit limits	Yes	Access limits	Access limits	Yes

Features of 'Fault' and 'No fault' schemes

The broad labels 'fault' and 'no fault' oversimplifies the situation, and fails to fully represent the full range of schemes and scheme features. There are a range of 'blended' schemes which take on some features of both 'fault' and 'no fault', providing some benefits on a 'no fault' basis and others only once fault has been proven. Fronsko (2001)[4] defines two types of 'blended' schemes:

Hybrid Schemes These schemes allow the claimant to receive both no fault and fault benefits. For example, the injured party can sue for particular damages over and above the basic no fault benefits provided by the scheme.

Choice Schemes The claimant can choose between no fault statutory benefits or common law benefits.

Most workers' compensation and many motor injury schemes in Australia are in fact blended schemes.

In addition to understanding these different scheme types, it is important to note that there are a number of more detailed issues that are defining features of personal injury compensation. Such features include:

- whether income replacement benefits are provided primarily in periodic streams or can be paid out in a lump sum settlement,
- whether benefits are purely financial and paid to the client, or whether treatment and rehabilitation services are provided and coordinated under a case management model,
- the extent of private sector participation and competition in underwriting and claims management.

While there is much variety across the different schemes, Table 4 considers the features which are typical to each scheme type. In comparing the performance of fault, no fault and blended schemes, it is often the underlying features of the scheme, rather than the overall 'fault' versus 'no fault' issue, which drives the difference in scheme outcomes. For example, whether or not benefits are payable in lump sum format or as periodic benefits can have a real impact on claimant outcomes, regardless of the type of scheme. Throughout this paper, we consider the relative impact of some of the scheme features typically associated with fault and no fault as a proxy for the performance of fault and no fault schemes.

Table 4 Typical features of 'fault and 'no fault' schemes

Design Approach	Fault	No Fault	Blended Systems	
			Option 1 'Choice' schemes	Option 2 'Hybrid' schemes
Social Attitudes	Accidents are result of careless or inappropriate behaviour, the careful do not have to pay	Risk inherent to life Compensation based on need rather than who is to blame	Strike a balance between fault and no fault philosophies. Balance varies by scheme.	
Delivery System	Predominantly Private insurance	Many state monopoly schemes, particularly in Australia & NZ. Some private insurance.	Many state monopoly schemes, particularly in Australia & NZ. Some private insurance.	
Examples	All public liability Most medical malpractice/ liability UK Employers Liability (workers) Most European auto NSW, SA, WA, ACT & QLD Auto	Most US workers Canadian workers NZ ACC Finland workers Quebec auto Sweden auto NT auto	Some US auto	Vic and NSW workers VIC & TAS auto Canada auto Some European auto schemes Most USA auto
Delivery Regulation	Courts & legal system	Often intensive regulatory oversight of no fault system	Intensive regulatory oversight of no fault system, coupled with Courts & legal system for fault-based component	
Determination of Eligibility	Courts & legal system; adversarial process	Scheme rules	Scheme rules determine eligibility for no fault benefits.	
Determination of Scheme Benefits	Courts or negotiated settlement: adversarial process	Scheme rules	Both courts and scheme rules	
Benefit Mechanism	Lump sum awards & settlements	Significant minority of schemes (e.g. Australian schemes) offer periodic benefits; lump sum dominated in the US.	Lump sum for fault-based benefits, mixed for no fault benefits.	
Financial benefits or case managed model	Financial benefits only	Some offer comprehensive case management in addition to financial benefits	Some schemes offer comprehensive case management, but fault-based benefits significantly financial.	

Evaluation Dimensions

In order to compare scheme experience, we have developed a range of evaluation dimensions against which the different scheme types have been assessed. These evaluation dimensions are summarised in Table 5 below.

Table 5 Evaluation Dimensions

Dimension	Definition
A	Proportion of Injured parties receiving benefits
B	Proportion of scheme cost going to claimant
C	Benefit levels / replacement rates (include Equity discussion)
D	Other Claimant outcomes
E	Equity: Spread of scheme cost relative to risk / cause of injury
F	Prevention impact: Does the scheme help reduce the incidence of injury?
G	Total Scheme Cost, as measured by 'true' premium rates

Contents of this paper

This paper is divided into sections which discuss each of the evaluation questions, setting out the international evidence in relation to a range of personal injury schemes around the world. It comprises the following sections:

- *Introduction*
- *Dimension A: Proportion of Injured Parties receiving benefits*
- *Dimension B: Proportion of Scheme Cost which goes to injured claimants*
- *Dimension C: Benefit Levels*
- *Dimension D: Other Claimant Outcomes*
- *Dimension E: Equity of spread of cost*
- *Dimension F: Prevention Incentive*
- *Dimension G: Scheme Cost*
- *Compensation Schemes in Context*
- *Conclusion*

Dimension A: Injured Persons receiving benefits.

Introduction

The first evaluation dimension we consider is the proportion of those who suffer a personal injury who receive direct compensation for their injuries. It is a feature of fault-based schemes that only those who can prove fault may receive compensation; however, evidence indicates that the burden of proving fault can make gaining access to compensation more difficult and time-consuming.

Evidence from Motor Injury Schemes

Table 6 summarises evidence from a number of Motor Injury Schemes. The two 'no fault' schemes in the table, New Zealand's Accident Compensation Corporation and Victoria's Transport Accident Commission, provide benefits to a significantly higher proportion of claimants than their counterparts in the US, Canada and New South Wales. Even though Victoria has a no fault scheme, it has a medical excess which excludes some smaller claims, and hence the proportion of injured persons who receive benefits is lower than the ACC. NSW is a fault-based system, Canada is a mixture of fault, no fault and blended systems and the United States is predominately blended systems. Further, the US has a fairly large proportion of uninsured drivers, resulting in a much low proportion of claimants receiving benefits.

Table 6 Proportion of Road Traffic Injuries leading to compensation

Schemes	Proportion of motor injuries who receive insurance benefits
ACC NZ (includes both entitlement and non entitlement claims)	88%
Victoria TAC	78%
Canada ‡	50%
United States‡	40 to 50%
NSW	40%

‡ From Dewees et al (1996)

Evidence from Medical Injury schemes

No fault compensation for treatment injuries is unusual. Most countries still have benefits based on the tort law system, although in many countries, specific legislation has been enacted to institute reforms and restrictions on the benefits for medical malpractice claims. Treatment injury systems around the world can be categorised into the following subcategories:

Table 7 Treatment Injury schemes around the world

Sub-Category	Coverage	Examples
Tort Law	Negligence-based	Australia and Most US states
Limited No fault	Birth related neurological injuries	Florida, Virginia
	Vaccination injuries	Taiwan, Italy
Pure No fault	All medical injuries	NZ ACC, Sweden, Norway, Iceland, Finland and Denmark

No fault compensation schemes for birth related neurological injuries were introduced in Virginia in 1988 and in Florida in 1989. Most other states in the US have purely tort-based schemes. Both schemes are true no fault programmes, but have very narrow definitions of coverage, so that most birth-injured children are in ineligible. There are also no fault schemes in Taiwan and Italy for vaccination-related injuries. The Italian scheme also covers injuries related to blood transfusions. Only New Zealand and a few countries in Scandinavia have schemes that provide comprehensive no fault coverage of medical injury.

In respect of fault-based schemes, increasing evidence indicates that very few negligently injured patients – perhaps only 8% - obtain any compensation through the tort system and that potentially compensable injuries themselves represent only a fraction of all medical injuries.[5] In the US, coverage for medical injuries is predominantly fault-based. Studies in the US have shown that only 17% to 26% of medical injuries involve provider negligence and that only 6.25% to 16% of negligently injured patients obtain any compensation through the tort system.[6] This evidence has added to criticisms of tort-based systems and increased interest in no fault alternatives to compensating medical injuries.

However, there is no firm evidence that 'no fault' schemes perform differently. A recent study based on a sample of hospital records audited by medical experts, found that in New Zealand, perhaps only one ACC treatment injury claim is filed for every 30 that are eligible, similar to the experience of fault-based schemes.[7] However, much of this evidence was collected before legislative changes were introduced in 2005, to broaden the injuries covered through the treatment injury scheme. Previously injuries were only covered only if there was fault (medical error) and if the injury was rare or severe. In July 2005, the requirement to prove fault was removed, and all injuries that are not an ordinary consequence of treatment, regardless of fault, are covered. ACC estimated this additional coverage would cost an additional $9 million a year[8], implying a significantly increased claim rate.

The authors put forward a number of possible reasons for this low claim rate. For example, many injured parties may be unaware that they have suffered an adverse event and are entitled to compensation.[9] Perhaps the main explanation is that those suffering treatment injury receive any needed additional treatment and care in the health system without filing a claim, and (just as in the broader ACC scheme) treatment services are the only requirement of the vast majority of injury victims. Bismark, Dauer, Paterson and Studdert[10] have further described the alternative avenues available for treatment injury victims who are not so much interested in receiving other injury benefits, but who wish to pursue other forms of redress, such as apologies or assurances of administrative action in light of adverse events.

Evidence from Work Injury Schemes

Evidence from work injury schemes is somewhat out-of-date, but consistent. A number of early studies in the US indicated that, prior to the introduction of modified tort and no fault workers'

compensation schemes, perhaps only 6% to 30% of industrial accident victims received compensation of any form from the employer, while only half of the families of victims of fatal accidents eventually received payment.[11]

Discussion

Unsurprisingly, ‘no fault’ schemes cover a significantly higher portion of injuries than fault-based schemes. This is true for most types of injuries, except for medical injury schemes where there is evidence that few injured claimants receive benefits under either scheme types, perhaps because treatment to remedy the injury is often provided free-of-charge to the injured party. Later in this report, we compare scheme coverage under New Zealand’s comprehensive no fault ACC scheme to that available for all accident-related injuries under typical mixed OECD systems, and estimate that just 30% of those currently receiving compensation under the ACC would be covered.

Dimension B: Proportion of Scheme Cost which goes to Claimant Benefits.

Introduction

This dimension can be considered a measure of efficiency – the higher the proportion of scheme costs which goes directly to meeting the injured claimants' benefits, the more efficient the scheme. We have defined 'claimant benefits' to include income replacement benefits, non-economic loss payments and reimbursements of treatment, medical and rehabilitation expenses. We have specifically excluded expenditure on administration, legal costs and any insurer profit margins from claimant benefits.

The key driver of differences in the claimant's portion often comes down to the issue of legal costs and, as a result, we discuss legal costs extensively in this section. In fault schemes, evidence indicates that administrative and legal costs under the tort system are substantial. Empirical research undertaken over the past 30 years on all forms of personal injury liability suggests that legal costs and claims administration expenses make up as much as 40% of the total costs of compensating a claimant.[12]

Evidence from work injury schemes

While there are no 'pure fault' workers compensation schemes, there are many schemes where there is significant access to common law benefits and the evidence indicates that it is this access to common law entitlements, rather than the initial 'fault' versus 'no fault' decision which is a key driver of legal and disputation costs. In the US, a lower portion of scheme costs goes directly to claimants' benefits in schemes with common law access. One US paper estimated that 50% to 60% of premium goes to administration and legal costs in tort systems.[13] In contrast, just 10% of every dollar goes to administration in the no fault system in Ontario, Canada, and around 11% to 12% of premium goes to operating and legal costs in the ACC's no fault scheme.

Studies on 'blended' compensation schemes show that legal costs are around 60% - 93% higher when lump sum compensation is sought through common law avenues, compared to similar claims handled via statutory and commutation settlements.

In its review of 4,493 closed common law claims that received a statutory lump sum payment greater than $5,000 from NSW WorkCover, PwC Australia[14] found that the average legal costs to the defendant (insurer) involved in a common law lump sum payment was $23,108. This compares to average legal costs incurred by *both* the claimant and defendant in an average statutory non-economic loss lump sum payment of $11,960. We note however that the average size of the common law lump sum was significantly higher than the statutory non-economic loss lump sum, so considered relative to the size of the award, the difference is less stark.

Similarly, the Australian Productivity Commission[15] found that legal costs declined in schemes that had imposed greater restrictions on common law access to compensation, such as specifying the amount claimants can recover in regulation. For example:

- Plaintiff legal costs in Queensland fell from an average $12,154 in 1998-99 to $1,792 by 2002/03.[16] The Productivity Commission attributed this reduction to the imposition of greater restrictions on common law access to compensation in 1996, limiting access to cost recovery prior to the commencement of a common law action and regulating the maximum amount that can be recovered through common law.

- The average legal costs of disputed decisions made under statutory law were found to be significantly less than those under common law. The average legal costs of a statutory dispute in 2001/02 through the Queensland system was $490, compared to $16,200 for common law claims, reflecting the additional cost associated with legal representation and court charges.

PwC[17] also found that legal costs as a proportion of total operating costs in various Australian workers' compensation jurisdictions *without* common law provisions were significantly lower compared to those jurisdictions that allowed *limited access* to common law (Table 8 below).

Table 8 Legal costs as a % of total costs for systems with varying access to common law

Workers' Compensation Jurisdiction	Legal costs as a proportion of total costs (%)	Access to common law
ACT	22	Blended
NSW	13	Blended
Tasmania	12	Blended
Queensland	10	Blended
Western Australia	7	Blended
Victoria	6	Blended
South Australia	4	No common law
Comcare (for federal employees)	2	Very limited common law access

Source: PwC Australia, Analysis of Trends in NSW Workers' compensation Common Law Claims, 2001

Further work by the Australian Workplace Relations Ministers' Council[18] concurred, indicating that legal costs as a proportion of total claim cost were higher in jurisdictions with greater common law access (NSW and ACT) and lower where there is no access to common law (SA, NT and Comcare). We note that in NSW, legal costs have dropped dramatically since the table above since the introduction of common law reforms which have restricted benefits and the reimbursement of legal fees.

It is important to note that cultural factors and the generosity of benefits can influence the uptake of common law entitlements where they are available. In the Netherlands, an integrated system of employee insurance, health insurance and social insurance provides comprehensive no fault incapacity coverage for all workers, including 24-hour injury and sickness. While it is possible to sue to obtain benefits over and above that provided by the scheme, (tort law overlay), consultation with Katherine Lippel of the University of Ottawa revealed that few people actually do, as their needs are generally met by the scheme. Another indicator of societal differences is that there is virtually no investigation of claims carried out in the Netherlands scheme, whereas New Zealand's ACC and other sources in Canada, for example, make use of private investigators. This many change in the Netherlands, with psychiatric injuries becoming a significant cost.

Evidence from motor injury schemes

Evidence from motor injury schemes is consistent. Table 9 below summarises key findings of Aaron Cutter's previous paper to the IAAust Accident Compensation Seminar in 2007.[19]

Table 9 Comparison of CTP schemes - Legal and Investigation payments as a proportion of total claim costs

Scheme	Type	Proportion of claims costs that goes to legal and investigations
NSW	Fault	15% to 20%
South Australia	Fault	Approx 15%
Queensland	Fault	Approx 15%
New Zealand ACC	No fault	negligible

In Australian motor injury schemes, around 15% to 20% of the overall cost of the scheme goes toward legal fees, compared to almost nil in New Zealand's ACC scheme.

In terms of administration costs, New Zealand has been able to maintain low administration and disputation costs also, at around 10% to 11%, so that 89% to 90% of scheme costs go toward claimant benefits. Victoria's Transport Accident Commission has restricted access to common law, with just those who are seriously injured qualifying. The proportion of claimants who follow this route is only around 9% (approximately 7% receive a settlement). Analysis based on information available from annual reports shows that total claims administration and legal costs for the Victorian TAC are around 15% of premiums, higher than New Zealand's ACC, but lower than other Australian states.

Evidence from medical injury schemes

In relation to fault-based schemes, estimates of the claimant's share of scheme costs varies, with many estimates at around 40% to 50% of total scheme costs, though some less optimistic calculations put the plaintiff's share of the medical malpractice insurance premium dollar between 18 cents and 28 cents.[20]

In contrast, Sweden's no fault Patient Insurance scheme provides access to common law only if negligence can be proven. Of the total compensation paid, 60% to 70% relates to pain and suffering, income loss and medical costs account for 15% of total payments. Only 0.1% of the cases went to court and approximately 18% went to overheads. Therefore including expenses, approximately 80% of the costs went to claimant benefits with minimal legal and investigation costs. In the ACC scheme, which has very limited access to common law, 88% to 89% of premium goes to claimant benefits.

There is also some evidence that common law access can lead to broader societal costs. Doctors can engage in enormous amounts of defensive medicine in the form of ordering tests and making records with a view towards creating defences in the event of a later malpractice suit. This can waste large amounts of taxpayer and insurance dollars annually. Two econometric studies found that there were statistically significant correlations between increases in malpractice premium levels and the frequency of specific diagnostic procedures.[21] A further study undertaken by Kessler (1999)[22] compared expenditure for ischemic heart disease and acute myocardial infarction (heart attack) in US states which had experienced reforms to their liability system – such as caps on awards or legal fees - and those which had not and showed that

> *"…patients from states without direct reforms experienced substantially greater growth in expenditures on their heart disease, without experiencing much greater rates of improvement in their health outcomes."*

Furthermore, apprehension about malpractice may lead to excessive documentation by health care providers. Although enhanced documentation to assist patient follow-up may lead to better quality

medical care, there are no studies to support the view that more documentation provides a benefit per se. On the contrary, while better record keeping is invaluable for risk management, documentation solely for the purpose of potential litigation increases medical costs without any benefits to patients.

Discussion

The portion of premiums going to claimants benefits is, unsurprisingly, significantly higher in ‘no fault’ schemes compared to fault-based schemes. The key driver of this difference is the extent of legal fees, although administrative fees appear to be higher in fault schemes too. The experience of blended schemes indicates that it is often the extent of access to common law benefits, rather than the overall issue of ‘fault’ and ‘no fault’ which is really the key driver of differences in scheme cost.

However, the story is not that simple - cultural factors can also play an important role. Some European schemes allow significant access to common law entitlements, but due to the generosity of no fault benefits as well cultural factors, uptake of common law is not common, and hence the schemes exhibit characteristics closer to no fault schemes. The implication is that scheme design must be cognisant of the cultural ‘norms’ in each country.

Dimension C: Benefit Levels

Introduction

Benefit levels vary considerably by scheme type, and there is no consistent rule that fault, no fault or blended systems will offer more or less generous benefits on average. However, there is evidence that benefits under fault-based systems can vary from one case to the next- proponents of tort-based systems argue this is because they have the flexibility to deal with different cases, whereas no fault schemes are too formulaic and broad-brush.

Variability of Benefit Entitlements

Pure tort systems are typically uncapped for benefits (damages), whereas defined benefit systems typically pay only a portion of pre-injury earnings (or other benefit base), with an overall cap. As a result, benefits under tort law arrangements can vary significantly from claim to claim, whereas no fault systems, which are more likely to be 'defined' statutory benefits, will have less variability.

A range of commentators have reported that benefits under tort law arrangements can vary significantly from claim to claim, and that this is the case even when the underlying characteristics of the claim are similar.[23] The importance of this issue becomes even more pronounced when one considers the differential coverage which typically accrues under tort liability systems. In particular, lower socio-economic and other disadvantaged groups typically have lower levels of effective cover and system access. Research from Australia suggests that uninsured and under-insured people are those in the lower socio-economic groups.[24] Vulnerable groups included single parents, ethnic minorities and the unemployed. Moreover, those individuals least likely to pursue compensation for injuries through the legal system are also those least able to afford to pursue the legal process; that is, lower income socio-economic groups and those with less ability to understand how to access legal compensation processes, such as certain minority groups where language barriers may exist.

There is a significant literature base which documents the tendency towards distributive injustice in tort liability awards and settlements, even amongst those who receive them. On average, under tort liability there is an unjust tendency to "flattening" awards, with the less seriously injured receiving too much on average, and the more seriously injured receiving not enough. In response, many Australian jurisdictions have needed to constantly adjust upwards the lower end of their general damages restrictions.

Nevertheless, we note that it is not just tort systems which have suffered from issues in determining appropriate benefit entitlements. Lump sum systems, even no fault systems, have suffered similar problems. For example, in US workers compensation, the most typical approach for calculating the Permanent Partial Disability (PPD) benefit is a 'schedule' approach. This involves converting a worker's injury to a percentage of total impairment. This is then looked up on a chart which shows the percentage for some injuries (e.g. 35% for a loss of leg below knee), which is then multiplied by the appropriate lost wage replacement figure (e.g. up to two-thirds) to determine what the pension should be. The key problem with this approach is that it does not recognise that injury affects different people in different industries in different ways, and leaves some people overcompensated and others under-compensated after two or three years.[25]. The key issue seems to be the lump sum nature of the benefit, and it's overly formulaic approach.

Discussion

Overall then, there is no evidence that, on average, benefit levels are either higher or lower in fault versus no fault systems. However, there is evidence that benefits can vary significantly from one

claimant to another in fault-based schemes, weak evidence that less serious injuries tend to be over-compensated while more serious injuries tend to be under-compensated and that lower socio-economic groups are likely to obtain poorer compensation outcomes than higher socio-economic groups. Additionally, it must be borne in mind that far fewer injured parties receive benefits in a fault-based system – for those who cannot prove fault, there is no compensation benefit at all. The availability of lump sum benefits (as compared to periodic benefits) is an important determinant of whether benefits will be adequate, regardless of whether the scheme is ‘fault’ or ‘no fault’.

Dimension D: Other Claimant Outcomes

Introduction

Most schemes do not measure claimant outcomes, so it is difficult to gather appropriate evidence for this dimension. As a result, we have drawn on evidence of claimant outcomes (such as return to work and health) predominantly from the work injury environment. We have also considered evidence on delay in receipt of benefits, which may be linked with claimant outcomes. The evidence indicates that two features often associated with 'fault' schemes – lump sum benefits and the adversarial environment of tort law – can lead to poorer claimant outcomes overall.

Delays and the 'adversarial' nature of common law

Under a tort system, claims are filed in a potentially adversarial environment that can promote the persistence of symptoms in claimants. In the course of proving that their pain is real, claimants may encounter conflicting medical opinions, unsuccessful therapies, and legal advice to document their suffering and disability. In the United States, excess use of medical services for traffic injuries (mostly strains and sprains) in response to incentives under a tort system is estimated to have accounted for about $4 billion of health care resources in 1993.[26]

In contrast, under the no fault system, there is reduced financial incentive to delay recovery, since claimants have immediate access to medical care and other benefits without being required to substantiate their injuries. In addition, research found that the involvement of a lawyer was associated with delayed claim closure. Studies in the United States have shown that motor injury claims in which a lawyer is involved take longer to close and cost more than those that do not involve a lawyer.[27] For workers compensation claims, US research shows that it takes about 15 to 20 months from initiation to completion of claims through the tort system, whereas uncontested claims in the workers' compensation system start flowing in about three weeks, and about four months for contested claims.[28]

An Australian Productivity Commission study (2004) examining common law access to Australian workers' compensation stated the following:

> *Of most concern to the Commission are the delays involved in reaching a settlement, which can be detrimental to the interests of the worker, and…can entrench the worker in behaviour that is incompatible with successful rehabilitation.*[29]

The report continues, stating that delays are inevitable and directly impact upon the financial position of the claimant, which can act as a disincentive for rehabilitation and return-to-work and add to the overall complexity of the process.

In addition to delaying rehabilitation and a healthy recovery, the NSW Legal Service Commissioner suggests that the delays and complexity of the compensation process under common law can further diminish a person's physical and mental health. The Commissioner states:

> *It is simply inhuman to expect a person to attain any sense of self worth or positive attitude when years can pass after an injury before any compensation becomes payable….We hear horror stories of the destruction caused to relationships, the physical and mental health of the injured and to the community generally by the huge delays involved in compensating people for their injuries.*[30]

Improving the timeliness of benefits is of particular value to lower income segments of the population who are particularly sensitive to even small losses of income.

The real cost of adversarial systems also resides in the long-term nature of their costs. In other words, 'winning' or 'losing' the claim does not resolve the health outcomes. The results of a survey of work-related injury claimants are compelling in this regard.[31]. Claimants compensated under litigated lump sum arrangements, compared to claimants under the same system at the same time compensated by periodic benefits, revealed that the risk of poor health outcomes was significantly greater for those compensated through litigated benefits. Moreover, the adverse health outcomes were enduring, evident up to 10 years post claim closure. The burden of these long-term health outcomes is likely to be significant in economic and social terms.

Lump sum versus periodic payments

The evidence indicates that whether the benefit is paid as a lump sum or as a periodic payment can have a dramatic impact on claimant outcomes. In the US, the UK and most jurisdictions in Australia, often workers' compensation benefits are provided in lump sum form, either as a result of a settlement with an insurer, claimants choosing to opt out of the statutory benefits to pursue tort law remedies, or choosing to commute their statutory periodic benefit to a lump sum. We summarise the key arguments in relation to lump sum versus periodic benefits below.

Table 10 Lump sum versus periodic benefits

Arguments for lump sums	Arguments for periodic benefits
Single payments should be cheaper administratively as they do not have ongoing assessment and admin costs. Provides individual with control over their future, which in itself has positive psychological impacts. Provides funder with greater certainty around cost. Clean break allows injured person to move on. Less risk of future benefit changes reducing benefits retrospectively.	More financial security over lifetime. Psychological benefit of peace of mind. More control from authorities on where the money goes. More equitable compared to similar lump sum cases. Less likely to fall back onto welfare. Protects from potentially adverse impacts of divorce and creditors. Easier to integrate periodic benefits with other social security benefits. Avoids family conflicts and other conflicts often associated with receipt of a lump sum: e.g. blow it all; risk of becoming crime target; demands placed by family and friends. People are generally more used to regular income and hence can manage this more effectively with less assistance. Lump sums are difficult for injured individuals to plan for their needs over their lifetimes. Even well managed payments will not last exactly for required period – since based on average lifetimes. Economic risks (inflation; poor investment returns; changing tax environment) are reduced.

A study by PwC for NSW WorkCover followed the outcomes for over 1,000 claimants receiving compensation under alternative compensation pathways – weekly benefits, common law and commutation lump sums. Common Law and Commutations claimants were found to have poorer health outcomes and worse return to work rates, than the Weekly Benefits claimants.[32] One of the major impacts of these common law opt-outs is to convert what would be a non-adversarial periodic payment-based scheme into an adversarial lump sum scheme, bringing with it the consequences of fault-based and lump sum benefits schemes.

The Association of Rehabilitation Providers in the Private Sector claims that people may delay rehabilitation and prolong time away from work, fearing that an early return may impact upon their final settlement.[33] The Insurance Council of Australia states:

> *As a result of the possibility of a (large) lump sum payment, common law can act as a fundamental disincentive to effective injury management and early return-to-work, which is, of course, the fundamental aim of workers' compensation.*[34]

Most research supports the PwC findings for NSW WorkCover that claimant outcomes are demonstrably worse in a lump sum environment. US research found that patients who received a lump sum payment based on a commutation of their future weekly benefits (compromise and release settlements) had worse outcomes than those on weekly benefits, especially in terms of return to work and financial outcomes.[35] Greenough and Fraser[36] found that the differences in time off from work and psychological disturbance between compensation patients and a control group were almost entirely attributed to the lump sum claimants in the sample. From interviews with the claimants, those patients who had claimed for lump sum compensation stated that they would not go through the claim procedure again because the process had been too stressful, too slow, it had caused too much family trauma, it appeared to reduce the treatment they were given, and they were unable to subsequently find a job.

Further research by the Australian Department of Human Services and Health suggested that the payment of compensation in a single lump sum does not always serve the interests of the claimant, and rarely lasts to meet all of the costs it was intended to cover.[37] A large majority of claimants become reliant on social security disability benefits as a source of income. One study reveals that over 90% of those who receive lump sums have spent the entire amount within 5 years.[38]

Furthermore, research shows that, while claimants are often satisfied with the lump sum they receive at the time of payment, claimant satisfaction reduces considerably as time since payment increases.[39] This decline is thought to be due to the claimants becoming gradually more aware of the reality of the long-term ill-effects of their injuries and their reduced capacity to work.

Evidence from Motor Injury Schemes

Furthermore, Cameron et al[40] found that changes to legislation within NSW, which included regulation to ensure earlier acceptance of compensation claims and earlier access to treatment for all types of injury, helped contribute to substantially improved health outcomes.

Fault-based systems are far more common in motor vehicle than in workers' compensation, and the experience of recent reforms to these schemes is helpful in considering claimant outcomes under both fault and no fault schemes.

Reforms to fault-based motor injury systems: examples

Saskatchewan (Canada)

In January 1995, a no fault insurance system was introduced in Saskatchewan (Canada) from a previous tort-based system. As a result there was a 28% reduction in the incidence of whiplash claims, and the median time to the closure of claims was reduced by more than 200 days. This decrease occurred despite increases in the number of vehicle-damage claims and the number of kilometres driven. Researchers also found that claims were closed faster under the no fault system than under the tort system, even though both the distribution and the severity of baseline symptoms were similar under the two systems. Not only did fewer persons file claims for whiplash injury under the no fault system, but also those who did recovered faster than similar claimants under the tort system.

The study concluded that the type of insurance system has a profound effect on the frequency and duration of whiplash claims, and that claimants recover faster if compensation for pain and suffering is not available.[41]

NSW (Australia)

Legislative change was introduced in 1999 to the fault-based, third party motor vehicle insurance scheme in NSW. Whiplash was the most prevalent injury in the scheme at that time. The change significantly

restricted tort benefits, by removing financial compensation for `pain and suffering' for minor injuries including most whiplash. At the same time, clinical practice guidelines for whiplash treatment were introduced and regulations were changed to permit earlier acceptance of compensation claims and earlier access to treatment, for all types of injury. PwC conducted a study in conjunction with the NSW Motor Accident Authority and the Rehabilitation Studies Unit to assess the health status of claimants two years after injury for a group of people pre and post the change. These superior outcomes were continued in a second group sustaining their injuries after the legislative change. Improvement was demonstrated in the degree of disability, physical functioning and pain, together with the percentage of people recovered. Importantly, the rate of injury claims remained unchanged, but the costs reduced. [42]

Discussion

Claimant outcomes tend to be driven predominantly by whether or not benefits are paid in lump sum or as a periodic benefit, the extent to which benefits are delayed and whether an adversarial process, such as tort law, is used to decide who is eligible for benefits and what these benefits should be. Fault-based schemes tend to be associated with lump sum benefits, adversarial processes and benefit delays and hence tend to exhibit poorer claimant outcomes than no fault schemes. However, evidence from the NSW motor injury scheme indicates that reforms can be introduced to predominantly fault-based schemes to help improve claimant outcomes.

Dimension E: Equity of spread of cost

Introduction

So far we have considered schemes largely from the perspective of the injured claimant. In this section, we consider the scheme from the perspective of the party who has caused the injury or who is paying the premium. It is often argued that fault-based systems are more 'fair' terms of equity of distribution of costs, because the burden of a compensation claim will fall to the partly who caused the injury in the first place. However, with most risks now being insured, it is more likely that the cost of compensation will be spread across a whole insured pool, rather than directly falling on the party who caused the injury. As a result, this link between 'cause' and 'burden of cost' is less clear.

What do we mean by an 'Equitable spread of costs'?

One possible answer to this question is that the cost burden of any injury should be met by the party who is at fault. But is this really equitable? To some extent this comes down to what we mean by 'fault'. If fault implies that the party causing the injury--be it an employer, a driver, a doctor--was negligent, and that their negligence caused the injury then many would agree that they should rightly bear the cost of this claim.

However, what if 'fault' was not quite so clear? What if an incident had extremely low probability, but very high cost – is it fair that the party 'at fault' pays the full cost of this, when it might be more 'bad luck' than 'bad risk' that caused the incident in the first place? And what of the case where a range of parties have contributed to the injury? Apportioning fault and allocating the cost of that fault can become a complex, time-consuming and costly exercise which often comes down to a matter of opinion, not fact.

We propose a definition of equity based on the traditional notion of actuarial fairness; that is, the cost of a scheme should be distributed according to the **risk** of injury. In this context, an appropriately designed insurance premium rating system can be just as successful as a fault-based common law system – some might argue more so – in allocating the cost of compensation in an equitable way.

The impact of Insurance Coverage

Many aspects of the insurance scheme design will impact the equitable allocation of costs of compensation schemes, and these elements can often be more important than the issue of 'fault' or 'no fault'. Key factors include:

Injury coverage – the broader the definition of 'injury' covered by the insurance scheme, then the more likely it is that the insurance scheme, rather than the tort system, which will be determining appropriate allocation of cost to any parties at fault. There is no clear-cut rule that 'fault', 'no fault' or 'blended' schemes will have particularly broader or narrower definitions of what injuries are covered.

Benefit coverage – the broader the range of benefits covered by the insurance scheme, then the more likely that the insurance scheme, rather than the tort system, will determine the allocation of costs. In terms of benefit coverage, again there is no clear-cut rule as to whether there is higher or lower coverage of claimant benefits in fault, no fault or blended systems. One exception to this is that many tort liability systems are uncapped, but often the insurance scheme supporting it offers capped benefits only, leaving a potential cost impact on the party at fault if the cost of compensation is high than the insurance cap. Fronsko (2001)[43] notes that in some states in the US, mandatory insurance cover is only required up to a specified minimum amount of cover. As a result, an at-fault

driver could be personally liable for damages above this amount, unless top-up insurance has been purchased.

Insurance coverage – the broader the group of parties who have insurance, then the more likely that the insurance scheme, rather than a tort system, will determine the allocation of costs. In terms of insurance coverage, probably the most defining issue is whether insurance is compulsory, and this varies considerably by injury cause, rather than whether the system is 'fault' or 'no fault'. Workers' compensation coverage tends to be compulsory, and this is often the case for motor injury schemes, although compliance tends to be lower. Other injuries can be covered by a mix of liability insurances, but in many instances these are not compulsory. Our observation is that no fault systems tend to have higher insurance coverage than fault-based systems, because insurance coverage is more likely to be mandatory.

Premium Rating System – the greater the power of the ratings variables used in any premium rating formulae, including experience rating, then the greater the ability of the scheme to allocate costs in an equitable manner. In terms of premium rating systems, again there is no strict rule to indicate that premium rating systems are any better or worse in fault, no fault or blended systems. However, whether an insurance system is mandatory appears to be important. Some mandatory insurance systems operate more like social insurance systems, where rating variables are restricted so that the overall impact is that there is significant cross-subsidisation, and the overall allocation of costs is less linked to the true underlying risk. Non-compulsory insurances are less likely to involve restrictions on premium rating variables.

Discussion

Overall it appears that whether a scheme is 'fault' or 'no fault' is probably **not** the most important factor in determining whether costs are allocated equitably. Whether an insurance system is mandatory is probably a more important driver of equity, as it impacts both the extent of insurance coverage and often the level of flexibility allowed in premium rating systems. Systems which are not mandatory probably lead to an allocation of costs closer to the underlying risk. On balance, fault-based and blended schemes probably have slightly more equitable allocation of costs than no fault schemes, because tort law awards are often uncapped, whereas the insurance systems supporting them can be capped, leaving a direct cost impact on the at fault party if a tort award is high.

Dimension F: Prevention Incentive

Introduction

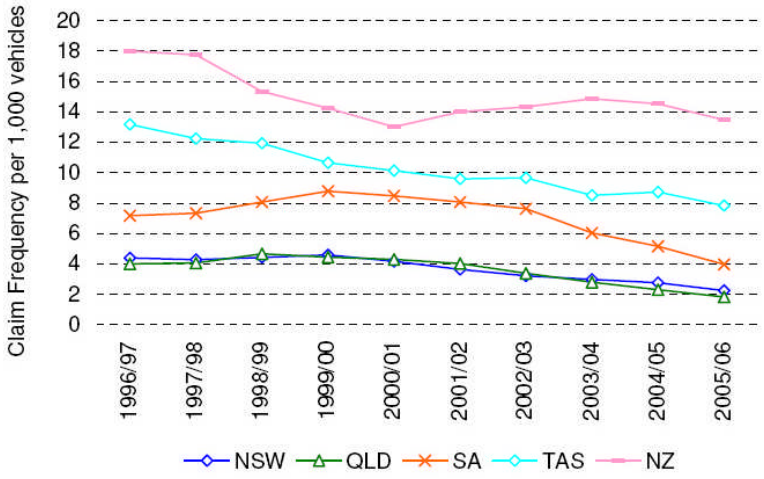
In the previous section, we noted that, depending on the structure of the insurance scheme, fault-based systems are argued to be more likely to allocate costs to the party at fault, which may act as a deterrent to injury. The threat of being sued, and the difficulty of dealing with a court case, may also act as a strong deterrent to minimise the risk of injury. In this section, we consider the evidence of injury incidence under fault, no fault and blended systems. A key challenge in considering this evidence is the difference between reported claim frequency and underlying claim frequency – propensity to claim can differ under fault and no fault schemes. In this section, we focus on evidence of actual underlying injury frequency as far as possible, rather than claim frequency.

Evidence from Motor Injury Schemes

The empirical evidence in relation to motor injury schemes is mixed and of variable methodological quality. Dewees et al., (1996)[44], for example, cites a number of empirical studies some of which report that no fault systems are associated with an increased risk in accident rates, injuries and fatalities, as well as a number of studies which do not support the hypothesis. Similarly, Sloane and Chepke (2007)[45] reported from their review of the literature that more recent studies have also yielded mixed results, both with respect to claims rates and with respect to injury rates.

Evidence from Australia and NZ has also been mixed. On first review, the claim frequency data shown in Figure 1 indicates that the two no fault schemes, New Zealand and Tasmania, are quite high compared to other jurisdictions, but this is misleading. New Zealand's ACC covers a much broader range of claims than the other schemes, including costs associated with one-off medical care only claims, which do not feature in other compensation schemes. Further, many other compensation schemes have 'excesses' below which the individual meets their own costs.

Figure 1 History of motor vehicle scheme claim frequency, Australia



Source: Aaron Cutter, Comparison across CTP schemes in Australasia, 2007

In many senses, this chart is a reflection of the broader coverage of the no fault schemes and the propensity to claim. Excluding medical-only claims from the ACC data, the claim frequency drops significantly to approximately two claims per 1,000 registered vehicles, which is very similar to NSW.

Fronsko (2001)[46] summarises evidence from Australia, which in fact indicated that over the period 1985 to 2000, Australia's no fault states (Victoria and Tasmania) have in fact achieved *lower* accident rates than their common law peer jurisdictions and notes that Victoria's road fatality rate was amongst the lowest in the western world during the 1990s with the Victorian road safety agencies being the focus of many international benchmarking exercises. Fronsko argues that this is probably because there are far stronger deterrence factors at play, including police enforcement activities, public attitudes to support safer driving (notably drink driving) and loss of a "no claim" bonus under insurance policies. Loughran (2001)[47] noted that the overriding reason for driving carefully is likely to be 'self-preservation'. Evidence around both the improvement in seat belt use and the reduction of drink driving in the US over the past decades suggests that it is enforcement, and not the level of financial penalty, that has been the biggest driver of change in these areas.[48] Other avenues, such as young/learner driver education[49] and public marketing campaigns, can also yield good results.

Even where there is evidence of a link between fault-based schemes and injury prevention, it is compounded by the impact of pricing effects. A study examining the effect on the rate of motor vehicle accidents in Québec looked at the first 12 months of data after introducing a no fault scheme. The number of accidents and fatalities increased over this time, but the researchers concluded that this was in part due to the adoption of a flat-rate premium structure that substantially reduced the cost of driving to high risk drivers.[50] The authors concluded that the insurance premium structure, rather than the issue of fault/no fault, is more important in managing accident rates, injuries and fatalities. A more recent and comprehensive review of the available research evidence (Sloan and Chepke 2008)[51] concluded that experience rating, which is rarely used in motor injury insurance, is likely to enhance road safety and suggested that the deterrent value of the tort system may be only marginally (if at all) better than a well designed no fault scheme.

Few studies have systematically considered the impact of tort vs. no fault in a truly multi-factorial fashion. Brown[52] in one New Zealand study specifically attempting to examine the traditional theory of tort deterrence, attempted to examine the contribution of a range of factors including exposure (kilometres driven), road safety legislative measures, and road safety compliance measures. Brown concluded: the removal of tort liability for personal injury in New Zealand did not produce an increase in motor accident and injury risk.

Evidence from Medical Indemnity Schemes

The evidence – and arguments – as to whether or not tort liability improves or worsens medical safety is also mixed. Proponents of tort argue that the financial impacts of tort provide a clear incentive to improve safety. Conversely, proponents of no fault argue that tort presents an incentive for cover-up of medical incidents, including hiding of crucial documents and conspiracies of silence. Tort law can also discourage safety improvements in the face of pending liability, as defendant's safety improvements are clearly admissible in many jurisdictions. Allowing physicians to come forward when an error occurs and join forces with their patients and the hospital system could improve the entire network of health care. Proponents of no fault systems argue that no fault encourages health care professionals to identify the system malfunction and take a proactive approach to fixing it, which would also decrease costs in the long run.[53]

However, there is no evidence that either tort based or no fault systems are better or worse overall.

> *…after thirty years of the ACC and nine years of independent complaint resolution, New Zealand hospitals appear no safer (or more dangerous) than those in other Western countries. The adverse-event rate of 12.9 percent stands midway between the levels recorded in two countries with shared medical traditions in training and practice: Australia (16.6 percent) and the United Kingdom (10.8 percent).*[54]

Discussion

Overall then, it appears that fault, no fault and blended systems may have similar performance in terms of preventing injuries. This is consistent with evidence from work injury schemes where, despite differences in claim rates, there is no evidence of a reduction in the incidence of work injuries or improvements in work safety arising from tort systems.[55] There is some weak evidence from motor injury schemes that the premium rating system, rather than 'fault' or 'no fault', can result in some prevention effect. More importantly, the evidence indicates that there are far more important drivers of safety improvements than the threat of tort.

Dimension G: Scheme Cost

Overview

The total cost of a scheme is affected by many factors, including coverage, design, compensation levels, social and economic factors as well as the co- existence of other forms of compensation such as other insurance coverage and the existence of a social welfare system. Nevertheless, some researchers have attempted to disaggregate the impact of scheme structure on total scheme cost. Proponents of no fault schemes argue that they can be cheaper as a result of significant savings in legal and administrative costs. Proponents of fault schemes argue that the fact that compensation is paid only where fault can be proved stops the scheme costs from 'blowing out' and restricts the costs to a smaller number of claims. We consider the evidence below.

Evidence from Motor Injury Schemes

The following graphs compare the premium rates for schemes in Australia with New Zealand, comparing the premium for a standard car in a metropolitan area.[56] Only the schemes in New Zealand, Victoria, Tasmania and NT are no fault, with the remainder of the states being fault-based.

Table 11 CTP Premiums for Motor Cars, Australia and NZ, July 2007

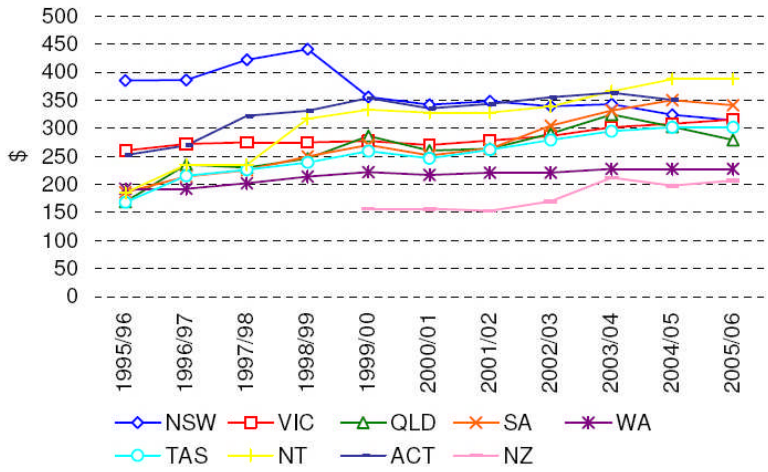
State	Scheme type	As at July 2007
Northern Territory	No fault	$426
Australian Capital Territory	Fault	$397
South Australia	Fault	$347
Victoria	Blended	$333
New South Wales	Fault	$317‡
Tasmania	Blended	$302
Queensland	Fault	$257‡
Western Australia	Fault	$214
NZ ACC	No fault	$100*

‡ For Queensland and New South Wales, lowest premium on offer amongst private insurers is shown.
* For ACC, includes licensing fee and petrol levy but excludes residual pre-99 funding.
Source: Insurance Council of Western Australia, ACC

New Zealand's ACC has the lowest premium overall. The premium shown for New Zealand includes both the petrol levy and licensing fee but excludes the allowance of $100 for the residual value for claims incurred prior to 1999. Even including this pre-99 funding, as has been done in

Figure 2 below, ACC's contribution level of $200 has still been below all the Australian jurisdictions for many years. The two no fault States in Australia, Victoria and Tasmania, have premiums which are broadly in line with the other Australian states.

Figure 2 History of motor vehicle scheme premium rates for standard vehicle in metropolitan area, $ Australia



Source: Aaron Cutter, Comparison across CTP schemes in Australasia, 2007

Fronsko[57] contains an excellent summary of the evidence in relation to Motor injury schemes. In summary:

- There have been mixed findings in US studies comparing the cost of fault and no fault schemes. The RAND Institute for Civil Justice found that no fault plans can reduce costs substantially compared to the traditional liability system, with most of the savings resulting from reduced compensation for non-economic loss.

- Canadian studies found that the transition from common law to no fault produced no lowering of insurance costs.

- Comparing NSW CTP insurance premiums to Victoria's for the 3 months to December 1999, Fronsko notes that a range of reasons are available to explain the higher premiums in NSW; the fact that NSW is a 'fault' State is only part of the story.

Evidence from Treatment Injury schemes

Studies in the US indicate that only 17% to 26% of medical injuries involve provider negligence and that only 6.25% to 16% of negligently injured patients obtain any compensation through the tort system. This suggests that a no fault system would be considerably more expensive than a tort system. However, it need not be as costly, mainly because the tort system tends to over-represent claimants with severe injuries and has higher administrative costs and lawyer fees. Furthermore, the system would socialise injury costs that are privately incurred.[58] This was supported by a 1997 study published in *Law & Contemporary Problems,* which suggests that a no fault system in the US is within economic reach. The study concluded that no fault could compensate two to three times more victims than the court system, while costing the same or less than what doctors and hospitals pay in malpractice premiums. The researchers came to this conclusion by hypothetically applying the Swedish avoidability test to Colorado and Utah patients injured by medical care in 1992. The no fault model was more effective at getting the compensation into the proverbial `right hands'.

Furthermore, if costs of a comprehensive no fault scheme are still considered too high, they can be made more affordable by introducing deductibles or co-insurance arrangements that effectively restrict eligibility to only the most severely injured patients. A Harvard study estimated that using a 6-month deductible, and only providing compensation for net economic losses, the total costs for a no fault comprehensive patient compensation plan for New York would have been around $900

million in 1984, which compared favourably to the $1 billion in malpractice premiums paid around that time.[59]

Finally a brief comparison of the cost of Sweden's no fault Patient Insurance scheme, with premiums of 0.16% of personal health care expenditures, indicates that no fault schemes can be affordable and compares well to medical malpractice insurance premiums in the US of 1% to 2% of total health care expenditures.[60]

Evidence from Workers' Compensation schemes

There is no evidence that fault, no fault or blended systems have maintained consistently higher or lower scheme costs than other. Nevertheless, one element of the evidence from workers' compensation schemes is important to consider. Australian evidence indicates that access to common law benefits, even where significantly limited in nature, has been one of the primary drivers of cost blow-outs in the schemes. In May 1998 Chris Latham and John Walsh from Coopers and Lybrand, (an antecedent of PwC) produced a report[61] for the Department of Labour New Zealand concerning the introduction of competition to the provision of ACC services. The purpose of the report was to provide advice on the premium and non-price impacts of competition on accident compensation schemes, and included a survey and benchmarking of a variety of Australian accident compensation schemes. The major conclusion was that:

> *Access to lump sums has been the single most significant reason for past deterioration in claims costs in Australian schemes…*

Discussion

There is no clear evidence that fault, no fault or blended schemes are, overall, more expensive than the other scheme types. However, what is clear is that, where schemes allow common law access, tight controls need to be maintained on access to common law and the quantum of benefits and legal expenditure to ensure that scheme costs remain in check.

Compensation schemes in context

Introduction

Throughout our evaluation discussion, we have consider only those benefits actually paid through designated personal injury schemes. However, all compensation schemes need to be considered in the broader context of the range of benefits, particularly social security and social insurance benefits, outside designated compensation schemes. Many who suffer an injury will be covered by these benefits, regardless of fault – including health costs (for example, free accident and emergency health treatment is a common feature of many countries), some financial benefits (for example via a social welfare safety net to provide basic income benefits on disability or sickness.)

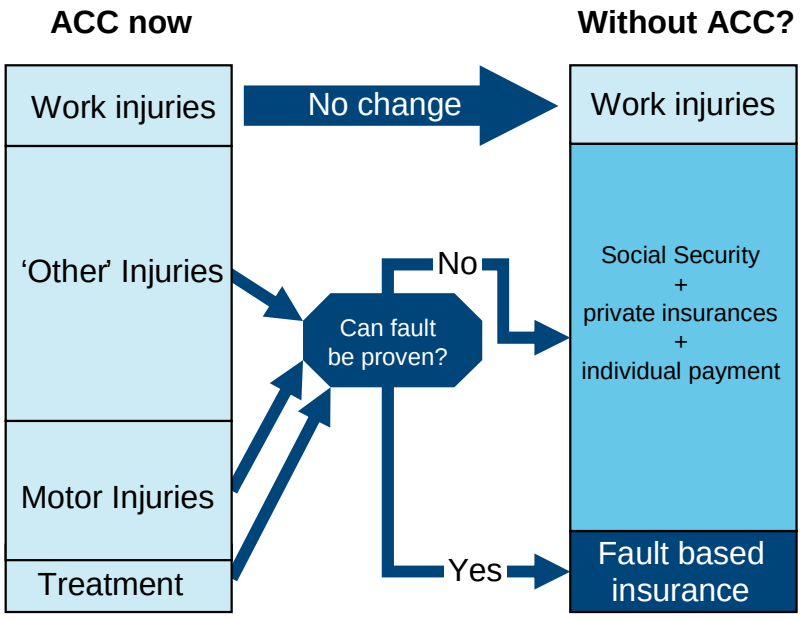
In this section of the paper, we summarise research which was undertaken as part of the review of the New Zealand ACC scheme[62], which attempted to compare the overall cost and outcomes of the ACC scheme with the societal cost and outcomes of an alternative 'No-ACC' scenario. The 'No-ACC' scenario was quite similar to that which we see in many OECD countries, namely:

- a mandatory scheme for work injuries, offering benefits not dissimilar in nature to those offered by ACC,
- a range of fault-based insurances. This would likely include a mandatory scheme for motor injuries along the lines of a fault-based lump sum scheme, similar to those in a number of Australian jurisdictions (probably with limited no fault benefits to a restricted number of claimants), as well as a mixture of mandatory and voluntary other private insurances, such as product liability, professional indemnity, medical malpractice and public liability, to meet the cost of various other injury claims where fault can be proven; and
- a social security and public health system, which is not unlike the present one, but which would be required to support a large proportion of people who have sustained an injury.

Figure 3 overleaf envisages where the current ACC claimants might have ended up under this alternative scenario.

Under the 'No ACC' scenario, it was assumed that all work injuries (around 15% of all injuries due to accident in New Zealand) would receive the same coverage as at present. It was estimated that a further 4% to 5% of all injuries would be able to prove fault and receive compensation under the various fault-based insurances. These would be predominantly motor injury cases, followed by treatment injuries, with a very small number of 'other' injuries, since many 'other' injuries do not involve third parties and where they do, often it is difficult to prove fault. The majority of claimants not covered by workers' compensation or unable to prove fault would be left to their own resources, personal insurance or a range of social welfare and public health schemes. Overall, this would represent about 70% of all claimants. Many of these claimants would fall back to social security and personal resources to meet the cost of their injury. Furthermore, there is considerable risk that many in this group will not be adequately compensated for their injuries and will end up relying on their own resources or social welfare systems to meet their needs. One study revealed that over 90% of those who receive lump sums have spent the entire amount within five years.[63]

Figure 3 Meeting compensation needs – with and without the ACC



Below we summarise some of the features of these other systems, in terms of the impact on the claimant.

Table 12 Summary of features of other systems compared to ACC

ACC		Alternative No-ACC Scenario		
		Worker's compensation	Fault-based compensation & insurance	Social welfare + Health system
Coverage	No fault	No fault	Fault	No fault, but rationed according to means
Benefit Type	Periodic	Periodic	Lump sum	Periodic
Return-to-work	Good	Good	Poor	Medium
Workforce Participation	High	High	Low	Medium
Rehabilitation	Full	Full	Limited	Limited
Treatment	Private	Private	Private	Public
Administration & legal costs	Low	Low	High	Low

Overall then, we would expect to see poorer claimant outcomes under the No ACC scenario – for example, the PwC report estimated that return to work might be significantly slower under a 'No-ACC' scenario. Converting this difference per worker (about three hours per worker per annum) to a proportion of GDP, the PwC report estimated that the impact on GDP of the extra hours gained was approximately $NZ315 million per annum. This gain was before any potential impact of increased productivity - in a study comparing the impact of tort liability reforms in the US, Kessler[9] notes that those states which instituted some tort reform between 1972 and 1990 experienced 1.7% greater aggregate productivity growth than states which did not.

This ‘gain’ needs to be compared to the differential cost of the ACC scheme, compared to the ‘No-ACC’ scenario, which PwC estimated to be NZ $190 million lower than the ACC scheme.

The conclusion of this analysis was that, considered in aggregate, the cost of a comprehensive no fault scheme compared to a mixed system to meet the cost of personal injury, might be similar, but that there were a broad range of economic and societal benefits to be realised from a no fault system.

Conclusion

In this paper, we have considered seven different evaluation dimensions to compare fault, no fault and blended schemes, and we summarise the findings below:

1. 'No fault' schemes cover a significantly higher portion of injuries than fault-based schemes. This is true for most types of injuries, except for medical injury schemes where there is evidence that few injured claimants receive benefits under either scheme type.

2. The portion of premiums going to claimants benefits is significantly higher in 'no fault' schemes compared to fault-based schemes. The key driver of this difference is the extent of legal fees, although administrative fees also appear to be higher in fault schemes. The experience of blended schemes indicates that it is often the extent of access to common law benefits, rather than the overall issue of 'fault' and 'no fault' which is really the key driver of differences in scheme cost. Cultural factors and the generosity of the underlying no fault benefits also impact the uptake of any common law entitlements.

3. There is no evidence that benefit levels are on average higher or lower in fault, no fault or blended systems. However, there is evidence that benefits can vary significantly from one claimant to another in fault-based schemes, that less serious injuries tend to be over-compensated while more serious injuries tend to be under-compensated, and that lower socio-economic groups are likely to obtain poorer compensation outcomes than higher socio-economic groups.

4. Fault-based schemes tend to be associated with lump sum benefits, adversarial processes and benefit delays and hence tend to exhibit poorer claimant outcomes than no fault schemes. However, evidence from the 'blended' schemes, such as NSW's motor injury scheme, indicates that reforms can be introduced to predominantly fault-based schemes to help improve claimant outcomes.

5. On balance, fault-based and blended schemes probably have slightly more equitable allocation of costs than no fault schemes, because the cost of any compensation payable over and above any insurance caps will often fall directly on the party at fault. Overall, however, whether an insurance scheme is mandatory is a more important driver than fault versus no fault.

6. Fault, no fault and blended systems may have similar performance in terms of preventing injuries. There is weak evidence that appropriate design of a premium rating system may help to reduce motor injuries.

7. There is no clear evidence that fault, no fault or blended schemes are, overall, more expensive than the other scheme types in aggregate, but we note that more people are compensated under no fault schemes, hence the per claimant cost is overall cheaper under no fault schemes. Where schemes allow common law access, tight controls need to be maintained on the common law system to ensure that scheme costs remain in check.

No fault schemes come out ahead on this evaluation, with a higher portion of claimants covered, a higher portion of scheme cost going to claimants, better claimant outcomes, a more equitable distribution of claimant outcomes and a similar level of scheme costs, average benefits and prevention effects. This needs to be weighed up against potentially less equitable allocation of scheme costs and the freedom of people to pursue tort law remedies in response to their injuries and grievances.

Of importance is the fact that in many cases, it is the underlying scheme features which drive these outcomes, rather than the simple issue of fault versus no fault. Periodic benefits, with appropriate access to case management of claims and rehabilitation, can achieve better claimant outcomes than similar lump sum schemes. Appropriately structured premium rating systems may help to achieve the desired

‘deterrent’ effect to reduce the incidence of injury and ensure an equitable allocation of costs to those parties with the highest risk. Adversarial processes can be kept to a minimum to help manage legal costs and improve claimant outcomes. Many recent reforms to Australian injury compensation schemes recognise this fact.

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