

Alternatives to the fault system, such as "no fault", their pros. and cons.

by

Professor S. Fredericq

After the second world war, proposals were made to abandon the concept of tort liability as the basis for indemnification. This trend started in 1932 in the United States (Plan of Columbia), it was put into effect in the Canadian State of Saskatchewan in 1946, and was put forward in a concrete manner in 1965 in the works of Keeton and O'Connell in the United States, in France in 1966, in a publication by Professor Tunc of Paris, and in New Zealand in the Woodhouse Plan.

Let us first examine these three projects, two of which have been already enforced ("no fault" in the USA; Accident Compensation Act of 1972, in New Zealand). These projects, formulated in the 1960s, stirred up an extensive, world-wide interest and were widely commented and in some instances imitated. Later, we shall see which other countries introduced the system of no fault, what advantages and disadvantages this system presents, and if possible, what were the practical consequences of its implementation.

A. The precursors of the system

1. Continental Europe : the Tunc project

The criticism formulated by Professor Tunc is principally based on the injustice of a system which indemnifies only a fraction of the number of victims (about half) while others, who suffer identical losses receive nothing. According to Professor Tunc - when driving - the "fault" is often unavoidable and is inherent in the human nature. Every driver, even the most prudent one every day makes a number of inadvertent inobservances which could result in an accident. Under these conditions it is unjust to deny some victims all compensation, while others receive it; the injustice is even greater where the family of the driver is made destitute even though it contributed in no way to the negligence. The motor risk has become a social risk and in principle all victims of this risk should be indemnified for the pecuniary losses they sustained, irrespective of whether they were at fault or not. The principle of tort should be abandoned and replaced by insurance; instead of a "third party liability", compensation for traffic accidents should be effected on the basis of "first party no fault insurance", thus all the victims would receive compensation (which would eliminate injustice), and the compensation would be paid by one's own insurer (which would eliminate at the same time the delays in claim settlement, and litigation between the victim and the insurer on the subject of responsibility). In order to keep insurance within reasonable operational costs upper ceilings would have to be established for the indemnities. He who is privileged to have high earnings will not be compensated on the basis of his income but on the basis of the level of the prevailing wage average. If he wishes to receive full compensation, he should take out a personal accident insurance. As regards the issue of the burden of indemnisation, each injured person in the car would be indemnified by the insurer of the car; pedestrians and cyclists

would always be indemnified - irrespective of their fault - by the insurer of the vehicle. As regards property damage, a deductible would be applied to the owner.

In the system advocated by Professor Tunc, the negligence no longer plays a role; the notion of responsibility is abolished and is replaced by insurance.

## 2. North America : "no fault" plans

In the United States, the issue of the cost of settlement of a claim and the procedural aspect of such settlement played a greater role than in Europe. It was observed that a large number of cases were brought to courts, with all the accompanying inconveniences. The expenses incurred for judicial process are extremely high, particularly as a result of the current contingency fee system, under which lawyers receive fees representing 30 to 50 per cent of the awards. Furthermore, since the social security schemes in the United States are less developed than those in Europe, a high proportion of the victims were left without any income after serious accidents, and yet they had to disburse high medical expenses.

Finally, experience showed that slight losses were over-paid, while those who sustained serious injuries received only a fraction of their damages.

The preliminary studies undertaken tended to give everyone a "basic indemnity". This explains the title of the work by Keeton and O'Connell: "Basic protection for the traffic victims".

In the United States, various systems of "no fault" were introduced, in about 20 States, between 1970 and 1975. Since then the system has not spread further. For economic losses only the minimum compensation is fixed per accident and prescribed by law (\$ 20,000 to \$ 50,000; unlimited in Hawaii), per person (\$ 10,000 to \$ 250,000), and for property damage (\$ 5,000 to \$ 10,000). This is therefore the "basic coverage". The "third party liability" remains in force for anything beyond these amounts. Thus, it is possible to accumulate the benefits from both the "no fault" insurance and from the "third party liability".

We should point out that in Canada, in Saskatchewan the "no fault" system is in use since 1946; the benefits of this system are deductible from the indemnities to be paid on the basis of the "third party liability"; in Quebec the "no fault" system was introduced in 1974.

## 3. New Zealand

In this country the Woodhouse Commission was appointed in 1967 to enquire into aspects of compensation for personal injury sustained by people in employment. It formulated various proposals which resulted in the passing of the Accident Compensation Act of 1972, and which provided a drastic reform of the Common Law system. Since 1st January 1974 a single system of indemnification is in effect for all victims suffering bodily injuries from any type

of accident, including traffic accidents, labour accidents, or those which happen in the private life. This was justified by the fact that the needs of all victims of accidents are the same, irrespective of the causes.

B. Introduction of the "no fault" system in other countries

Over the past few years, "no fault" systems were introduced into the legal systems concerning traffic accidents in four countries: Sweden, Algeria, Israel and Quebec.

(a) Sweden

The reform is in the context of a very developed system of social security, covering practically the whole population. Motor insurance is a complement of the social security. No distinction is made between the case of negligence or no negligence. The only exception is made in the case of driving under the influence of drink. Subrogation rights for the social security against motor insurer do not exist.

As regards property damage, the "third party" system still applies.

(b) Algeria and Israel

Amongst the countries which introduced "no fault" insurance there are two situated by the Mediterranean, i.e. where the majority of the population has only the minimum resources, as is the case in the major part of the third world. The two countries in question are Algeria and Israel. Although, neither of the countries can be considered as poor - Algeria has resources from petrol, and Israel is a special case - yet, the situation of these two countries seems closer to that of the developing countries than to that of Western Europe and North America.

The Algerian Enactment of 30th January 1974: maintains the "third party liability" for damage to property. As regards bodily injuries, a distinction is made between the driver and the other victims:

(a) The driver: if the rate of invalidity is less than 49 per cent his negligence is taken into account; above this percentage full indemnity is payable to him. In this case the concept of social protection prevails.

(b) Other victims: are indemnified, regardless of their fault.

Indemnities are calculated according to a scale and fixed in accordance with invalidity rates as well as the earnings of the victim.

The Israeli Law 5735-1975, which became effective on 5th September 1976: has a twofold effect: as regards bodily injury, everyone except the driver, is covered by the "third party liability" insurance of the driver; the latter, however, cannot invoke the fault of the victim unless it is deliberate. As for the driver himself, he must be covered by a personal accident insurance.

In the calculation of the compensation, the upper limit of indemnification does not go beyond three times the average wage of the active population of Israel. Any suit based on the common law for loss in excess of this amount is excluded.

Property damage continues to be subject to the principle of the third party liability.

(c) Quebec

A system based on "no fault" was introduced in the Province of Canada in 1978.

C. Plans for reform

In several countries there are plans to introduce the "no fault" system for bodily injuries only. We shall only refer to the "Pearsons Report", but there are others, as in Holland where a report was prepared by the Ministry of Justice.

In Great Britain a commission presided over by Lord Pearson was set up in 1977 to examine the matter. This decision was taken after the Thalidomide disaster, when it was realised that under the legal system in effect a serious risk existed that some victims would not be compensated. The task entrusted to the Pearson Commission (the Royal Commission on Civil Liability and Compensation for Personal Injury) was to consider reforms of the system of compensation for traffic accidents, and accidents caused by defective products (pharmaceutical products included), but other accidents occurring on the premises of private homes were not included.

The Pearsons report lays a great stress on the role of the social security. It recommends the payment of basic indemnities irrespective of where the fault lies; in serious cases periodic, index-linked payments could be made. As regards pain and suffering awards, these should not be recoverable unless the temporary invalidity exceeds a period of three months, so as to avoid high administration costs for trivial cases. The cost of compensating traffic victims should be financed through a social tax on petrol (one penny per gallon). In case of serious bodily injuries, as well as in case of property damage, victims should continue to exercise their right of action based on the "third party liability" ("tort"), which is covered by private insurance.

If therefore we analyse the successes of the "no fault" system, we reach the conclusion that with the exception of the United States, where the system of insurance based on "no fault" was introduced because of the special conditions prevailing in this country, where any further amounts going beyond the "no fault" level can be claimed under the "third party liability", the "no fault" system had only a limited success: it is applied only in a small number of countries in which the population or the economic strength are rather limited. Since 1975 it seems that the legislative trend came to a halt, although studies continue to be carried out in a number of countries.

Comparison of the advantages and disadvantages of the "third party liability" versus "first party no fault insurance" systems

Preliminary remark: A clear distinction should be made between the two forms of "no fault" which are totally different:

(a) In the first form, the system of the civil liability is abolished and

replaced by "no fault". If under this system only basic indemnities are provided, the victim has no right to sue the feason of the accident for the damages exceeding the benefits under "no fault": the "responsible" for the accident no longer exists. This is the situation, for example, in the Tunc system.

(b) In the second system, the two rules co-exist. The "no fault" offers the basic compensation which is ultimately deducted from what the victim is able to secure under the civil liability system, that is if the victim finds the responsible. This system is applied in the United States of America.

In this system, the "no fault" is only an insurance system which is superimposed on the principle of common law. Besides this insurance, "third party liability" insurance continues to exist to supplement the damages which are not indemnified under the "no fault".

It is the first system, called "pure no fault" that we shall compare with the "third party liability". In this comparison we shall assume that the drivers are covered by insurance and that such insurance is sufficient to indemnify the victims (unlimited insurance or an insurance with a large minimum sum insured). Insufficient cover, or complete absence of cover have the same results anyway under the two systems.

Third party liability

- only a proportion of the victims receive compensation
- those indemnified receive full indemnity
- the relations between the victim and the insured are antagonistic
- there is a risk of a law suit
- the insurer does not settle the claim until responsibility is established
- high administration cost
- this system has a preventive effect

First party "no fault" insurance

- all victims are indemnified
- but indemnisation is made subject to a ceiling
- in this case the protection of victims is assured in case of inflation
- this psychological obstacle is eliminated
- this risk does not exist
- the insurer pays the claim immediately, or at least makes an advance payment
- lower administration costs
- risk of fraud is higher
- this system may induce imprudence in drivers

Now I wish to make a brief comment on each of these points, since some of the criticisms levelled at the "no fault" system seem not to be sufficiently justified.

1. Advantages of "no fault"

The "no fault" system - in its two forms - provides a solution to the two fundamental criticisms of the systems based on "tort":

- (a) It gives everyone the right to be indemnified. This indemnisation can be either total, or cover only the basic needs. In any case the victims of accidents who are the most concerned, i.e. those killed or injured, and their near relatives, will receive compensation; this amount varies, since it is established according to the financial possibilities, but no one is left without compensation. As regards damage to property, it might be covered or not.
- (b) It does away with litigation and speeds up the settlement of claims. Since tort liability is not taken into account, the insurer of the vehicle settles the claims, and he can do so rapidly. Once the conditions required for compensation are met, payment becomes due. This modifies the psychological relations between the victim and the insurer, abolishes the hostility and the frustration. This procedure would obviously result in a reduction of costs, and render the "no fault" system less expensive.

2. Disadvantages

If the "no fault" system could indemnify all damage one hundred per cent, at the same cost as that of tort liability, it could be said that it is ideal. Unfortunately, these conditions cannot possibly be met. We shall examine this further, at a later stage.

- (c) The fundamental criticism of the system of "no fault" is that indemnities are limited by ceilings, and that some totally innocent victims have before them a solvent debtor (the insurer) and yet they are not fully indemnified by him. It is shocking that they are unable to recover all their damages. This injustice is particularly flagrant in serious cases.

The risk of under-paid claims is increased by spiralling inflation which is characteristic of some countries. Even if at first the benefits were sufficient, they will not continue so if they are not adapted regularly to the loss in money value. In this respect we know how reluctant governments are to permit increases of insurance premiums.

- (d) If we accept the system of tort liability for certain damages (transporter's liability, liability of the authorities for the state for the roads, products and salesman's liability, or that of the garage in case of a defective vehicle), a very complex legal situation could arise if the two different systems of indemnisation were to be applied to the same accident.

- (e) The cost of switching to the system of "no fault" is unpredictable. If it is generally admitted that the "no fault" system costs more than the tort liability system, yet there is still no consensus on the amount of the increase.

Besides the fundamental opposition and basic criticism of both systems of indemnity, there are other secondary observations which have to be made.

(i) The "no fault" system could encourage fraud. This could be facilitated by the fact that there are no longer two adversaries (or two insurers) who control one another.

This does not seem to me a decisive argument; already some types of cover pay losses caused by traffic accidents without recourse against anyone. This is for instance the case of "own property damage", or "personal accident for car-passengers". Moreover, in Europe the practice of direct payment of claims to victims by their own insurer is spreading. This was referred to in my first paper and insurers feel quite satisfied with this state of affairs.

(ii) The "no fault" system could encourage irresponsible driving. Since negligence would not entail the penalisation of the driver, it could be feared that he would be less prudent. This argument is not convincing. I do not believe that a different system of indemnisation would have any effect on the prevention of accidents.

(iii) If the system of "no fault" is introduced into motor insurance, why should it not be also applied to all accidents, since the needs of victims are identical? Why not extend it to cover all illness?

The reply to this query could be linked with the financial requirements: in fact, it is possible to pass the burden of indemnifying victims of traffic accidents on to the motorists.

(iv) Finally, in the United States, it was argued that the introduction of the "no fault" system did not have the hoped for effects, and that in particular it did not lower the number of law suits. Also, the costs of "motor insurance" did not go down, on the contrary, insurance premiums increased. All this may be true, but could be countered by the fact that the situation in the United States is rather special, and by the existence of a dual system of indemnisation - "no fault" for a basic compensation and tort liability for the excess of the basic compensation which is relatively low. It may be that if the liability is replaced by the "no fault" system, under which the victims can claim only the benefits of "no fault", the number of law suits could be reduced and the operating cost of motor insurance could be lowered.

Final remarks:

To end with, I should like to make three observations with regard to the alternatives to tort liability systems:

1. Attention should be drawn to the fact that recently a tendency developed and is apparent in several projects of reform in Western Europe (already applied in Algeria and Israel), to differentiate between the system applicable to property damage and that governing bodily injuries.

(a) ~~For property damage to the vehicle of the insured, it is proposed to maintain the rules of tort liability. This may seem paradoxical since many car owners cover their vehicle against own damage, and the cost of~~

this insurance is not prohibitive. It should therefore be possible to make this type of insurance compulsory. However, this cannot be done because everyone should be free to decide whether or not he wishes to take out an insurance cover for his own property.

- (b) However, as regards bodily injuries, the proposal is to make the insurance cover compulsory in respect of "pecuniary losses" only, irrespective of those covered in total or by a pre-agreed lump sum (starting with a certain percentage of invalidity, and subject to a certain maximum of earnings). Tort liability would remain applicable to any excess beyond these benefits. In this way, the snags attributed to the "no fault" system concerning limited indemnisation are avoided.

2. It is possible to dissociate entirely the problems of "third party liability" from those of "insurance". It is possible, for instance, to conceive a system where "third party liability" is combined with a compulsory insurance based on "no fault", either providing fixed benefits or not; it could cover all damage, or just as well could cover certain damages only. The choice could be as follows :

third party liability:      based on tort  
                                 based on the risk  
                                 no fault

This liability could be:    covered compulsorily by insurance  
                                 covered facultatively

This insurance could be : limited, or unlimited.

first party insurance (direct): this would normally be a "no fault" insurance, but it could cover:

- the whole effective damage, or up to a certain limit
- cover all damage, or only some damage (bodily injuries)
- it could replace "third party liability" insurance, or co-exist with it.

Thus the "no fault" is not necessarily an alternative to the "third party liability" insurance. For instance, it is possible to have a "first party" direct insurance for certain benefits, as well as a "third party liability" insurance, both being compulsory; just as it could be decided that the first becomes compulsory, but not the second. Various options are possible.

3. It is imperative to point out the importance of abolishing the subrogation rights of social security schemes, regarding the cost of the system. In some countries it seems impossible to introduce a system generalizing the "no fault" without first abolishing this recourse, because the costs of operation would be prohibitive. This brings out the inter-dependence of the various factors which must be taken into account, before any legislative reforms are introduced.