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ALONG FOR THE RIDE: An Examination of the Merit System and Policy Terminations Provisions of the Massachusetts No-Fault Law

It might seem impossible for anyone to devise an auto insurance plan more fouled up than the one now in effect in the United States. . . . Massachusetts politicians, however, have almost succeeded in producing something worse. They have taken a highly promising plan for reform and turned it into a hash.¹

One might wonder whether "hash" is an appropriate term but in light of the fact that there were more than 350 bills² before the Massachusetts Legislature to change the automobile liability law it is easy to see how the statute became a hodgepodge of political concessions.³ Since Massachusetts was the first state⁴ to enact no-fault legislation as an answer to the automobile tort problem, the pressures imposed by competing groups upon the legislature were understandably enormous. Concessions and compromises were the only means by which no-fault could become law.

The new law was soon subjected to a court test. On June 29, 1971, the Massachusetts Supreme Judicial Court handed down its decision in *Pinnick v. Cleary*,⁵ upholding the constitutionality of the no-fault law. The court made the scope of its decision clear:

The plaintiff has raised and argued a number of issues which are not presented by what appears in the record. We realize that where questions of pressing public importance are involved we may in our discretion express our opinion on matters fully argued even though they are not essential to disposition of the exact controversy before the court. . . . However, such issues raised here by the plaintiff call

1. TIME, August 31, 1970, at 66.

2. Boston Sunday Globe, May 7, 1970, at 79, col. 1.

3. Commented one critic:

But the Mass. law—born in a political maelstrom of Republicans and Democrats jockeying for votes in an election year with each trying to outfox the other as the "public's champion" to reduce costs—has quickly showed serious technical flaws and posed constitutional problems.

TRIAL, Aug./Sept. 1970, at 17.

4. The enacting dates in the first no-fault states are as follows: Mass.: Aug. 13, 1970; Del.: May 27, 1971; Fla.: June 3, 1971; and Ill.: Sept. 2, 1971.

5. ____ Mass. ____, 271 N.E.2d 592 (1971).

for interpretation of terms and provisions of c. 670 which are not self-explanatory and which are not called into question at all by the record. It is inevitable that this first legislative attempt at a fundamental alteration and modernization of an important segment of the common law of torts will generate many problems arising out of such provisions. We cannot deal with these problems in the abstract and refrain therefore from dealing with c. 670 in its effects beyond the set of facts before us.⁶

The court thus acknowledged that there were in fact many questionable provisions in the new law. This article will focus on two of the provisions that pose serious problems for the average auto insurance consumer: surcharges and policy terminations.

Rates, Surcharges, and Discounts

Background

The advent of a no-fault system in Massachusetts affected automobile insurance premiums in two ways: first, a 15 percent across the board reduction in premiums was authorized;⁷ and second, a merit rating system was established.⁸ Before an evaluation of these two changes can be made an explanation of how automobile insurance premiums are fixed should be discussed.

Full freedom of competitive pricing does not exist in the automobile insurance industry.⁹ Aside from this distinction, the price of an automobile insurance premium and the wholesale price of consumer goods are derived in a similar manner.¹⁰ Both prices reflect the aggregate of three components: average cost of production per unit, allocation of overhead (fixed cost per unit), and expected return on capital per unit (profit). The determination of the average cost per unit, in the respective products, is the only material difference between the two

6. *Id.* at 595.

7. MASS. GEN. LAWS ANN. ch. 175, § 113B (Supp. 1971).

8. *Id.*

9. State regulation does not permit the price of an automobile insurance premium to fluctuate with the insurer's cost. Notwithstanding this fact the insurer will determine his cost so that he can make a decision as to whether to offer insurance at the rates established by the Commissioner of Insurance. And so, while the Commissioner of Insurance has the authority to fix premiums, MASS. GEN. LAWS ANN. ch. 175, § 113B (Supp. 1971), he must take into consideration the insurer's cost of production, since the insurer will not offer insurance unless he can cover his cost and have a projected profit.

10. See U.S. DEP'T OF TRANSPORTATION, PRICE VARIABILITY IN THE AUTOMOBILE INSURANCE MARKET 48-49 (1970) (prepared by Brainard and Carbine) [hereinafter cited as PRICE STUDY].

prices. A discussion of the other two components—fixed cost and profit—is unwarranted since they are nearly the same in both situations.¹¹

The average cost of a unit of production, be it consumer good or automobile insurance policy, is equal to the overall cost of production divided by the number of units produced. This formula is equally applicable to either industry. However, the factors which comprise the overall cost in the respective products are not at all the same. The automobile insurer must use the projected inputs¹² of frequency of occurrence¹³ and severity of loss¹⁴ to derive his overall cost of production, while the manufacturer of a consumer good uses fixed inputs.¹⁵ The consequence of this difference is that the insurer's actual overall cost of production will not be determined until after the policy issued has expired.¹⁶ It is

11. Fixed costs are the same in both situations while profits vary since the producer of consumer goods may set his profit at what the market will bear, while the insurance selling price is regulated by state control. MASS. GEN. LAWS ANN. ch. 175, § 113B (Supp. 1971). The profit markup of an insurance premium is also unique in that it can be decreased if the insurer pays out more claims than anticipated. PRICE STUDY 48.

12. Projected inputs are actuarial factors which suggest the probability of the occurrence of an event. Since they are based on statistics they are uncertain and are only as valid as the source from which they are derived. See note 17 *infra*.

13. Frequency of occurrence refers to the ratio of accidents to number of policyholders insured. For example, if 1,000 policyholders were involved in 50 accidents the frequency of occurrence for that group would be .05 percent. PRICE STUDY 1.

14. Severity of loss refers to the ratio of amount of claims paid to number of policyholders insured. For example, if 1,000 policyholders annually produce 700,000 dollars in claims the severity of loss per policy would be 700 dollars. *Id.*

15. Fixed inputs refer to factors which are certain since they are determined before production starts. For example, the producer of consumer goods uses the fixed inputs of labor and materials. The cost of both these factors can be determined prior to the start of production by the use of long-term procurement contracts for the purchase of services and raw materials. In any event, the cost is determined prior to the offering of the product to the consumer—an advantage the insurer does not have.

16. The use of projected inputs by the insurer to derive his overall cost results in a projected average cost per policy. This cost is passed on to the policyholder. For example, if 1,000 prospective policyholders annually produced 40 claims necessitating the payment of 500 dollars per claim the projected average cost of supplying each buyer would be 20 dollars [severity of claims (500 dollars) multiplied by frequency of occurrence (40) then divided by the number of policies issued (1,000)]. However, the projected average cost is only as valid as the projected inputs. If the insurer underestimates either the frequency of occurrence or the severity of loss per claim, because of reliance on invalid actuarial statistics, his profit will be diminished and he may suffer a loss. To illustrate, assume that the 20 dollar projected average cost resulted in a premium of 35 dollars, the additional 15 dollars being allocated between fixed cost and profit on a 10 dollar and 5 dollar basis respectively. The profit of 10 dollars provides the insurer with a margin for error in the event the actual average cost exceeds projected average cost. Assume further that the initial frequency of occurrence has doubled by the time the 1,000 policies expire. The actual average cost would be 40 dollars [severity of claims (500 dollars) multiplied by frequency of occurrence (80) then divided by the number of policies issued (1,000)]. Since the projected average cost represents what the insurer has collected from the policyholders, while the actual average cost represents what the insurer paid out

therefore essential that the insurer obtain reliable inputs so that his actual overall cost will not exceed his projected overall cost.

The best method of acquiring valid projected inputs is to apply the "law of large numbers,"¹⁷ which in turn increases the probability of actuarial accuracy. The broadest application of the latter rule normally occurs when overall cost for an entire state is divided by the total number of policies issued in that state to derive a statewide average cost. For example, in 1967 the average cost for all 1,788,624¹⁸ private passenger automobiles constituting the entire Massachusetts market would have been \$50.¹⁹ However, since one group of definable homogeneous motorists would annually produce a higher frequency of occurrence than another well-defined group, such an abnormally large pool would discriminate against drivers with better driving records and lower average cost. Therefore, in the interest of equity, Massachusetts long ago established a system of classes²⁰ determined by objective characteristics²¹ which are associated on a probabilistic basis with the degree of care used. Thus, standard class 10, comprised of non-commuting motorists who had no operator under 25 in the family, had an average cost of \$38.26.²² While assigned class 20, comprised of male operators under 25 who are not the principal operator or owner of the insured vehicle, had an average cost of \$606.51.²³ The respective frequencies of occurrence, 5.6 percent²⁴ and 78.2 percent,²⁵ reflect the equitable basis for the disparity

to the policyholder, the combination of the two would give the insurer a net loss of 20 dollars per policy. Taking the profit into account the loss would be 10 dollars per policy.

The actual average cost may exceed the projected average cost in another situation. Assume that the insurer in accepting his share of the market obtains a biased sample containing relatively more policyholders who are involved in accidents than the projected number [e.g., insurer accepts 1,000 policies which should produce no more than 40 accidents, based on valid actuarial projections, but in fact produce 100 claims]. The projected average cost remains at 20 dollars, since the insurer cannot increase the premium, while the actual average cost is 50 dollars [severity of claims (500 dollars) multiplied by frequency of occurrence (100) then divided by the number of policies issued (1,000)]. The net loss to the insurer, including his projected profit or margin for error, is 20 dollars.

17. The law of large numbers states that as the number of the sample increases so does the probability of the accuracy of the projection. Application of the principle to the projected inputs used in the insurance industry is highly desirable since it increases actuarial accuracy, which in turn produces a more valid projected average cost.

18. PRICE STUDY 75.

19. *Id.*

20. MASS. GEN. LAWS ANN. ch. 175, § 113B (Supp. 1971).

21. The objective characteristics considered in determining the class in which an individual is placed are: age, sex, marital status, ownership (or principal operator), and driver education. PRICE STUDY 63.

22. *Id.* at 75.

23. *Id.*

24. *Id.* at 64.

25. *Id.* at 68.

between the two average costs. Low average cost was equated with careful driving and lower frequency of occurrence, while high average cost was equated with less careful driving and higher frequency of occurrence. The system of assigned and standard risk classification provides the deterrent of an economic burden for poor driving while rewarding careful driving with lower premiums. The desirability of such a scheme is well recognized, for it has been noted that

Prevention is an integral part of all well-structured insurance price systems and an equitable distribution of loss costs according to causation provides a necessary economic incentive to risk reduction.²⁶

Insurance Under No-Fault

The present no-fault system retains both the standard and assigned risk classifications.²⁷ Authority to establish premiums is still vested in the Commissioner of Insurance.²⁸ But since recovery under no-fault ignores causation, the factors used to determine average cost will be altered. Involvement²⁹ will replace frequency of occurrence, making average cost equal severity of loss multiplied by involvement and divided by the number of units produced. And since "involvement" doubles the number of motorists collecting from the insurer for each accident the cost of premiums would naturally be expected to rise.³⁰ The con-

26. *Id.* at 76.

27. MASS. GEN. LAWS ANN. ch. 175, §§ 113B and 113H (Supp. 1971).

28. *Id.* at 113B.

29. See PRICE STUDY 44-45 where one illustration of the effects of no-fault are set out. The authors note that "[u]nder nonfault, all victims are eligible for payment, whereas a fault system compensates only innocent victims of negligent operators." The significance of this change is that frequency of occurrence will double since both drivers are considered to have been involved in an accident. Under the tort system only the guilty party was charged with a frequency of occurrence since the innocent party's insurance company paid no claim. Legal liability determined frequency of occurrence. Under the no-fault system causation is ignored and payment is made to both parties. Thus involvement, rather than frequency of occurrence predicated upon legal liability, will be used to determine the average cost of a premium.

30. Under the tort system if a driver was at fault he was responsible for injuries inflicted. His insurance company would pay the innocent party and the tortfeasor would be charged with a frequency of occurrence and the amount of the claim. These figures would be used the following year to determine the average cost for the tortfeasor's class. In addition, the tortfeasor would collect nothing from his own insurer and the innocent party would not contribute a severity of loss or a frequency of occurrence to his class. This has changed under no-fault. To illustrate:

	Tort System		No-Fault System	
	Tortfeasor	Innocent Party	Tortfeasor	Innocent Party
Severity of claim	\$1,000	---	\$500	\$1,000
Frequency of occurrence	1	---	1	1
Average cost	\$1,000	0	\$500	\$1,000

verse has occurred for two reasons: first, the no-fault approach has probably confused motorists much the same way the introduction of workmen's compensation confused claimants when it was introduced³¹ with the result that motorists are not asserting claims; and second, the premiums have been reduced by 15 percent across the board.³² However, once motorists become aware of their rights under the no-fault system more claims will be made and insurance premiums will naturally rise.³³

Public awareness, or the lack of it, will have no effect upon the latter cause of lower premiums, since the 15 percent rate reduction reflects a projected decrease in fixed cost for the insurer. The introduction of the no-fault system ended the need for litigation and its concurrent cost for accidents involving not more than \$2,000 in out-of-pocket expenses.³⁴ In addition, the severity of loss is decreased since pain and suffering are not allowed in cases involving less than \$500 in medical expenses.³⁵ The decreases in fixed cost and severity of loss were no doubt motivating factors in the creation of the no-fault system. Said the court in *Pinnick*:

The high cost of automobile insurance in Massachusetts was a present fact of which the Legislature did not need to be reminded. It might have suspected that there was a correlation between this high cost and the inefficiencies and administrative expense involved in running the traditional system, contributed to heavily by the prevalence of the elaborate pre-trial proceedings detailed above. That any such suspicion would have been well founded was confirmed by a report of the United States Department of Transportation. . . . The report concluded on this subject that "[t]he automobile accident tort liability insurance system would appear to possess the highly

From the example above it can be seen that the tortfeasor's loss, heretofore unsatisfied by *liability* insurance, is recognized and paid. Also, a shifting of cost has occurred since the innocent party must now shoulder the burden of the tortfeasor's mistake while the tortfeasor's burden is less because he was fortunate not to do extensive injury to himself. As noted in the PRICE STUDY, a consequence of no-fault is that the "high risk sector might no longer pay the highest prices. Similarly, buyers at the other end of the risk spectrum might no longer pay the lowest prices." PRICE STUDY at 45.

31. See *Boston Globe*, June 6, 1971, at 1, col. 1.

32. MASS. GEN. LAWS ANN. ch. 175, § 113B (Supp. 1971).

33. The initial optimism (78 percent dollar savings) in Massachusetts has been toned down by a re-evaluation of the statistical data for the first six months. See TRIAL Sept./Oct. 1971, at 11. Commentators have indicated that part of the reason for the favorable early figures was due to the fact that the public was unsure of the mechanics of processing claims under the new system and that lawyers were advising their clients to await the (unsuccessful) constitutional challenge to no-fault in the Supreme Judicial Court.

34. MASS. GEN. LAWS ANN. ch. 90, § 34A (Supp. 1971).

35. *Id.*

dubious distinction of having probably the highest cost/benefit ratio of any major compensation system currently in operation in this country. As has been shown, for every dollar of net benefits that it provides to victims, it consumes about a dollar."³⁶

The reductions in fixed cost and severity of loss are a most laudable feature of the no-fault system since they reflect a decrease in economic waste. And the concurrent across the board reduction is not objectionable in itself, since a lower cost to the consumer is also favorable. However, since a merit rating system was established with the passage of the no-fault legislation it would have made more sense to integrate the funds derived from the decrease in fixed cost and severity of loss, into the merit system rather than distribute them outright. In order to illustrate how this could have been done the merit system must be explained.

Merit System

Under the traditional insurance pricing system the insured paid a premium for liability coverage lasting for a definite period of time, usually one year. Once this payment was made the insured's premium could not be increased within that year because of conduct subsequent to the policy's issuance. Nor would the insured recover a discount or rebate if he operated his automobile safely. The outer limit of cost to the consumer as well as expected profit of the insurer were predetermined. This has been changed with the introduction of the merit system.

The concept of a merit system is not a new one to Massachusetts,³⁷ having been tried once in 1954 and proven unsuccessful. In addition, the original no-fault legislation of 1970 contained a merit system which provided for increases in the basic premium when the insured was convicted for certain criminal violations: 100 percent increase for conviction of driving under the influence of alcohol or a narcotic drug, 20 percent increase for conviction of a speeding violation, and a ten percent increase for conviction of other moving violations.³⁸ In the event an insured operated his automobile free of any accident involvement for one year a two percent discount was awarded.³⁹ The words of the 1970 statute authorized the Commissioner of Insurance to investigate this system and alter it if he deemed necessary.⁴⁰ As a result of extensive hearings the original

36. ____ Mass. ____, 271 N.E.2d 592, 604-05 (1971).

37. See the demerit rating provisions of the Massachusetts Highway Safety Act of 1953, ch. 570, § 1 [1953] Mass. Acts, repealed by ch. 51 [1956] Mass. Acts 32.

38. MASS. GEN. LAWS ANN. ch. 175, § 113B (Supp. 1971).

39. *Id.*

40. *Id.*

merit system was discarded and a new one produced, which provided: a surcharge of 40 dollars for conviction of driving under the influence of alcohol or a narcotic drug, a surcharge of 20 dollars for conviction of leaving the scene of an accident or driving to endanger, and a four dollar surcharge for a conviction for speeding or for any other moving violation.⁴¹ The purpose of the initial merit system promulgated by the legislature was no doubt to promote safe driving under the no-fault system. The initial merit system attempted to provide an economic incentive to risk reduction by placing financial burden on any individual convicted of an enumerated violation, which in turn created a fund out of which discounts were to be awarded to drivers not engaged in a reportable accident in the preceding year.⁴² The apparent purpose of the initial merit system is not questioned. As one author has noted, an insurance system

. . . offers opportunities to encourage desirable conduct by utilizing rewards in addition to penalties. Psychologists tell us that conformity to particular standards of behavior is enhanced if, in addition to penalizing improper responses, proper responses are rewarded.⁴³

It is questionable whether the initial merit system promulgated by the legislature, or the present system established by the Commissioner of Insurance, can provide the necessary penalties or incentives needed to achieve its objective.

Penalties and Incentives

The surcharges are penalties or sanctions provided by the merit system. They are designed to inhibit certain conduct since they, in effect, command drivers not to drive "under the influence of intoxicating liquor or narcotic or hallucinogenic drugs," speed, or commit "moving violations"⁴⁴ unless prepared to suffer the consequences of an increase in their automobile insurance premium. Before considering the deterrent effect of these sanctions it is necessary to distinguish between "general" and "specific" deterrents,⁴⁵ the two types of preventive

41. Regulations promulgated by the Commissioner of Insurance: Accident Involvement Classification Plan and Surcharge and Discount Plan, Nov. 12, 1971. These regulations called for percentage surcharges on a state-wide flat rate of 40 dollars. The result produces the 40, 20, and four dollar figures. A state-wide flat rate was chosen to eliminate the disparity between a surcharge for the same offense on a high rate (*e.g.*, urban) and a low rate (*e.g.*, rural) driver. The 40 dollar figure was chosen arbitrarily.

42. Letter from Massachusetts Department of Banking and Insurance to *Catholic University Law Review*, Oct. 7, 1971, on file in Catholic University Law Review Office.

43. Cramton, *Driver Behavior and Legal Sanctions: A Study of Deterrence*, 67 MICH. L. REV. 421, 445-46 (1967).

44. MASS. GEN. LAWS ANN. ch. 175, § 113B (Supp. 1971).

45. The definitions of "general" and "specific" deterrents, as used in this article, are substantially the same as those in Cramton, *supra* note 43.

effects which a sanction may produce. A "general deterrent" is a threatened consequence upon a population to whom the sanction is addressed, and all individuals within that population are allowed to function in society, with only the threat of future punishment if one commits the forbidden act. A "specific deterrent" refers to the effect of punishment on an individual who experiences it. The offender is not allowed to function in society until he has suffered the consequences of the sanction for an act already done. Cast in these terms the surcharges would have a "general deterrent" effect in regard to the commission of one of the enumerated violations, and a "specific deterrent" effect after the offender was convicted. The distinguishing feature between the two is that the former threatens the imposition of the sanction of an economic burden, while the latter actually imposes that penalty. The effectiveness of these deterrents in preventing the acts prohibited is difficult to forecast. Aside from a study of capital punishment—a general deterrent to the commission of a murder—little investigation of the effectiveness of legal sanctions in achieving their purported goals has been carried out.⁴⁶ Some examination of the general deterrent of civil liability has been made, and although no unanimity of opinion exists,⁴⁷ it is generally conceded that the remoteness—that is the threat of a future consequence for an act done now—detracts from a general deterrent's effectiveness.⁴⁸ In light of the above it would seem that the surcharges would have meager preventive effects as a general deterrent. This marginal value, which is even more apparent in the Commissioner's merit system than in the one promulgated by the legislature, places a greater burden on the incentives to fulfill the objectives of the merit system.

The legislative two percent discount was changed to one-half of one percent by the Commissioner.⁴⁹ The original discount created a range of \$.48 to \$.79, depending upon the insured's driver classification and his residence within the state. The Commissioner's discount amounts to a flat \$.20 discount per policy. Neither system is an incentive to safe driving.

Proposal

The legislature had an opportunity to provide a much more meaningful incen-

46. See Sellin, *THE DEATH PENALTY, MODEL PENAL CODE APP.* (Tent. Draft No. 9, 1959).

47. Compare Calabresi, *Fault, Accidents and the Wonderful World of Blum and Kalven*, 75 *YALE L.J.* 216 (1965), with, Blum & Kalven, *The Empty Cabinet of Dr. Calabresi: Auto Accidents and General Deterrence*, 34 *U. CHI. L. REV.* 239 (1967).

48. Cramton, *supra* note 43, at 445, with reference to the effectiveness of general deterrents, states that "[m]any legal scholars appear to feel that any such deterrent effect is a small one"

49. Regulations of Commissioner of Insurance, *supra* note 41. The one-half of one percent is applied to the state-wide flat rate of 40 dollars.

tive to promote safe driving. Had they withheld the 15 percent rate reduction pending a full year free of a reportable accident the discount available would have increased substantially.⁵⁰ In addition it would have been possible to place a greater economic burden on those who were habitually involved in accidents, a result which is equitable⁵¹ and has the effect of a specific deterrent.⁵² The increased funds made available for discounts could also have allowed some latitude for a more flexible refund system. A system could be devised where discounts or rebates would depend upon the number of accidents in which a driver was involved. For example, drivers involved in one or no accidents would receive the full 17 percent (15 percent from the reduction withheld plus two percent generated from the surcharge fund), two accidents would merit only a five percent discount, and three accidents would merit only a two percent discount. Involvement in four or more accidents would prohibit any recovery. It should be noted that the proposed percentage of recovery is not based on statistics and would have to be readjusted to conform with projected involvement in the same manner that the present discounts are determined.⁵³ The

50. In addition to the two percent discount provided for by the surcharge pool, and the 15 percent per policy withheld there would be other funds made available for distribution as drivers became disqualified for any discount through accident involvement.

51. See *supra* note 30.

52. It was noted earlier that a specific deterrent prevents an individual from functioning in society until he has suffered the consequences of violating the sanction. See note 45, *supra* and accompanying text. Taking this into account, it is evident that the sanction of economic burden, as imposed by the tort system, had the effect of making tortfeasors pay for their misconduct before allowing them back on the road. The economic burden imposed under the accountability theory of the tort system was of two types: civil liability and increased insurance premiums. Civil liability had the effect of a general deterrent since it threatened an economic burden, and as noted earlier this was not an effective means of accident prevention. See notes 47, 48, *supra* and accompanying text. However, the automobile insurance premiums have the effect of a specific deterrent in states which require compulsory automobile insurance, such as Massachusetts, MASS. GEN. LAWS ANN. ch. 90, § 34A (1969), since the tortfeasor must bear the cost of his actions before he may operate his automobile again. Therefore, if the cost of premiums is increased by withholding the rate reduction, certain drivers with high risk potential might have been priced out of the conventional insurance market, and hence off the road. Such a result might seem harsh, but as some authors have noted

When 72 percent of the insureds in Massachusetts can operate year after year at an average frequency of five claims per 100 autos, it is very difficult to understand why other insureds should be entitled to frequencies as high as 111 claims per 100 autos. The solution indicated by concern for the safety of the general public would be to base class price on class cost and to make driving dependent upon insurance. Those who could not buy at that price would then be forced to reduce their class cost or to cease driving. PRICE STUDY 82.

Those same authors have also stated that it is "in the public interest that the pricing mechanism be allowed to exert full economic pressure on careless drivers." *Id.* at 56.

53. See *supra* note 42.

proposed system, unlike the present one,⁵⁴ recognizes that one accident should not prohibit recovery of a discount or rebate altogether, since there is the possibility that an innocent driver might be the victim of another's negligence. The better result would be to have the percentage of the rebate or discount decrease as accident involvement increases. But since the 15 percent rate reduction has already been distributed, implementation of this proposed system could only come about if further reductions were forthcoming, since a substantial fund is needed to provide the flexibility of graduated rebates.

Summary

It was noted earlier that "[p]revention is an integral part of all well-structured insurance price system"⁵⁵ The present merit system, if intended to satisfy this purpose, has failed since it provides meager incentives⁵⁶ and watered-down penalties. If the merit system was not intended to encourage accident prevention, then what is its purpose? Perhaps the merit system provisions are merely part of the compromise which evolved when proponents of no-fault and their opponents battled before the Massachusetts Legislature. Or perhaps it was meant to be an integration of the no-fault recovery concept with the tort concept of accountability. If one accepts the proposition that "prevention" is an important part of an insurance price system then the initial purpose of the merit system need not be known. All that should be recognized is that a workable merit system is an effective tool which belongs in the arsenal of highway safety techniques. It is thus discouraging to note the present ineffective status of the merit system. The dilution of its provisions is analogous to abandoning enforcement of our traffic laws or ignoring technological advances which would produce a safer automobile. None of the above will cause an automobile accident, since standing alone they lack the catalyst of human error. But neither do they act to prevent one. The purpose of a workable merit system is to provide one method of accident prevention. It may not be the best method and is certainly not the only method, but if it exists it should be effective.

Terminations

The Problem

In 1968 Congress authorized a study of the automobile reparations system in

54. Under the present merit system an insured driver must operate his automobile one full year free of a reportable accident to qualify for a 2 percent discount. MASS. GEN. LAWS ANN. ch. 175, § 113B (Supp. 1971).

55. PRICE STUDY 76.

56. See *supra* note 49 and accompanying text.

the United States by the Department of Transportation (DOT).⁵⁷ The maladies that had plagued the fault liability system had reached the point where national attention was focused on them. The major grievance was expected to be high premium charges. Surprisingly, in testimony before the House Committee on Interstate and Foreign Commerce prior to the authorization of the study, the abusive termination⁵⁸ practices of the insurance companies emerged as the chief complaint of the general public.⁵⁹

Regulation of the insurance business has long been considered a matter of state control.⁶⁰ Until recent years state control of the termination of automobile policies has been almost non-existent. Initial reform attempts were limited to detailing the procedures by which a *notification* of termination was sent to the insured. Legislatures are only now beginning to place restrictions on the *reasons why* a company can terminate. Most of this legislation was aimed at cancellation abuses while renewal refusal abuses were virtually unchecked.⁶¹

Some of the insurance companies and associations realized that changes were necessary and suggested voluntary restrictions on terminations.⁶² Others defended their practices, pleading underwriting methodology which was accomplished with almost mathematical precision:

Thus when policies are terminated, insurance companies insist that the reason is not that an *arbitrary* judgment has been made, but is that the statistics dictate that the financial risk has become so great that it can no longer be accepted.⁶³

The hearings before the House Committee are filled with examples of what must be classified as arbitrary terminations. Senator Gaylord Nelson of Wis-

57. Act of May 22, 1968, Pub. L. No. 90-313, 82 Stat. 126.

58. "Termination" refers to both "cancellations" and "refusals to renew." The distinction between these two situations is often confused. "Cancellation" means that a policy is curtailed at some time during its effective period. A "refusal to renew" occurs only at the expiration period when the insurer simply doesn't issue another policy.

59. See *Hearings on H.J. Res. 958 Before the Subcomm. on Commerce and Finance of the House Committee on Interstate and Foreign Commerce*, 90th Cong., 2d Sess. 11,29,68,69 (1968).

60. *Paul v. Virginia*, 75 U.S. (8 Wall.) 168 (1868). This principle was upset by *United States v. Southeastern Underwriters*, 322 U.S. 533 (1944). However in the following year Congress passed the McCarran-Ferguson Act, 15 U.S.C. §§ 1011-15 (1964) to restore state regulation.

61. See compilation in Ghiardi & Wienke, *Recent Developments in the Cancellation, Renewal and Rescission of Automobile Insurance Policies*, 51 MARQ. L. REV. 219, 251-53 (1968).

62. One insurance association announced that its members would cancel policies only for non-payment of premiums or suspension of drivers' licenses or auto registrations. Some companies have adopted "non cancellation guarantees." See 113 CONG. REC. 36720 (1967) (article presented by Senator Magnuson entitled *The Auto Insurance Muddle: Cancellation Practices of Firms Bring Complaints and Reforms* by Tom Talburt).

63. H.R. REP. NO. 815, 90th Cong., 1st Sess. 53 (1967) (emphasis added).

consin told of a policyholder who asked his insurance company why he had been cancelled. The company replied that his neighborhood was "going downhill."⁶⁴

If it is conceded that the DOT study has precipitated the passage of no-fault legislation in the United States it might be expected that the new laws would cure the ills which the study uncovered. Generally speaking, the concept of no-fault liability insurance is aimed at improving the poor cost/benefit ratio which has plagued the tort system.⁶⁵ This is of course a major problem, but the terminations field also loomed as an area ripe for reform. The Massachusetts law was the first solution to appear.

Prior Law

At the time when most states offered little or no protection against arbitrary cancellations by insurance companies,⁶⁶ Massachusetts had an elaborate scheme. In the first place, insurance companies were allowed a 90 day period wherein they could cancel a named insured arbitrarily.⁶⁷ This practice is common in most states and is mutually beneficial; it enables an applicant to obtain insurance immediately while allowing the insurer a reasonable amount of time to conduct an underwriting investigation. If the company subsequently decided to cancel a policy it was required to send a notice by registered mail 20 days before the effective date indicating the specific reasons for the cancellation.⁶⁸ The notice requirements, in effect since 1925, have been rigidly enforced by the courts,⁶⁹ thus placing a heavy burden on the insurer.

If a policyholder is "aggrieved" by the cancellation notice a complex appeal

64. 113 CONG. REC. 36719 (1967). For more comments on arbitrary terminations see 113 CONG. REC. 1681 (1967) (articles presented by Senator Magnuson), and 113 CONG. REC. 1704 (1967) (article presented by Senator Brewster).

65. Many critics feel the Massachusetts no-fault system will not accomplish this basic goal. See, e.g., Brainard, *Prices and Politics*, TRIAL, Oct./Nov., 1970, at 25.

66. See Ghiardi & Wienke, *supra* note 61; 1969 DUKE L.J. 327 (1969).

67. MASS. GEN. LAWS ANN. ch. 175, § 22C (Supp. 1971).

68. MASS. GEN. LAWS ANN. ch. 175, § 113A (Supp. 1971).

69. In *Gulesian v. Senibaldi*, 289 Mass. 384, 194 N.E. 119 (1935) the court found the insurance company's notice inadequate. One of the reasons upon which the court based its decision was that Mr. Senibaldi's name was spelled Senebaldi in the notice. Said the court

The name while perhaps idem sonans was incorrect, and the misspelling of it might mislead the registrar of motor vehicles in checking the registration number of the automobile

289 Mass. at 385, 194 N.E. at 120. The courts have adhered to the rule that "[s]trict compliance with these notice provisions is required." *Fields v. Parsons*, 353 Mass. 706, 234 N.E.2d 744, 745 (1968); see also *White v. Edwards*, 352 Mass. 655, 227 N.E.2d 354 (1967).

system is available to him.⁷⁰ If the insured feels the notice is deficient he can complain that it is "invalid."⁷¹ If he feels the reasons why he is being cancelled are "improper and unreasonable" he can challenge the insurance company on that ground.⁷² His complaint will first be heard by a "board of appeal on motor vehicle liability policies and bonds."⁷³ The board's decision can be reviewed by the Superior Court whose decision is final.⁷⁴

"Improper and unreasonable" is the standard by which the board and the courts test the reason for the cancellation. It was readily apparent that the impact of this language was to eliminate arbitrary cancellations.⁷⁵ Aggrieved policyholders who challenged the insurance companies through the appeals machinery had a very good chance of success.⁷⁶

In 1969 the Massachusetts Legislature shed some statutory light on the meaning of "improper and unreasonable." A new law, chapter 175 § 22C, stated that all policies

[s]hall be noncancellable by the company, except for nonpayment of premium, fraud or a material misrepresentation in obtaining the insurance, or unless the driver's license or motor vehicle registration of the named insured or of any other operator who resides in the same household as the named insured and who customarily operates a motor vehicle insured under the policy has been under suspension or revocation during the policy period.⁷⁷

This delineation of the reasons why an insurer is allowed to cancel a policy is a strong check against cancellation abuses.

Massachusetts was one of the few states⁷⁸ which placed some restrictions on the insurance companies' right to refuse to renew. The companies were required

70. MASS. GEN. LAWS ANN. ch. 175, § 113D (1958). Few states have any appeals machinery and none have anything as elaborate as Massachusetts' system.

71. *Id.*

72. *Id.*

73. MASS. GEN. LAWS ANN. ch. 26, § 8A (1966). The board consists of "the commissioner of insurance or his representative, the registrar of motor vehicles or a representative, and an assistant attorney general. . . ."

74. MASS. GEN. LAWS ANN. ch. 175, § 113D (1958).

75. See *Factory Mut. Liab. Ins. Co. of America v. Justices of Superior Court*, 300 Mass. 513, 16 N.E.2d 38 (1938).

76. See statistics cited in R. KEETON & J. O'CONNELL, *BASIC PROTECTION FOR THE TRAFFIC VICTIM* 80 (1965).

77. MASS. GEN. LAWS ANN. ch. 175, § 22C (Supp. 1971).

78. As of 1968 there were only two others: South Carolina, S.C. CODE ANN. § 46-750.54 (Supp. 1967), and Wisconsin, W.S.A. § 204.341 (now W.S.A. § 631.36 (1969)). See 9 B.C. IND. & COM. L. REV. 998, 1005-06 (1968).

to give a 45 day notice of intent not to renew.⁷⁹ The policyholder could utilize the same appeals procedures available to a cancelled insured where again the test of insurance company conduct would be the "improper and unreasonable" standard. The insurers nevertheless retained a certain amount of freedom in renewal situations.

The New Law

The no-fault bill proposed no changes in the law regarding cancellations. Perhaps the legislature felt that the recent addition of § 22C sufficiently tightened up that area. The original bill, passed by the legislature on August 11, 1970, did contain a concise statement of a change in renewal law. No liability policy was to be issued unless such policy

[c]ontains a provision that it shall be automatically renewed by the company except for fraud, conviction for use of unlawful drugs or driving under the influence of liquor, or nonpayment of premiums.⁸⁰

Automatic renewal was a revolutionary concept in the field of automobile liability insurance. No state law had approached such restriction of insurance company policy. The companies responded accordingly. For 12 days the Massachusetts insurance scene was chaotic while the companies threatened to leave the state. The main thorns in the side of the insurance industry were the across-the-board premium reductions⁸¹ and the mandatory renewal provisions. The political pressure continued to build until the legislature felt compelled to back down. An amendment was drafted and adopted⁸² and the insurance companies had their plum. The new provisions make no mention of automatic renewals and are in substance nothing more than an opening of the door to random renewal refusal.⁸³

79. MASS. GEN. LAWS ANN. ch. 175, § 113F (1958).

80. Ch. 670, § 8, [1970] Mass. Acts 549.

81. The bill called for an across-the-board premium reduction of 15 percent for both compulsory liability and property damage coverage. However, the Massachusetts no-fault plan, known as the Personal Injury Protection Plan (PIP) did not extend the principle of no-fault to the property damage area. The tort system remained for property damage claims. The insurance companies challenged this provision as confiscatory and hence unconstitutional. The Supreme Judicial Court agreed and the property damage premium reduction was disallowed in *Aetna Cas. & Sur. Co. v. Comm'r of Ins.*, ___ Mass. ___, 263 N.E.2d 698 (1970). No-fault was subsequently extended to cover property damage reducing premiums in that area. Ch. 978 [1971] Mass. Acts 1124.

82. Ch. 744, § 1 [1970] Mass. Acts 610.

83. The petitioner in *Pinnick v. Cleary* raised the question of the constitutionality of the new renewal law. The court responded:

The bill also questions the constitutionality of St. 1970, c. 744. Chapter 744 amends the provisions of c. 670 dealing with the renewal and cancellation of policies, and provides

The new, somewhat complex law is embodied in chapter 175 §§ 22E, F, and G.⁸⁴ These sections comprehensively list all the reasons upon which an insurer may base his refusal to renew:

- (1) Fraud in the application for insurance or renewal of insurance.
- (2) A guilty finding for a moving violation.
- (3) Suspension for a period of more than thirty days of an operator's license.
- (4) Revocation of an operator's license or registration.
- (5) Ineligibility for merit rating discounts due to *accident involvement*.
- (6) Conviction of driving under the influence of intoxicating liquor or drugs, reckless driving, or failing to stop after a collision.
- (7) Nonpayment of premiums, and
- (8) One exceptional situation where an insurer who is generally reducing the volume of his insurance writing in Massachusetts refuses to renew anyone.

In the case of persons 65 years of age or over, if none of these reasons are present insurers are required to renew.⁸⁵ This section represents the first effort by the legislature to remedy some of the abuses to which elderly policyholders had been subjected.⁸⁶ For persons under 65, refusal to renew may be made arbitrarily but if the reason is not one of the eight specified reasons then the insurance company must pick up one additional risk from the assigned risk pool.⁸⁷ These provisions result in some pressure on the insurer to refuse renewal

also for the contingency that parts of c. 670 might be held unconstitutional. It raises no separate issues. If c. 670 is held constitutional, a fortiori c. 744 will likewise be constitutional. We thus do not discuss it further.

— Mass. —, 271 N.E.2d 592 (1971), n. 1.

84. MASS. GEN. LAWS ANN. ch. 175, §§ 22E, F, & G (Supp. 1971). It is interesting to note that non-cooperation by the insured in an investigation of any claim by the company is not mentioned. Two states specifically make this failure a grounds for *cancellation*. DEL. CODE ANN. tit. 21, § 2908(b)(8) (1953); MINN. STAT. ANN. § 72A.142(4)(5)(6) (Supp. 1968). The omission is probably due to the comprehensive scope of all the other grounds for renewal refusal. Recently the Massachusetts Supreme Judicial Court made it quite clear in a case *not* decided under the new law that an insurer could terminate a policy if the insured committed a material breach of the cooperation clause of the policy. *Foshee v. Insurance Co. of North America*, — Mass. —, 269 N.E.2d 677 (1971).

85. MASS. GEN. LAWS ANN. ch. 175, § 22E (Supp. 1971).

86. For a comment on some prior abuses regarding the elderly, see 113 CONG. REC. 6938 (1967) (article presented by Congressman Snyder entitled *Your Money's Worth—Discrimination Against Elderly Drivers* by Sylvia Porter).

87. MASS. GEN. LAWS ANN. ch. 175, § 22G (Supp. 1971).

only for the reasons which the legislature felt were justifiable.⁸⁸

Finally, anyone who is entitled to the "merit discount" of two percent for two consecutive years (*i.e.*, a net discount of four percent) can only be refused renewal for fraud in the application for insurance or nonpayment of premiums.⁸⁹

Evaluation

Not too long ago it was predicted that

[s]tate legislatures which have not enacted laws changing the rules on the cancellation and nonrenewal of automobile insurance policies can expect to see the introduction of proposed statutes in future legislative sessions. It is not inconceivable that even those states which have recently enacted legislation can expect to receive suggestions for revisions that will impose greater restrictions upon the insurer's right of cancellation or nonrenewal.⁹⁰

Certainly no greater an opportunity to revamp the terminations law in the state could arise than at the time when the whole automobile tort system was being reevaluated and restructured. Indeed, the emphasis on terminations in congressional hearings and the facts uncovered by the DOT study were a further stimulus to squarely addressing the problem. That the Massachusetts Legislature was prepared to rise to the challenge is clear from the provisions of the first bill wherein strict renewal regulations were enacted. What is unfortunate is the manner in which the legislature so quickly, so blithely, and so cryptically abandoned their original stand. The new law is clothed with complexity and phraseology which appear to be consumer oriented; the realities of the law, however, are decidedly in favor of the insurance companies.

The "improper and unreasonable" standard which had operated quite efficiently to protect policyholders⁹¹ is no longer viable. The new specified stan-

88. Some additional changes were made by Section 22E. The new law requires the insurance company to specify the reason for its refusal to renew:

Any company which is authorized not to issue a renewal policy because of the exceptions contained in this section shall give a thirty day written notice of its intention not to issue a policy for the ensuing policy period, containing a statement of the reasons therefor.

MASS. GEN. LAWS ANN. ch. 175, § 22E (Supp. 1971). The thirty day notice is a minor change. Prior law, ch. 175 § 113F (which was not amended), required the company to send a forty-five day notice to either the insured or his agent or broker. The agent or broker was then required to forward a thirty day notice to the insured.

89. MASS. GEN. LAWS ANN. ch. 175, § 22F (Supp. 1971).

90. Ghiardi & Wienke, *supra* note 61, at 249.

91. *See supra* note 76.

dards are broad enough to encompass all the possible reasons which had previously been used as factors in reaching an underwriting decision to refuse renewal.⁹² The insurance companies now have a legislative sanction for their methods. The net result is a virtual return to the arbitrary refusal.⁹³

It should be conceded that the statutory reasons which justify termination are in fact somewhat indicative of what might be loosely termed "bad driving." But a policy holder should not lose his insurance on the basis of a single failure in any one of the listed areas. The person who has only a slightly blemished record is entitled to some protection. As the insurance industry so often repeats⁹⁴ the public reaps a significant benefit when bad drivers are eliminated from the highways.⁹⁵ There can be no quarrel with a system which in fact removes the "bad" drivers. But it is questionable whether this is the system which Massachusetts has chosen. A person should not be considered a "bad" driver for a single violation. The law in Massachusetts seems to say that he is. The test is not a qualitative one. If a driver in one instance fits into just one of the pigeonholes he may lose his insurance.

Perhaps the most striking example of the inequitable results which the new law will produce is the termination of a policy based on "accident involvement."⁹⁶ The assessment of high premiums or the termination in any fashion of the policies of those people who *cause*⁹⁷ accidents is undeniably justified. But this determination is never made in a no-fault system. "Involvement" is as far as the inquiry goes. Theoretically, fault is immaterial and the person who is struck in the rear by a grossly negligent driver is just as susceptible to termination as the negligent policyholder. The lack of a fault determination may be a workable concept in a well organized no-fault system, but when its influence is felt in associated areas, that is, in the policy termination field, inequity can

92. Also, in the same context, the renewal guarantee of ch. 175, § 22F is almost meaningless. Anyone who has met the standards of that section would have little worry about renewal refusal. The mandatory renewal is thus of minimal significance.

93. It does appear that the arbitrary practices have been eradicated. *See, e.g.*, text example, *supra* note 64.

94. *See, e.g.*, Talburt article, *supra* note 62, at 36721.

95. Three states—Massachusetts: MASS. GEN. LAWS ANN. ch. 90, § 34 J (1969); New York: N.Y. VEH. & TRAF. LAW § 312 (McKinney 1970); and North Carolina: N.C. GEN. STAT. § 20-309 (1965)—have compulsory insurance laws. When rates become prohibitively high driving can become financially unfeasible.

96. Compare MASS. GEN. LAWS ANN. ch. 175, § 22E (Supp. 1971), with 9 B.C. IND. & COM. L. REV. 998, 1014 (1968):

The most significant protection afforded by the statutes [generally in the United States] is that the insurance company cannot cancel when the insured has an accident or makes a claim.

97. That is, as to persons who repeatedly cause accidents.

result. From the policyholders' standpoint, in situations where economic loss is not great, a decision must be made as to whether a claim for no-fault benefits should be made. A claim places the insured in the "involved" category and exposes him to nonrenewal dangers. This dilemma has been intensified by the extension of no-fault to the property damage field.⁹⁸ Drivers who are concerned about renewal of their policies will be reluctant to risk termination by making a claim where property damage is small. Instead, they might opt for guaranteeing their reinsurability and underwrite the loss themselves. Clearly, this is not a desirable function of the no-fault system.

Experience under Massachusetts no-fault has been described as "exceed[ing] all expectations."⁹⁹ All the statistics indicate that fewer claims are being made,¹⁰⁰ that the amount of the average claim has decreased,¹⁰¹ and that insurance companies are paying out much less money.¹⁰² One might ask whether no-fault is intended to reduce the number of claims (since accidents will occur regardless of what reparation system is in force) or rather is it intended to pay just claims promptly and adequately. It is suggested that when insurance companies begin to make use of their right to refuse renewal due to "accident involvement" the number of claims made may decrease even more.

Conclusion

The adoption of a no-fault system in Massachusetts was the product of a long process which left behind it a long history of bitter debates and controversies. The legislative task was indeed monumental but *quaere* whether the legislature performed its function. It is said that

Careful examination of existing and proposed legislation to determine whether its purposes are likely to be achieved—and at what cost in terms of social effort and undesired consequences—is now a necessity rather than a luxury that a rational government might eschew.¹⁰³

That a thorough examination of the merit system and policy terminations occurred prior to enactment is questionable. These provisions were not essential

98. Ch. 978 [1971] Mass. Acts 1124, extending the no-fault concept to property damage coverage.

99. Manuscript by Hon. Edward J. Dever, Jr., Chairman, Massachusetts Legislature's Joint Committee on Insurance, on file in Catholic University Law Review Office.

100. *Id.*

101. *Id.*

102. *See supra* note 33.

103. *See Cramton, supra* note 43, at 421.

to the implementation of the no-fault system. Perhaps they were merely along for the ride—part of the price no-fault proponents had to pay to insure passage of the bill.

It was hoped that a balance could be struck among the competing interests involved: the insurance industry, the policyholders, and the general public.¹⁰⁴ The Massachusetts attempt in the merit system and policy termination areas leaves much to be desired.

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104. Ghiardi & Wienke, *supra* note 61, at 250.