OOIDA Foundation

RESEARCH · SAFETY · ECONOMICS

WHITE PAPER

Analysis of Cost to Owner-Operators in Raising the Insurance Requirements

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Table of Contents

Introduction

In Response to The Trucking Alliance and Congressman Cartwright's Bill to increase the Public Liability mandate for all carriers operating in interstate commerce to $4.4M.

"Let them eat cake"

Jean-Jacques Rousseau attributed this phrase to a French princess during one of the worst famines in French History. Upon hearing that the peasants had no bread to eat, the princess exclaimed, "let them eat cake." It has come to symbolize the obliviousness and selfishness of the French upper-classes at that time. The Trucking Alliance representatives and Congressman Cartwright are either oblivious to the plight of the tucking industries struggles or there is another agenda to eliminate competition by pricing smaller companies out of the industry. Perhaps they wish to provide more incentive for attorneys to seek higher and higher judgments against companies that insure the trucking industry. To understand the comparison of the Trucking Alliance to the French elitist let us look at the revenue of the five original members of the Trucking Alliance for 2013.[1]

- J.B. Hunt $5,585,000,000
- Schneider National $3,600,000,000
- U.S. Xpress $1,600,000,000
- Knight Transportation $969,237,000
- Maverick $315,014,000

These elitist mega carriers constitute less than 1% of the for-hire fleets that operate in interstate transportation. It is because of their fleet size and therefore their risk exposure to crashes, along with the fact that they haul hazardous material, that they carry the maximum amount required for Public Liability (the greater the number of trucks and miles driven the greater the crash risk). It is also noteworthy that three of the five (J.B. Hunt, Schneider and Knight Transportation) are self-insured so any changes would not affect them. The insurance carried by any carrier is to protect their assets, so the larger carriers with millions of dollars in assets will hold millions of dollars in insurance protection.

It is important to recognize that the trucking industry is composed of small business entrepreneurs with over 48% of all fleets consisting of 1 truck operations and 95% have 20 trucks or less.[2] The "law of large numbers" informs us that if you have 5,000 trucks on the road at a time, you are more likely to be involved in an accident than if you have one truck on the road. From information based on the Owner-Operator Independent Driver Foundation Member Profile 2012 (Member Profile),[3] we know that for its membership, the average owner-operator member has driven over 2,000,000 miles and less than 1%

[1] "Essential Financial and Operating Information for the 100 Largest For-Hire Carriers in the U.S. and Canada," Transport Topics (2013), http://www.ttnews.com/top100/for-hire/

[2] *Examining the Appropriateness of the Current Financial Responsibility and Security Requirements for Motor Carriers, Brokers, and Freight Forwarders – Report to Congress*, FMCSA (2014) http://www.fmcsa.dot.gov/sites/fmcsa.dot.gov/files/docs/Financial-Responsibility-Requirements-Report-Enclosure-FINAL-April%202014.pdf

[3] *Owner-Operator Independent Driver Profile 2012*, OOIDA Foundation (2012).

have had a reportable accident. To suggest that somehow the one truck operator should be judged as a risk comparable to a mega carrier is illogical.

By comparing the Trucking Alliance's press release and the actual analysis of the data conducted by an actuarial consulting firm, Bickerstaff, Whatley, Ryan & Burkhalter, Inc. ("BWR&B"), we find that "BWR&B" makes several caveats to the analysis that the Trucking Alliance chose not to reveal in their release. Taken from the Analysis, "In our opinion, this report does not constitute a Prescribed Statement of Actuarial Opinion as defined by the American Academy of Actuaries. It is an informal analysis and report intended only for the use of the Trucking Alliance and its membership."[4] In other words it doesn't meet the criteria for acceptance under actuarial guidelines and is only to be used as a report to the Alliance.

"BWR&B" continues to observe that crash settlements of $750,000 and above, accounted for only about 1% of all settlements. "BWR&B" also provides another caveat that, "The data sets were accepted as provided without audit or modification. Any formal actuarial analysis of these settlements would require additional review and possible augmentation of the database. The calculations shown here should <u>not be</u> construed to constitute a formal actuarial analysis."[5] The Trucking Alliance mentions none of these caveats in the press release and instead the statement is made that, "This uninsured exposure means the trucking companies must pay out the additional dollars from within the business or in the worse case, file bankruptcy to avoid paying."[6]

The biggest question has to be why would this Alliance of mega carriers, with a net income in the billions of dollars, want to mandate a higher insurance requirement. A simple inquiry into the FMCSA Licensing and Insurance web site shows that each of the original Alliance members carries the maximum amount of Public Liability required, and undoubtedly millions more as they pay for coverage of their assets. Thus, they would not have to pay a greater premium than they already pay now, however, all other carriers would be required to pay a higher premium and carry a greater amount of insurance, even though their crash risk may be 10,000+ times less. This is part of the so called "leveling of the playing field" so often mentioned by mega carriers to justify that small entities should pay the cost of the growth and leverage that the mega carriers have incurred. Most owner-operators carry $1 million dollars in Public Liability, which more than likely is 10 times the amount needed to cover their company's assets, thereby paying much more proportionately than the mega carriers do.

The "BWR&B" study also states that 42% of the dollar settlements paid by trucking companies in the Alliance report for motor vehicle accidents exceeded the minimum insurance requirements. However, this is only true for the Trucking Alliance members who presented selected claims for analysis. Looking carefully at the statement, it implies that 42% of all the settlements were more than the mandatory requirement, but a single large settlement could easily make up the 42% of the dollar settlement figure.

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[4] Christopher J. Burkhalter, *Analysis of Crash Settlement Data from The Trucking Alliance*, Bickerstaff, Whatley, Ryan & Burkhalter, Inc. 2013.
[5] Ibid, pg. 4.
[6] The Trucking Alliance, Press Alliance "Study Shows Trucking Companies Underinsured," June 4, 2013.

These mega carriers only are required to show the $5 million dollars of Public Liability but carry millions more of insurance to cover their assets. What is clearly evident, is that even while picking the accidents to be analyzed, these Trucking Alliance carriers have had numerous accidents.

Congressman Cartwright's bill, "A SAFE HAUL"

Representative Cartwright, an attorney who specialized in the representation of consumers in personal litigation, has introduced a bill in Congress to raise the public liability mandate to $4,422,000 for all commercial carriers with trucks weighing 10,001 pounds and greater.

In the bill, Representative Cartwright quoted The American Association for Justice (AAJA), an association of trial lawyers, who indicate that it would take $4,422,000 in 2013 dollars to be equivalent to the 1980 $750,000 value of the dollar based on the Consumer Price Index (CPI). "In present dollars, adjusted for the increase in the cost of medical care it takes more than $4.4 million to provide the equivalent of $750,000." This would seem to be more of an indictment against rampant rising medical cost than an insurance liability problem.

In order to justify his proposed bill, Rep. Cartwright utilized spiraling medical cost as a catalyst for mandating higher insurance coverage. Instead of seeing this as a reason to examine the escalating medical cost, he uses these out of control percentages, along with the CPI, to justify his bill. The Rand corporation, has noted that between 1999 and 2009, U.S. health care spending nearly doubled, climbing from $1.3 trillion to $2.5 trillion.[7] Bloomberg reports that health care costs have risen faster than the U.S. inflation rate, and Time Business reports that health insurance premiums are up 131% in the last ten years, whereas the general rate of inflation has risen 28%.[8] The AAJA would undoubtedly argue that medical expenses are the appropriate costs to consider as to what public liability is supposed to cover. It is also a fact that one of the reasons for such high health care costs is the number and size of litigation claims brought by attorneys representing plaintiffs in a lawsuit.

In fact, trial attorney fees are generally paid based on the size of the settlement that they get from the tort litigation. Recall the court case where McDonalds was required to pay what many considered an exorbitant penalty for a woman who spilled coffee on herself. The facts of that case are forgotten but the case has taken on the persona of lawsuits that run amok. The case also demonstrates the necessity for tort reform, which happens to be opposed by litigation attorneys whose wealth and status are increased by large settlements.

In 1986, the U.S. Justice Department cited the expansion of business liability under tort law as the factor explaining higher premiums and reduced coverage limits. It should be noted here that in the OOIDA survey of its members, 29% have no medical insurance coverage (the number one reason is too expensive). This is a travesty that was brought on by higher medical costs in relationship to income

[7] David I. Auerbach and Arthur L. Kellermann, "A Decade of Health Care Cost Growth Has Wiped Out Real Income Gains for an Average US Family," Health Affairs (2011).
[8] Brad Tuttle, "Health Insurance Premiums Up 131% in Last Ten Years," Time magazine, (September 2009) http://business.time.com/2009/09/16/health-insurance-premiums-up-131-in-last-ten-years/

levels, which should sound alarms for anyone truly concerned with the safety and health of the American worker.

The impact of raising the Public Liability coverage and associated premiums on the majority of carriers

As aforementioned, the trucking industry is primarily composed of small trucking companies. In fact, approximately 50% of all carriers are one-truck operations. According to David Golden, senior director of commercial lines for the Property Casualty Insurers Association of America, "The free market does a good job of determining the appropriate level of insurance and the appropriate rates, and does this regardless of the financial responsibility requirements that the government sets." Furthermore, Mr. Golden emphasizes that the majority of "zone-rated vehicles" have limits of at least $1 million if not more. Drawing on the experience of the OOIDA membership, the vast majority of owner-operators carry a minimum of $1 million in Public Liability.

Insurance rates are based on the "risk" factors that the carrier represents. Consequently, the Trucking Alliance members are composed of mega carriers whose "risk" is magnified by the fact that they operate thousands of trucks on the highways daily, while also recording hundreds of millions of miles annually. In fact, Schneider alone racked up over a billion miles in 2011. It is simply impossible to compare the 80% of carriers (1-5 trucks), whose risk exposure is limited to 100,000 to 500,000 miles annually, to those mega carriers. Large carriers have used this "law of large numbers" to justify the number of reportable accidents. However, the OOIDA Foundation Member Survey found that of the approximate 100,000+ owner-operator members, less than 1% had a D.O.T. reportable accident. These members drive approximately 10 billion miles annually.

Nonetheless, these conclusions are not just isolated to the OOIDA Foundation's research, but can be found by looking at data from FMCSA as well. FMCSA's crash statistics show that large carriers who predominantly use owner-operators have lower crash scores and higher mileage before an accident, than carriers of equal size who utilize employee drivers. Recent research presented before the Motor Carrier Safety Advisory Committee of FMCSA, clearly showed that small trucking companies and those that use owner-operators have far fewer accidents than the larger employee driver carriers do.

If we apply the same CPI formula that AAJA utilized to compare the rising cost of medical care to the income of drivers over the last ten years, we find that the gross revenue for owner-operators in the year 2000 was $127,441, whereas the gross expenses were $84,983. The net income for the owner-operator in 2000 was $40,787. In 2012, the gross revenue increased to $191,212 but the gross expenses were $143,880, and the net income was $50,000. Despite the increase in net revenue, the CPI purchasing power of the owner-operator in those 12 years decreased by $4,196 (by looking at the mode net income of the owner-operator, $40,000, and CPI would render a $14,196 loss in equivalent dollars).[9]

[9] *Owner-Operator Independent Driver Profile 2012.*

The average annual insurance premium for the single truck owner-operator (50% of the industry) for Public Liability is $5,000 for $1million. If the increase in mandatory Public Liability was $2 million, the increase in premium would be 100% and the net income and loss as determined by the CPI would be $9,146 in actual dollars.

There are 10,270,693 registered large trucks according to the Federal Motor Carrier Safety Administration as of March 2013. If every truck has an average of $1million in Public Liability then the premium annual cost would be over $51 billion. Increasing premiums has to account for a number of contingencies and there is no linear relationship between the liability coverage and the increase in premiums. Simply put, if the liability coverage goes up $2 million, the premium will likely be greater than double the amount it was for $1 million. (To make it simple for this paper we will assume a direct linear relationship of coverage to premium)

When researching the impact of an increase for public liability insurance, it is important to note that the increase will not affect the mega million net revenue carriers, who are pushing for the mandate, but the remaining 96% of the industry. In addition, keep in mind that the $5,000+ increase in premiums is for every truck in the fleet, and would have a devastating effect on small carriers.

Operating ratios, which show a company's expenses as a percentage of its revenue, are a prime indicator of profitability. Within the industry, the standard operating ratio for a successful truck within a fleet is 92.5%; this means that a carrier is looking to make 7.5 cents for every dollar in expenses in order to be successful. Utilizing the 2012 Member Profile, a small business owner with a fleet of five trucks could profit $11,332 per truck after all expenses, which would amount to a respectable net income of $56,660 for all five trucks.

However, if the public liability insurance requirement were to increase to just $2 million, another $5,000 would need to be added per truck to the gross expenses. Therefore utilizing the example above, the small owner's expenses would increase to $184,880, whereas the net income per truck would shrink to $6,332. The small business owner's overall net income would be just $31,660 for all five trucks, which is less than a single truck owner-operator expects to make.

Obviously, a jump to $4 million of Public Liability would mean a substantial loss and result in negative revenue. The owner then would either have to raise their rates during a recovering recession, or go out of business. This would of course benefit the mega carriers with all their leverage of discounts on fuel, tires, parts etc., and has a much better chance of producing a profitable operating ratio. A large carrier with net revenue of over $3.7billion, can weather the storm of unpredictable operating ratios, but the small carrier goes bankrupt, which may be exactly what the mega carriers are looking to achieve.

Raising the minimum Public Liability coverage for the small carriers, which constitutes 98-99% of the trucking carriers, would create economic disaster and a serious roadblock to the recovery efforts. Trucks deliver over 68% of all freight in the United States and are the only form of transporting freight for a majority of the small communities that comprise rural America. The small, middle class, American

business will be the entities to suffer, which will produce a ripple effect on the economy and could produce a serious roadblock, or possible double dip, in the recession.

The ripple effect: A spreading, pervasive, and usually unintentional effect or influence

The present recession has often been compared to the recession that occurred in the 1980's. While most people who study such economic events do not believe the present recession is as bad as the previous recession, there are certainly similarities. The prior recession suffered a "double dip," meaning that just when it looked like things were getting better, the economy flat lined and things got worse. It took some very difficult decisions with considerable economic uncertainty to come out of that recession. One of the leading causes of the 80's recession was what has been called a "Liability Insurance Drought."

A basic fact of business is that companies must have liability insurance in order to operate. Without such insurance, lenders will not loan money and investors will not invest, therefore, business stagnates and the economy goes into free fall. This was the ripple effect where insurance companies were not in a position to offer liability insurance at a reasonable premium and keep enough reserves on hand to maintain their status as a viable insurance carrier.

There are basically two schools of thought as to what brought about the drought of liability insurance protection. The insurance industry blames the litigation attorneys who went after companies and products asking for, and often winning, what many considered outrageous settlements for plaintiffs. The attorneys found ways to include in their lawsuits, companies and individuals that were only tangentially involved in the product or service, in order to pad the settlement cases. This was referred as the "litigation explosion" that has made realistic underwriting for commercial liability risks problematic.

Litigation attorneys denied the accusation from the insurance companies and said that the insurance companies just made bad decisions on investments and were not able to earn the kind of cash reserves that were needed to operate. The 1980s, and early 1990s, was tumultuous time for businesses, and the trucking industry was especially hard hit. As more and more businesses failed or were stymied because they could not obtain the liability coverage needed to operate, the trucking industry had less and less freight to haul.

Similar to the 1980s recession, the present recession has a product liability insurance crisis, which has rippled to affect a wide range of businesses that depend on liability insurers to secure loans and attract investors. David Golden, senior director of commercial lines for the Property Casualty Insurers Association of America recently stated that, "Insurance capacity is finite. There is only so much capacity out there."

Insurance Capacity:

The simple fact is that insurance is a business that affects almost all levels of the economy. Insurance companies must retain a certain amount of capitalization (cash) to cover anticipated claims. To be successful, insurance companies rely on premiums from their insured consumers and the investment revenue that they make in the marketplace. If the insurance company loses premium dollars, they then rely on investments to counter the loss. If they lose on investments then they will normally increase premium rates to make up the losses. The issue becomes when they lose both premium dollars and investment income.

The amount of capital, or cash, the insurance companies have in anticipation of claims to be paid, determines their capacity to continue to offer insurance liability. In the recession of the 80's, there was a "capacity crisis" within the industry. The consequence was a Liability Insurance Drought, whether it was because of the crisis resulting from tort litigation, as the Justice Department suggested, or because insurance carriers made poor decisions on their investments and did not adjust their premiums correctly. Insurance carriers were very meticulous about who and what they would insure along with the amount they would insure for, this then created a ripple effect where businesses were not getting the loans they needed to function, municipalities were not able to build and develop, and we were into a full-blown recession. Unemployment rose, the stock market tumbled, which created a vicious circle as investments tanked, and insurance became even scarcer. This is referred to as a "hard market" in insurance, which directly affected the middle class. Moreover, trucking company bankruptcies were rampant.

While I am sure that Representative Cartwright and the litigation firm he is a partner in would deny that a raise of Public Liability insurance would contribute to a Liability capacity crisis, we need to examine what is happening now within our own recession. The characteristics of a hard market are:[10]

- Higher insurance premiums (Since the end of 2012 we are facing a hard market as premiums across the board have increased)
- More stringent underwriting
- Reduced capacity, which means insurance companies write less insurance policies
- Less competition among insurance carriers

PSA Financial believes that we are already looking at a hard market in insurance because:

- Mother Nature made 2011 one of the worst years in world history in terms of losses due to natural disasters worldwide. In the United States, there were tornadoes in the Southeast and Midwest, flooding on the East coast, and a drought in the South. In 2012, Hurricane Sandy struck, while Japan suffered from earthquakes continually into 2013. All of these natural disasters meant insurance carrier's reserves were reduced, which forced insurance companies to replenish their reserves by increasing the rates. Economic downturn has meant that

[10] Craig English, "Hard-market-vs-soft-market-the-insurance-industry's-cycle-and-why-were-currently-in-a-hard-market," PSA Financial (2013).

investments are not obtaining double-digit returns and have dropped to a 3-5% return, resulting in higher rates.

- Business Insurance premiums are affected by payroll and revenue. As the recession hit, trucking companies began to lay off drivers and experienced a decrease in revenue as consumers had less capital to spend and freight took a nosedive. As a result, insurance carriers saw a decrease in premium revenue.
- Most underwriters today want a five to ten percent higher rate upon renewal and some are requiring substantially more. Rates will vary from insurance carrier to insurance carrier and will depend on a business's inherent risks, claims history, and finances.

In addition, capacity becomes strained and limited to those that can afford it. For the small trucking industry, an increase in the mandatory Public Liability insurance will expose the insurance carrier to more claims risk and will offer an incentive for more tort litigation awards. The insurance carriers will be forced to "harden" their requirements for insurance, raising rates that will force small carriers out of business, which will again create a rippling effect. This will of course have little or no affect on the mega carriers with their mega millions in revenue, while they continue to self-insure through surety bonds and assets. Many other carriers will merely pass on any premium hikes to the driver by taking it out of their settlement. Unfortunately, the regulations require the carrier to hold the insurance but do not require them to pay for the insurance.

The *Insurance Journal* released a report on the National Interstate Corp., which insures transportation providers, that stated the corporation posted an 18 percent loss in the second quarter of 2013. They experienced higher than normal claims costs, and in fact, higher costs were fueled by only three claims.

Another little known fact about insurance coverage is the incentive for insurance carriers to settle claims even though they may doubt the authenticity of the claim. If the plaintiff is willing to settle the claim against an insurer for the maximum amount of the coverage or below, and the insurance carrier denies the offer and the case goes to trial, a jury can give a much higher award to the plaintiff than the policy limits. This would assure bankruptcy for the small trucking company, as it will be responsible for the award amount over the policy limits. However, the attorney for the plaintiff can now represent the insured and sue the insurance carrier for being negligent in not settling earlier. There is precedent for this in law and although the insured will undoubtedly still lose his or her business they would not be obligated for the excess judgment.

For this reason, insurance carriers are incentivized to settle claims within policy limits as most claims are handled. This litigation process takes a great deal of time and attorneys are not incentivized to bring these suits to court when policy limits are where they are today. They may win a big judgment but they also may not, and even if they do, an appeals court may overturn the mega settlement and reduce the award. If the policy limits were to be raised to $4.4 million, then the attorneys will have much more incentive to sue and challenge insurance carriers who may offer settlements even when they believe the claim is unfounded. The attorneys can collect substantial settlements because the policy limits have been raised, and insurance carriers will have to keep much more money in reserve to meet the potential

claim settlements. In the present economy, raising premiums would be the only option, which would force the smaller and safest carriers out of business.

Basic premise has no evidence to corroborate its conclusions:

The proposed bill, and the report from the Trucking Alliance, makes their case based on a statement that has absolutely no evidence. Both claim that by increasing the Public Liability requirements there will be a direct and positive relationship on fatalities and crashes involving large trucks. However, there is absolutely no research that indicates the amount of insurance a carrier has is in any way related to the safety of the carrier. In fact, the evidence argues that owner-operators and other small carriers are more likely to use drivers that are more experienced and committed, than large carriers who simply carry more insurance.

Large carriers are more likely to hire drivers with less experience to increase their operating ratios as they pay their drivers less. These same well-insured carriers, routinely report turnover rates in excess of 100% and express the need to fill positions because there is a purported driver shortage, which are indicators of heightened "risk" for accidents and fatalities.

Recent research done by the OOIDA Foundation on large carriers and the relationship of CSA scores to crashes, which was taken from publicly available information, shows that large, self-insured carriers, like those in the Trucking Alliance, have higher crash rates per power unit and more accidents for mileage driven than carriers that use predominately owner-operators. It is not the amount of insurance that makes a carrier safe but the experience and commitment of the driver.

A recent article in the Kansas City Star, Sunday, August 4, 2013 reported on a growing practice for hospitals to not accept medical insurance as payment for those injured in automobile accidents, but to put a lien on the crash victims settlement to make sure they get their money. The hospitals do not discount the cost as they would for health insurance, thereby making huge profits and further victimizing those who have been injured in crashes.

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