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TEACHING TORTS WITHOUT INSURANCE: A SECOND-BEST SOLUTION

DAVID A. FISCHER* AND ROBERT H. JERRY, II**

Teachers, scholars and practitioners have long appreciated the symbiotic relationship of torts and insurance. Indeed, the assertion that tort law and insurance law are intertwined is utterly unremarkable; many commentators have observed that tort law cannot be understood if the business of insurance and the law regulating it is ignored, and that insurance law cannot be understood if tort law is ignored.¹ Several generations of law students have

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1. See, e.g., Tom Baker, *The Incidence, Scope, and Purpose of Punitive Damages: Reconsidering Insurance for Punitive Damages*, 1998 WIS. L. REV. 101, 130 (1998) (“[T]ort law cannot be fully understood without paying close attention to insurance, and insurance law cannot be understood without paying close attention to tort law.”); Seth J. Chandler, *The Interaction of the Tort System and Liability Insurance Regulation: Understanding Moral Hazard*, 2 CONN. INS. L.J. 91, 93 (1996) (“The tort system and the insurance regulatory system work together to determine the welfare of injurers and victims in society. Neither one can be understood properly without an understanding of the other.”); PETER CANE, *TORT LAW AND ECONOMIC INTERESTS* 432 (2d ed. 1991) (“It is now accepted wisdom that the practical operation of the law of tort cannot be understood without paying attention to the fact and extent of insurance, whether it be liability (that is, third-party) insurance, loss (that is, first-party) insurance, or legal expenses insurance (which covers the cost of making or defending legal claims).”); Kent D. Syverud, *The Duty to Settle*, 76 VA. L. REV. 1113, 1114 (1990) (“Tort litigation and liability insurance are symbiotic institutions. They are dissimilar organisms intimately associated in a mutually beneficial relationship.”) [hereinafter Syverud, *The Duty to Settle*]; Allen E. Smith, *The Miscegenetic Union of Liability Insurance and Tort Process in the Personal Injury Claims System*, 54 CORNELL L. REV. 645, 646 (1969) (“The relationship of liability insurance and the tort process is difficult to characterize in a pithy phrase. . . . [A] ‘miscegenetic union’—like that of fish and fowl—incapable of producing social welfare as its offspring, seems most apt as a shorthand description.”); Fleming James, Jr. & John V. Thornton, *The Impact of Insurance on the Law of Torts*, 15 L. & CONT. PROB. 431, 444 (1950) (“Insurance in the law of torts has served during the past fifty years to modify some legal rules and to broaden both the base of recovery and the possibility of recovery.”); MARC A. FRANKLIN, *CASES AND MATERIALS ON TORT LAW AND ALTERNATIVES* 444 (1971) (“Private insurance . . . and social insurance have greatly influenced the formal and informal development of tort law”); DAN B. DOBBS, *THE LAW OF TORTS* 45 (2000) (“[T]ort law does not operate in a sterile laboratory. Its hope for compensation and its hope for deterrence, for corrective justice and for social utility are all among the aspects of

read casebooks, which in varying degrees pay homage to the connections between torts and insurance.² Many law review articles³ and noteworthy books (or portions thereof)⁴ have plumbed the tort-insurance relationship. Although one of us has taught Torts for many years but has never taught Insurance,⁵ and the other of us has taught Insurance for many years but has never taught Torts,⁶ both of us have both long believed that each of our

tort law affected by the presence of liability insurance.”); MARK C. RAHDERT, *COVERING ACCIDENT COSTS: INSURANCE LIABILITY, AND TORT REFORM 1* (1995) (“Scarcely anyone familiar with the American system for tort compensation would deny that it has been profoundly influenced in the twentieth century by the fact that many, if not most, defendants who wind up paying damages to plaintiffs both are able to and do routinely insure against such losses.”). The interconnections also have significant implications for proponents of tort and insurance reforms. See Kenneth S. Abraham & Lance Liebman, *Private Insurance, Social Insurance, and Tort Reform: Toward a New Vision of Compensation for Illness and Injury*, 93 COLUM. L. REV. 75, 75-76 (1993) (“Proposals to reform tort law often do not recognize the role played by public and private insurance programs in compensating for health care expenses and lost income, even though insurance programs dwarf tort law as a system of reimbursement.”). This premise is not, however, without its detractors. See W. PAGE KEETON, ET AL., *PROSSER AND KEETON ON THE LAW OF TORTS* 589, 596 (5th ed. 1984) (“Although liability insurance undoubtedly has had its effect, a dispassionate observer, if one is to be found in this area, might quite as readily conclude that the impact of insurance upon the law of torts has been amazingly slight; that most of the changes that have been pointed out are due to other causes; and that it is in truth astonishing that a system by which the defendants can and do obtain relief from all liability upon payment of a relatively small premium has received so little mention and visible recognition in the tort decisions. . . . The list is far from being an impressive testimonial to the importance of liability insurance as a factor in the development of the law of torts up to the present day.”).

2. See, e.g., JAMES A. HENDERSON ET AL., *THE TORTS PROCESS* 701-19 (5th ed. 1999); LEON GREEN ET AL., *CASES ON THE LAW OF TORTS* 635-52 (2d ed. 1977); FRANKLIN, *supra* note 1, at 442-512.

3. See, e.g., Fleming James, Jr., *Accident Liability Reconsidered: The Impact of Liability Insurance*, 57 YALE L.J. 549 (1948); Michael J. Trebilcock, *The Role of Insurance Considerations in the Choice of Efficient Civil Liability Rules*, 4 J. L. ECON. & ORG. 243 (1988); Seth J. Chandler, *supra* note 1; George L. Priest, *The Current Insurance Crisis and Modern Tort Law*, 96 YALE L.J. 1521 (1987).

4. See, e.g., RAHDERT, *supra* note 1 (discussing influence of insurance on substantive rules of tort law); STEVEN SHAVELL, *ECONOMIC ANALYSIS OF ACCIDENT LAW* 186-227, 235-45 (1987); A. MITCHELL POLINSKY, *AN INTRODUCTION TO LAW AND ECONOMICS* 67-76 (2d ed. 1989); I REPORTERS’ STUDY, AMERICAN LAW INSTITUTE, *ENTERPRISE RESPONSIBILITY FOR PERSONAL INJURY* 55-103 (1991) (analyzing functioning of tort system in relationship to liability insurance “crisis” of mid-1980s).

5. Professor Fischer has taught Torts for almost thirty years and Products Liability for almost twenty years.

6. This refers to Professor Jerry, who has taught Insurance Law for almost twenty years. When he teaches in the first-year curriculum, his course is Contracts. The common wisdom among insurance scholars is that most of them approach the study of insurance law from a torts perspective as opposed to a contracts perspective, but a review of the information provided by law school faculty in THE AALS DIRECTORY OF LAW TEACHERS 2000-01 shows a fairly narrow gap between the two perspectives: a total of one hundred sixty-six law faculty self-identify as

respective principal subjects is diminished if it is studied without the rich context provided by the other's primary field. Neither of us would operate a motor vehicle, set up a business, or venture very far from home without insurance; we suggest that it is just as unwise to teach torts without insurance.

We do not dwell, however, on what is lost in torts if insurance is ignored. Rather, we examine how the study of torts is enriched when insurance concepts play a role in students' analysis. Our discussion is divided into two parts. Part I offers a "macro" perspective on the connections between tort and insurance. In this Part, we summarize the principal issues in play when the purposes of tort law are analyzed against the backdrop of first-party and third-party insurance compensation mechanisms. Part II provides a "micro" perspective on tort-insurance connections. In this section, we take a sample of discrete tort law principles, representative of those discussed in a typical first-year torts course, and we discuss how a student's understanding of these doctrines can be enriched if an insurance perspective is combined with the traditional "tort presentation." We offer a few concluding thoughts in Part III.

I. A "MACRO" PERSPECTIVE ON THE CONNECTIONS BETWEEN TORTS AND INSURANCE

Although many interesting points are embedded in the voluminous array of teaching materials and scholarship on the torts-insurance intersection, we underscore two particularly important ones. First, whether tort law's substantive doctrines successfully implement tort law's underlying policies cannot be assessed without considering the influence of insurance. Second, the impact of insurance on the tort litigation process is so profound as to make it impossible to understand tort litigation without understanding the structure of the liability insurance contract. We will take up each of these observations in turn, but to put this discussion in context, we first provide a brief overview of the liability insurance contract.

A. *The Origin, Structure and Purposes of the Liability Insurance Contract*

Not much could be said about tort law before 1850; this would change with the arrival of the Industrial Revolution.⁷ Initially, courts were unsympathetic

now teaching or having taught Insurance Law, and sixty of these also self-identify as now teaching or having taught Torts, whereas forty-six self-identify as now teaching or having taught Contracts. Interestingly, the gap appears to be wider with newer faculty: of thirty-three law faculty with one to five years experience who are teaching Insurance Law in the 2000-01 academic year, twenty-four indicate that they are currently teaching Torts, whereas only ten indicate that they are currently teaching Contracts. (Professor Jerry appreciates the assistance of John Wood in compiling this data, a copy of which is on file with the *Saint Louis University Law Journal*.)

7. See LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 299-302, 467-68 (2d ed. 1985); G. EDWARD WHITE, TORT LAW IN AMERICA: AN INTELLECTUAL HISTORY 3-4 (1985).

to efforts to expand the liability of firms for injuries suffered by employees,⁸ but statutory reforms in the late nineteenth century, along with judicial relaxation of limitations on recovery imposed in earlier years, removed many of these barriers.⁹ Almost as quickly as the new liabilities developed, insurers brought “employers’ liability insurance”¹⁰ to the market. In 1886, an English insurer issued what is thought to be the first policy of liability insurance in the United States;¹¹ the insurer promised that it “will pay to the Employer or his

8. See Edmund Dwight, *How Employers’ Liability Entered U.S.*, THE EASTERN UNDERWRITER, Mar. 28, 1930, at 37 (“[T]he theory of the common law as it had developed up to the third quarter of the last century enabled the employer to interpose so many defences against a claim for damages suffered by his injured workman that a suit at common law gradually came to be a poor remedy . . .”). Prior to the era of industrialization, injured workers typically relied on the charitable benevolence of their employers. The changing relationship between employers and workers in the new economy altered to the point of elimination this manner of caring for the injured. See MORTON J. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW, 1780-1860*, at 208 (1977). In his remarkable study of all nineteenth century tort cases decided by New Hampshire and California courts, Professor Gary Schwartz verifies that the courts of those two states were generally pro-defendant in employer-employee cases. Gary T. Schwartz, *Tort Law and the Economy in Nineteenth-Century America: A Reinterpretation*, 90 YALE L.J. 1717, 1768-69 (1981). His study, however, disputes the generally accepted view that nineteenth century common law courts adopted restrictive rules that gave emerging industries protection from liability to non-employees. The California and New Hampshire cases were very protective of accident victims in suits against emerging industries. *Id.* at 1771.

9. See FRIEDMAN, *supra* note 7, at 477-85.

10. See Sylvester C. Dunham, *Liability Insurance*, in II YALE INSURANCE LECTURES 233 (1903-04) [hereinafter YALE INSURANCE LECTURES].

11. This policy was issued by The Employers Liability Assurance Corporation, Ltd., an English company which shortly before 1886 had established an American branch in Boston. See Edwin W. DeLeon, *Historical Sketch*, in II THE BUSINESS OF INSURANCE: A TEXT BOOK AND REFERENCE WORK COVERING ALL LINES OF INSURANCE 191 (Howard P. Dunham ed., 1912) [hereinafter THE BUSINESS OF INSURANCE]. This detail is corroborated by the agent who supposedly sold “Policy No. 1” in the United States. See Dwight, *supra* note 8. See also Raymond N. Caverly, *The Background of the Casualty and Bonding Business in the United States*, INS. COUNSEL J. 62, 63 (1939) (crediting Employers Liability Assurance with selling first third-party liability policy in the United States). The first policy was limited to coverage for employers’ liability to employees, not to the company’s potential liability to the public. Caverly, who in 1939 was the Vice President of the Fidelity and Casualty Company of New York, attributed this to “the fact that they did not have ambulance chasing lawyers in those days.” *Id.* at 63 (quoting June 1902 discussion in *The Insurance Post* on “ambulance chasers”). The timing of the creation of the Employers Liability Assurance Corporation’s branch in Boston does not seem coincidental; by 1886, the possibility of placing liability on employers for workplace injuries must have been under active discussion, as the first employers liability law would be enacted in 1887 in Massachusetts, and many other states would soon follow suit. See DeLeon, *supra*, at 192-211; Dunham, *Liability Insurance*, *supra* note 10, at 227 (describing employers liability acts, and how they limited the employers’ defense that the employee’s injury was caused by the negligence of a “fellow servant”). The English Employers’ Liability Act was enacted in 1880. See C.A. KULP & JOHN W. HALL, *CASUALTY INSURANCE* 21 (4th ed. 1968). It was no doubt a reasonable prediction at the time that the concept would spread across the Atlantic.

legal representatives all such sums for which such Employer shall become liable to his workmen by virtue of the Common Law or any Statute with the following limitations and conditions. . . .”¹² Additional insurers quickly entered this market, and the total annual premiums written by liability insurers in the United States grew ninety-fold between 1887 and 1906 (from approximately \$200,000 to more than \$110 million).¹³ As the range of activities on which liabilities were imposed expanded,¹⁴ the coverage of the liability policy expanded as well; by 1912 one commentator described the typical policy in the United States as providing broad protection “against the legal liability of the Assured arising from bodily injuries resulting from negligence.”¹⁵

Growth in premium volume continued throughout the twentieth century.¹⁶ By 1998, more than \$107 billion was spent annually in the United States on

It is possible, however, that the employers’ liability policies may have been preceded by a kind of liability insurance sold to owners of steam boilers. According to an 1893 commentary on the “new” employers’ liability coverage, “[i]t has been a long time usual for companies doing this insurance to cover the liability of the owners of boilers in case of personal injuries, whether to employes [sic] or others, caused by explosions of their boilers. It will be seen that this feature of the boiler policy is quite within the definition of Employers’ Liability insurance given in the New York law.” George F. Seward, *Liability Insurance*, THE WKLY. UNDERWRITER, July 1, 1893, at 495. To the same effect is W.F. Moore, *Liability Insurance*, THE WKLY. UNDERWRITER, MAY 20, 1905, at 485 (noting that steam boiler began as property insurance, but indicating that almost all present boiler coverage has liability insurance component). Professor Jerry expresses his appreciation to Ms. Sheila Mulrennan, of the Insurance Archaeology Group in New York, for sharing with him documentation she compiled on the origins and development of liability insurance in the United States.

12. “Employers’ Liability Policy” issued to the Gender and Paeschle Manufacturing Co., Oct. 28, 1886 (copy on file with the Saint Louis University Law Journal). Coverage for workers compensation, which would first appear on the United States scene in the 1910s, could be added by endorsement. See FRIEDMAN, *supra* note 7, at 682; R.S. Keelob, *Liability Policy Forms*, in THE BUSINESS OF INSURANCE, *supra* note 11, at 214.

13. Keelob, *supra* note 12, at 203. See also YALE INSURANCE LECTURES, *supra* note 10, at 233 (in reference to employee claims against employers, “[t]he development of liability insurance as the instrumentality for sharing and distributing such losses and expenses was probably only hastened by the later definite course taken by the courts and the legislatures.”).

14. According to Kulp and Hall, contractors’ coverage began in 1886, elevator coverage in 1888, teams in 1891, manufacturers in 1892, owners-landlords-tenants in 1894, and contractual in 1900. More recent additions were product (originally called “poison”) coverage in 1910, sports in 1915, accountants in 1923, personal in 1932, and storekeepers in 1948. KULP & HALL, *supra* note 11, at 22.

15. Keelob, *supra* note 12, at 213.

16. By 1951, liability insurance premium dollars for auto property damage and bodily injury liability and “miscellaneous” property damage and bodily injury totaled \$1.935 billion, and this figure would grow to \$7.25 billion by 1966. KULP & HALL, *supra* note 11, at 23 tbl. 2-1 (based on data from *Best’s Fire and Casualty Aggregates and Averages*).

liability insurance,¹⁷ which amounted to \$380 for every person in the nation¹⁸ and approximately 1.1% of gross domestic product (GDP).¹⁹ These are large numbers, but the benefits provided by liability insurance are also enormous. Liability insurance gives individuals and firms some measure of security against the risk of financial ruin that can result if one's tortious conduct causes substantial injury to a third party. Indeed, it is difficult to imagine how the modern national and global economies could have matured and developed without the protection afforded to commercial enterprises from the consequences of their acts and neglect upon others.

A policy of insurance is a contract between insurer and policyholder, and like any contract, the insurance policy creates rights and duties between these two parties. In contrast to "first-party" coverage, which insures the policyholder's own interest in a piece of property or a life, liability insurance protects the policyholder against her risk of being liable in tort for damages owed to a third party. Both the first-party and third-party contract protect the policyholder's interests, but when the insurer pays proceeds under the liability insurance contract, the proceeds go not to the policyholder, but to the person to whom the policyholder is indebted by virtue of a judgment or settlement. That is the reason liability insurance is often labeled "third-party" insurance, even though the rights and duties in the contract, like first-party insurance, run between policyholder and insurer.²⁰

Although contract law would afford third-party rights to an intended beneficiary (*i.e.*, a tort victim) of the liability insurance contract, standard

17. According to data assembled by the A.M. Best Co., Inc., in 1998 total premiums in the United States in the following lines of insurance were as follows: private passenger auto liability, \$70.6 billion; commercial auto liability, \$13.0 billion; medical malpractice, \$5.1 billion; and general liability (including product liability), \$19.0 billion, for a total of \$107.7 billion. INSURANCE INFORMATION INSTITUTE, FACT BOOK 2000 1.9 (1999).

18. As of April 1, 2000, the United States resident population was thought to be 281,421,906. U. S. DEP'T OF COMMERCE, CENSUS 2000 SHOWS RESIDENT POPULATION OF 281,421,906; APPORTIONMENT COUNTS DELIVERED TO PRESIDENT (Dec. 28, 2000), *available at* <http://www.census.gov/Press-Release/www/2000/cb00cn64.html>.

19. GDP was estimated at \$9,752.7 billion in the first quarter of 2000. *See* Survey of Current Business (Jan. 2001) at D-3 (copy on file with the Saint Louis University Law Journal). Professor Kent Syverud performed this calculation with the same sources in 1994 using 1988-89 data. He found per-person expenditures at \$300 and the percentage of GDP to be 1.89%. *See* Kent D. Syverud, *On the Demand for Liability Insurance*, 72 TEX. L. REV. 1629 (1994). The economic boom of the 1990s exceeded the growth in liability insurance, which accounts for the percentage decline; but the increase in per-person expenditures shows that the demand for liability insurance remains very high. The long-term growth in liability insurance is indisputable; the foregoing data show that liability insurance grew fifty-six fold from 1951 to 1998, while GDP grew twenty-six fold during the same period. Comparing data from Bureau of Econ. Analysis, U.S. Dep't of Commerce, *GDP and Other Major NIPA Series, 1929-2000*, 80 SURV. OF CURRENT BUS. 120 tbl.1 (2000), with *supra* notes 17-18 and accompanying text.

20. *See* ROBERT H. JERRY, II, UNDERSTANDING INSURANCE LAW 38-39 (2d ed. 1996).

liability insurance policies contain a “no-action clause,” which expressly states that the contract creates no rights in third parties unless and until a judgment is entered against the policyholder. This means that a victim of a tort cannot sue the insurer directly in tort for the consequences of the policyholder’s allegedly wrongful conduct; the tort victim is not in privity with the insurer, and the contract does not bestow third-party rights on the victim. (In a very few states, statutory law provides a direct action to the tort victim against the insurer, and it is not uncommon for state statutes to provide limited direct action rights for discrete kinds of coverages, such as liability insurance for common carriers.²¹) This means the third-party’s tort claim must be brought against the policyholder; if the claim is within the coverage, the insurer will provide a defense to this claim and will indemnify the insured against any resulting judgment or settlement by paying proceeds to the plaintiff-victim. Thus, at least in theory, the tort claim owned by the victim is to be resolved in accordance with the same substantive rules that apply irrespective of the tortfeasor’s insurance coverage. As a practical matter, however, the presence of insurance makes a huge difference in how the victim’s liability claim is pursued, a topic taken up in more detail later in this Part.²²

Although liability insurance had its origins in protecting insureds against liabilities that might become owed to third parties, the compensatory potential of private liability insurance was recognized early on. Almost as soon as automobiles began to share highways with horses and carriages, the dangers of this new product were all too apparent, and the lack of compensation for highway injuries quickly became a matter of public concern.²³ Some early proposed reforms favored mandatory first-party insurance that would pay victims directly without regard to fault,²⁴ but the first statutory reforms

21. See JERRY, *supra* note 20, at 548-51. Note that if a first-party policy of property insurance pays for a loss caused by the negligence of a third-party, tort law will still be relevant to the insurer’s rights. After paying the insured loss, the insurer will be subrogated to the insured’s rights against third parties, meaning the tortfeasor that caused the insured’s loss. The insurer’s claim as subrogee will be asserted in the name of the insured; after the successful assertion of subrogation, the loss will ultimately fall on the party that caused it, *i.e.*, the tortfeasor. If the tortfeasor has liability insurance, the victim-insured’s insurer will seek recovery, then, from the tortfeasor’s insurer. For more on subrogation in the insurance context, see *id.* at 600-27.

22. See discussion in Part I.C.

23. See JERRY S. ROSENBLOOM, *AUTOMOBILE LIABILITY CLAIMS: INSURANCE COMPANY PHILOSOPHIES AND PRACTICES* 1 (1968) (“‘Carriages without horses shall go, [a]nd accidents fill the world with woe.’ With the advent of the automobile, the above prophecy credited to a 16th-century philosopher has proved to be a correct assessment of the 20th century. The automobile has influenced almost every facet of modern life and, unfortunately has precipitated a reign of terror on the American highways. . . . It is apparent from the date that both highway usage and motor vehicle accidents have shown steady increases since 1920 . . .”).

24. See, *e.g.*, Ernest C. Carman, *Is a Motor Vehicle Accident Compensation Act Advisable*, 4 MINN. L. REV. 1 (1919). For a summary of other early automobile accident compensation

required owners of motor vehicles to purchase liability insurance or demonstrate financial responsibility so that the victims of accidents would be compensated.²⁵ Statutory requirements that liability insurers pay proceeds to victims even if the insured-tortfeasor were insolvent (and thus could never be able to satisfy a judgment) underscored the fact that liability insurance was understood to have compensatory purposes that transcend the product's role in indemnifying policyholders from the consequences of their tortious conduct.²⁶

B. *Insurance and the Objectives of Tort Law*

By most accounts, three normative perspectives compete to define the objectives of tort law: the economic perspective; the corrective justice perspective; and the compensation perspective. Insurance has major implications for each.

The economic perspective, which is the core of most modern law and economics scholarship as it pertains to tort law, is concerned with the impact of liability, including potential liability, on individual behavior. Richard Posner was the first scholar to use economic analysis to explain the tort system.²⁷ Numerous other scholars have now joined Posner in using economics to analyze tort cases.²⁸ This approach emphasizes *deterrence*. Proponents of this perspective “evaluate existing legal doctrine or proposed reforms in terms of whether appropriate incentives are created for the various causal contributors to a given personal injury to minimize the sum of accident and avoidance costs by taking cost-justified precautions that will reduce the likelihood and severity of that outcome.”²⁹

Insurance has obvious implications for the deterrence objectives of tort law. If injurers are risk neutral the prospect of liability will lead them to take appropriate precautions.³⁰ A risk-neutral actor would spend \$450 to prevent a \$500 accident, but would not spend \$550 to prevent the accident. This is

proposals, see ROBERT H. JOOST, AUTOMOBILE INSURANCE AND NO-FAULT LAW 2D § 2:9, at 9-10 (1992).

25. See JERRY, *supra* note 20, at 843-49.

26. See JOOST, *supra* note 24, § 2:7, at 8 (“The law of torts began to put less emphasis on the fault concept, with its concern for the actor rather than the victim, and more emphasis on increasing the number of accident victims who were entitled to receive compensation.”).

27. Gary T. Schwartz, *Mixed Theories of Tort Law: Affirming Both Deterrence and Corrective Justice*, 75 TEX. L. REV. 1801, 1806 (1997); see Richard A. Posner, *A Theory of Negligence*, 1 J. LEGAL STUD. 29 (1972); Richard A. Posner, *Killing or Wounding to Protect a Property Interest*, 14 J.L. & ECON. 201 (1971).

28. See, e.g., SHAVELL, *supra* note 4; Guido Calabresi, *Concerning Cause and the Law of Torts: An Essay for Harry Kalven, Jr.*, 43 U. CHI. L. REV. 69 (1975); Saul Levmore, *Probabilistic Recoveries, Restitution, and Recurring Wrongs*, 19 J. LEGAL STUD. 691 (1990).

29. DON DEWEES ET AL., EXPLORING THE DOMAIN OF ACCIDENT LAW: TAKING THE FACTS SERIOUSLY 5 (1996).

30. SHAVELL, *supra* note 4, at 209.

socially desirable because it is wasteful to spend \$550 to save \$500. Waste occurs because resources spent to prevent accidents are just as valuable as resources lost because of accidents. If injurers are risk averse, however, they may be led to take excessive precautions (*i.e.*, spending \$550 to prevent a \$500 loss) or to engage in too little activity (depending on the liability rule and how accurately courts determine negligence).³¹ Making liability insurance available to risk-averse injurers corrects this problem, but only if insurers can charge premiums according to each injurer's level of care.³² If, for example, an injurer uses a level of care that creates a five percent risk of causing \$10,000 in damages, the appropriate insurance premium is \$500, but if her level of care creates an eight percent risk of causing the same damages, her premium should be \$800.³³ If the injurer can reduce the level of risk that she creates from eight percent to five percent for less than \$300, she will do so because her premium will be reduced by \$300, which is more than the cost of taking the additional precautions. Thus, the desire to reduce the insurance premium induces insureds to use cost-justified precautions.

It is obviously impossible for insurers to set premiums with the precision suggested by the above example. Attempting to determine the precise level of risk created by an insured would often require a very costly investigation. Furthermore, the attempt would often be futile because the level of care that an insured uses may vary from activity to activity and from time to time. If insurers cannot ascertain injurers' levels of care, liability insurance can cause injurers to take less than optimal care.³⁴ Indeed, this concern with moral hazard³⁵ explains nineteenth century opposition to liability insurance in some circles, a view that was not rejected until early in the twentieth century.³⁶ Insurance companies can partially correct the moral hazard problem by structuring coverage and premiums in such a way as to control the risks created

31. *Id.* at 209-13.

32. *Id.* at 211; Gary T. Schwartz, *The Ethics and the Economics of Tort Liability Insurance*, 75 CORNELL L. REV. 313, 337-49 (1990). For a discussion of how insurers classify risks and set prices, see KENNETH S. ABRAHAM, *DISTRIBUTING RISK: INSURANCE, LEGAL THEORY, AND PUBLIC POLICY* 64-100 (1986).

33. SHAVELL, *supra* note 4, example 9.1 at 207 and example 9.3 at 211.

34. *Id.* at 211-12.

35. Moral hazard refers to insurance's inherent tendency to increase loss through either intentional destruction of property or lives or, as is more typically the case, the diminished incentives created to prevent loss to property through the failure to take precautions at the margin that would reduce the incidence of loss. For more on moral hazard, the tort system, and insurance, see Chandler, *supra* note 1.

36. See PROSSER & KEETON, *supra* note 1, at 585-86. In England, liability insurance was considered to be against public policy until the last half of the nineteenth century. See W.A. DINSDALE, *HISTORY OF ACCIDENT INSURANCE LAW IN GREAT BRITAIN 176-77* (1954).

by the insured.³⁷ Examples include sharing the risk with insureds by issuing policies that do not cover the entire risk, making premium adjustments based on the insured's history of claims, and requiring insureds to take precautions (such as installing sprinkler systems) that reduce risk.³⁸ While these measures probably do not eliminate all of the problems caused by inaccurate pricing of insurance, the measures likely ameliorate the problems sufficiently so that less harm results from inaccurate pricing than would result from the disallowance of insurance. If insurance were unavailable, risk-averse actors would either refrain from offering some socially desirable goods and services or would offer them only at excessively high prices.³⁹ Therefore, the disallowance of insurance would harm the users of those goods and services.⁴⁰

Although much more can be said about the effect of insurance on incentives to use care,⁴¹ further detail is beyond the scope of this Article. The point for our purposes is that tort law, by itself, cannot achieve optimal levels of deterrence; this will occur only if liability insurance is available and is accurately priced, and this, in turn, will not happen if insurance law and regulation operate inefficiently so as to frustrate accurate pricing.⁴²

A second normative perspective stresses *corrective justice*. Under this view, the purpose of tort law is to nullify losses and gains that arise between individuals when one individual wrongfully injures the other.⁴³ Aristotle is

37. A. Mitchell Polinsky & Steven Shavell, *Punitive Damages: An Economic Analysis*, 111 HARV. L. REV. 869, 932 (1998).

38. *Id.* at 933. For more discussion on the effect of the price of insurance on levels of care, see ABRAHAM, *supra* note 32, at 10-18, 45-49.

39. Polinsky & Shavell, *supra* note 37, at 933. A risk-averse firm that self-insures will charge a larger "premium" for the insurance than will a liability insurance company. The firm's premium will include a sum sufficient to cover the risk insured against and an additional sum to compensate the firm for "being subject to risk—something it does not like . . ." *Id.*

40. *Id.*

41. For an insightful discussion of the issue and an elaboration upon Polinsky and Shavell, see Schwartz, *supra* note 32, at 336-59.

42. Judge Richard Posner argues that the normative premise of the tort system should be wealth maximization. Each person is a potential injurer and a potential victim, and thus purchases both liability insurance and first-party insurance to convert uncertain future losses into current certain costs. This mix of insurance purchased will be affected by the extent to which negligence or strict liability dominates the tort system (strict liability encourages more liability insurance, and negligence encourages more loss insurance; the price of the insurance is a function of the liability rules, as a strict liability environment makes liability insurance more expensive, and a negligence environment makes first-party insurance more expensive due to the larger number of uncompensated torts). A negligence regime will be optimal if it produces lower total premiums and everyone prefers that regime *ex ante*, even though some individuals will be left worse off *ex poste*. See Richard A. Posner, *Wealth Maximization and Tort Law: A Philosophical Inquiry*, in PHILOSOPHICAL FOUNDATIONS OF TORT LAW 103-05 (David G. Owen ed., 1995). This framework also depends on the availability and accurate pricing of insurance.

43. Catharine Pierce Wells, *Tort Law as Corrective Justice: A Pragmatic Justification for Jury Adjudication*, 88 MICH. L. REV. 2348, 2350, 2355 (1990).

usually credited as the first to articulate a theory of corrective justice.⁴⁴ The first modern explanation of the relationship of corrective justice to tort theory appeared in an article written by George Fletcher in 1972.⁴⁵ In recent years, numerous scholars have emphasized a corrective justice rationale for tort law.⁴⁶ These scholars advocate widely divergent theories of how to define the concept of corrective justice.⁴⁷

At first glance, liability insurance might seem to be completely inconsistent with the corrective justice perspective. A number of scholars have adopted this position, arguing that liability insurance undermines corrective justice because the notion of “personal responsibility based on fault” is abandoned when insured wrongdoers do not “themselves” compensate victims.⁴⁸ Others contend that the existence of liability insurance is compatible with at least some versions of the corrective justice perspective.⁴⁹ For example, Ernest Weinrib, a leading corrective justice scholar, states:

[C]orrective justice is applicable in the modern world despite the fact that the prevalence of liability insurance means that the defendant personally does not compensate the plaintiff for the loss. Corrective justice goes to the nature of the obligation; it does not prescribe the mechanism by which the obligation is discharged. Liability insurance presupposes liability, and it is that liability which is intelligible in the light of corrective justice. Nothing about corrective justice precludes the defendant from anticipating the possibility of liability by investing in liability insurance.⁵⁰

Any tendency of liability insurance to undermine corrective justice is largely a function of how accurately the insurance is priced. If the price of insurance accurately reflects the injurer’s level of care, then the injurer, and not the insurance company, compensates the victim. Furthermore, the amount the

44. *Id.* at 2350.

45. George P. Fletcher, *Fairness and Utility in Tort Theory*, 85 HARV. L. REV. 537 (1972).

46. See generally PHILOSOPHICAL FOUNDATIONS OF TORT LAW, *supra* note 42; Ernest J. Weinrib, *Corrective Justice and Formalism: The Care One Owes One’s Neighbors*, 77 IOWA L. REV. 403 (1992).

47. See Fletcher, *supra* note 45 (noting that corrective justice is based on reciprocity of risk); Richard A. Epstein, *A Theory of Strict Liability*, 2 J. LEGAL STUD. 151, 152 (1973) (noting that corrective justice is based on causation of harm); Jules L. Coleman, *Moral Theories of Torts: Their Scope and Limits: Part I*, 1 LAW & PHIL. 371 (1982); Jules L. Coleman, *Moral Theories of Torts: Their Scope and Limits: Part II*, 2 LAW & PHIL. 5 (1983) (proposing that one should develop “foundational” principles, and use them to formulate specific rules for resolving cases); Ernest J. Weinrib, *Toward a Moral Theory of Negligence Law*, 2 LAW & PHIL. 37 (1983) (noting that corrective justice based on Kantian principles); Wells, *supra* note 43 (noting that tort law should strive to enforce community standards of just compensation; this should be accomplished by using procedures that encourage juries to do justice in individual cases).

48. DEWEES ET AL., *supra* note 29, at 41.

49. Schwartz, *supra* note 32, at 331-36.

50. ERNEST J. WEINRIB, *THE IDEA OF PRIVATE LAW* 135-36 n.25 (1995).

injurer pays is based on her fault. Recall from our prior example⁵¹ that if insurance is properly priced, an insured that creates a five percent risk of causing a \$10,000 harm would pay a premium of \$500, and an insured that creates an eight percent risk of causing the same harm would pay an \$800 premium. The effect of an injurer having insurance is that she makes incremental payments to the insurance company in advance for the harm likely to result from the risks that she creates. Thereafter, the insurance company pays the victim if a risk materializes in a loss. But it is the injurer, and not the insurance company, who compensates the victim. The money for the payment comes from the premiums paid by the injurer because over the long run the injurer pays sufficient premiums to cover the losses that she causes. It is only when the price of insurance does not accurately reflect the injurer's level of care that corrective justice is undermined. In such circumstances, the injurer may pay an insurance premium that is either too low or too high to finance the payment of the victim's damages.

Even if insurance is accurately priced, one can defend liability insurance on corrective justice grounds. Liability insurance can serve to smooth the blunt edges of the tort system from the perspective of both the victim and the injurer. Victims benefit from insurance because in its absence, many tort suits would not be brought on account of injurers not having enough assets to make the suit worthwhile. The injurers in such cases would escape the civil justice system entirely, and this result might well undermine corrective justice to a greater extent than permitting injurers to purchase imperfectly priced liability insurance.⁵² Injurers also benefit from insurance. This is especially true in cases where an injurer whose negligence is slight produces enormous damage. In such cases, the availability of liability insurance can ease the crushing burden that would otherwise fall on one whose wrong is minor.⁵³ Further, one can argue that intentional act exclusions in liability policies facilitate bringing

51. See *supra* text accompanying notes 30-33.

52. Cf., Ellen S. Pryor, *The Stories We Tell: International Harm and the Quest for Insurance Funding*, 75 TEX. L. REV. 1721, 1750 (1997).

53. See Tony Honoré, *The Morality of Tort Law—Questions and Answers*, in PHILOSOPHICAL FOUNDATIONS OF TORT LAW, *supra* note 42, at 89-90.

[T]hough loss spreading (through third-party insurance) is distributive, the reason why it is needed as an adjunct to the tort system is, in part at least, to satisfy the demands of retributive justice. It serves to cushion losses which, whether defendants are at fault or not, are out of scale with the gravity of their conduct. This does not entail that loss spreading is an aim of the tort system as such, merely that some form of insurance is essential if a system of corrective justice is to operate fairly in modern conditions.

Id. See also Jeremy Waldron, *Moments of Carelessness and Massive Loss*, in PHILOSOPHICAL FOUNDATIONS OF TORT LAW, *supra* note 42 (contrasting two drivers, Fate and Fortune, who are momentarily inattentive; no consequence arises from Fortune's carelessness; Fate's neglect causes \$5 million of bodily injury to innocent victim; "[third-party] [i]nsurance makes Fate's predicament easier to accept").

the full measure of tort law's sanction on parties whose deliberate wrongs produce injury.

On the other hand, the pervasive use of liability insurance might undermine the ability of the tort system to achieve corrective justice. Dewees, Duff and Trebilcock argue that this has occurred in Canadian automobile accident law, where tort liability has become more of a strict liability compensation system than a fault-based corrective justice system.⁵⁴ This transformation, they contend, has resulted from a number of factors. First, the widespread use of liability insurance "has encouraged judges and juries to elevate the effective standard of care expected of a driver from that of a reasonable driver susceptible to inadvertent mistakes and momentary lapses of attention, to that of an exceptional driver divested of such unseemly human traits."⁵⁵ Second, most cases are settled by insurance company employees who, without legal advice, apply "rules of thumb which have little relation to liability rules as applied by appellate courts."⁵⁶ Third, even where liability is based on fault, it is "the institution of liability insurance that ultimately dictates the amount of compensation actually received and the extent to which damages are actually 'corrected' by the wrongdoer."⁵⁷ Therefore, it is impossible to achieve complete corrective justice if liability insurance fails to fully penetrate the relevant market. Even in compulsory liability systems, it is impossible to achieve one hundred percent compliance.⁵⁸ Thus, wrongful injuries will often remain uncorrected through the tort system if uninsured and underinsured drivers do not fully compensate plaintiffs for the injuries they inflict, which experience shows will usually be the case.⁵⁹

A third normative perspective, led by such scholars as Fleming James, stresses distributive justice and communitarian values.⁶⁰ The *compensation* perspective urges "that accident costs should be borne collectively, not individually, and that the tort system should be evaluated in terms of its capacity to spread risk and provide meaningful, expeditious, and low-cost compensation or insurance to the victims of these activities."⁶¹ Imposing liability on injurers ultimately shifts the costs of accidents to potential accident

54. DEWEES ET AL., *supra* note 29, at 39-42.

55. *Id.* at 40.

56. *Id.* at 41.

57. *Id.*

58. For example, despite laws in almost all of the states requiring car owners and drivers to maintain liability insurance, approximately fourteen percent of the nation's drivers are uninsured. Insurance Research Council, *IRC Study Estimates 14% of Drivers Are Uninsured*, at <http://www.ircweb.org/news/uninsured2000.htm> (Feb. 1, 2001).

59. DEWEES ET AL., *supra* note 29, at 41.

60. 2 FOWLER V. HARPER & FLEMING JAMES, JR., *THE LAW OF TORTS* 762, 759-64 (1956) ("The best and most efficient way to deal with accident loss . . . [is] to distribute the losses involved over society as a whole or some very large segment of it.").

61. DEWEES ET AL., *supra* note 29, at 6.

victims because these costs will be reflected in higher prices for goods and services.⁶² Tort, then, functions much like insurance, and this function is enhanced if strict liability is promoted, causation rules are diminished, and other barriers to recovery in tort are reduced.⁶³ Some adherents of the compensation perspective deny that tort law is capable of achieving these goals, and thus urge that the tort system be replaced with no-fault insurance mechanisms.⁶⁴ They, probably rightly, claim that as an insurance system, tort law is too expensive, it leaves too many people out, and the implicit premiums, in the form of higher prices for goods and services, are regressive because low-income consumers (who have lower recoveries for economic losses) pay the same premiums as high-income consumers.⁶⁵

For the reasons discussed above, few scholars claim that the tort system could effectively function as a compensation system.⁶⁶ Yet, the compensation goal cannot be completely dismissed. Many changes in the tort system, such as the adoption of strict products liability and the almost universal adoption of comparative negligence, can best be explained as an attempt to implement cost-spreading principles. Plainly, insurance is highly relevant to these attempts to provide compensation; without effective insurance and insurance law principles that facilitate risk transfer and distribution, compensation objectives are unattainable.

In the final accounting, whatever purposes one ascribes to tort law, the importance of insurance cannot be disregarded. Although, as discussed above, insurance law cannot guarantee that tort law's rules will match up well with tort law's purposes, disorder in the house of insurance law can easily disrupt tort law's fulfillment of its underlying aims.

C. *Insurance and the Torts Litigation Process*

As Professor Mark Rahdert observes, "insurance usually determines whether tort cases are brought, whom plaintiffs sue, how much they claim, who provides the defense, how the case gets litigated, the dynamics of

62. *Id.* at 6-7.

63. For a more detailed discussion, see Priest, *supra* note 3, at 1534-36.

64. DEWEES ET AL., *supra* note 29, at 7.

65. *Id.*

66. See Schwartz, *supra* note 27, at 1801 (noting that most United States torts scholars subscribe to either the deterrence school or the corrective justice school); CANE, *supra* note 1, at 456-57 (arguing that English law has never adopted compensation as a normative premise of tort law; "the basic principle underlying social welfare programmes funded by general taxation is that those who *can* pay *ought* to help those who are less well off. But the common law of obligations has never adopted this normative principle. . . . The common law of obligations is seen as based on notions of corrective justice rather than on any idea of distributive justice.") (emphasis in original text).

settlement, and how much plaintiffs ultimately recover.”⁶⁷ Rahdert’s first point is clearly correct: if the tortfeasor is uninsured, the odds that the injured victim will sue the tortfeasor decline. In many situations, the tortfeasor will have no significant assets with which to pay a judgment owed a third party apart from insurance. This is true not only with respect to individual insurance but also in the commercial sector. Many commercial enterprises that are not large enough to self-insure purchase liability insurance because of fear that they will not have ample resources to satisfy a judgment obtained by a victim of the firm’s negligence.⁶⁸ If the tortfeasor denies liability for the victim’s injuries and the tortfeasor is uninsured, it will rarely be productive for the victim to pursue litigation against the tortfeasor unless it is a large commercial enterprise.

If the tortfeasor is uninsured, the victim’s ability to obtain compensation will frequently turn on whether the victim has first-party insurance (health insurance for the medical expenses caused by an accident; disability insurance for lost income suffered while the insured’s injuries prevent her from employment; modest first-party medical payments coverage if an auto accident is involved; perhaps some property damage coverage; and uninsured motorist insurance if an uninsured tortfeasor injures the insured with a motor vehicle) to help with these losses, but this is hardly a given. Millions of Americans lack health insurance,⁶⁹ and disability coverage is even more sporadic.⁷⁰ If an auto accident is the cause of the loss, first-party medical and uninsured motorist coverage are optional in many states and therefore are often declined by policyholders.⁷¹ Where the coverage exists, the limits are often less than the typical tortfeasor’s liability coverage; underinsured motorist insurance, which

67. RAHDERT, *supra* note 1, at 1.

68. *See* CANE, *supra* note 1, at 432.

69. *See* Abraham & Liebman, *supra* note 1, at 80.

70. Approximately sixty million Americans (roughly fifty-five percent of the work force) have some kind of short-term disability coverage (defined as coverage against disability lasting less than two years), but only about twenty-four million persons (roughly twenty-two percent of the work force) are covered by long-term disability plans. *See* Abraham & Liebman, *supra* note 1, at 81-82. Employees in medium and large private firms (100 or more workers) fare slightly better. In 1997, forty-three percent of all employees had some kind of long-term disability insurance plan, while fifty-five percent had some kind of short-term disability plan. U.S. Dep’t of Labor, *Employee Benefits in Medium and Large Private Establishments, 1997*, at <http://www.bls.gov/ebshome.htm> (released Jan. 7, 1999); *Percent of Full-Time Employees Participating in Selected Employee Benefit Programs, 1997*, at <http://www.bls.gov/news.release/ebs3.t01.htm> (last modified Jan. 7, 1999). Some government programs fill in these gaps, but they only come close to replacing all income lost due to disability for only the lowest-income workers. Abraham & Liebman, *supra* note 1, at 84-85.

71. *See* JERRY, *supra* note 20, § 134[a], at 866.

is designed to make up this gap, is also optional, and is therefore frequently nonexistent.⁷²

If the tortfeasor has insurance, the calculus changes. In explaining why this is so, one needs to begin with the language of the insuring agreement in the typical liability insurance policy. The text of the Insurance Services Office (ISO)⁷³ Personal Auto Policy, to take one standardized form in widespread use in the United States, reads as follows:

We will pay damages for "bodily injury" or . . . "property damage" for which any "insured" becomes legally responsible because of an auto accident. . . . We will settle or defend, as we consider appropriate, any claim or suit asking for these damages. In addition to our limit of liability, we will pay all defense costs we incur. Our duty to settle or defend ends when our limit of liability for this coverage has been exhausted. We have no duty to defend any suit or settle any claim for "bodily injury" or "property damage" not covered under this policy.⁷⁴

Other common insurance policies, such as the Homeowners Policy and the Commercial General Liability Policy, have substantially similar language in the insuring agreement.⁷⁵ Policyholders become potential or actual defendants in tort actions millions of times each year, and the foregoing language, or text very similar to it, is implicated in each of these instances.

Tortfeasors who are covered by one of these policies are generally much more attractive targets for injured victims. Of course, the victim must have sufficient damages and a sufficiently plausible theory of recovery to make a lawsuit feasible. But if this is true, it is probable that the victim will pursue any and every potential defendant who has insurance that might be used to compensate her injuries. To the extent the injured party has first-party insurance, the victim will be less likely to sue, although the tortfeasor may not escape litigation if the first-party insurer has and chooses to pursue subrogation rights.⁷⁶ In the same vein, the size of the claim may be a function of the amount of insurance in force; the insured who increases her policy limits may attract claims that would not otherwise be made.⁷⁷

72. *See id.* § 134[c], at 875.

73. Insurance Services Office, Inc. is a leading supplier of statistical, actuarial, and underwriting information for and about the property/casualty insurance industry, and provides advisory services to more than 1,500 participating insurers and their agents. INS. SERV. OFFICE, INC., WHAT IS ISO?, available at <http://www.iso.com/docs/about.htm> (visited Feb. 28, 2001).

74. INS. SERV. OFFICE, INC., PERSONAL AUTO POLICY, PP 00 01 06 98 (1997). For the most recent version of the full text of this policy, see ROGER HENDERSON & ROBERT H. JERRY, II, INSURANCE LAW: CASES AND MATERIALS app. E (3d ed. 2001).

75. For texts of these other forms, see HENDERSON & JERRY, *supra* note 74, at apps. B and C.

76. *See* CANE, *supra* note 1, at 432.

77. Syverud, *The Duty to Settle*, *supra* note 1, at 1114-15.

In short, regardless of whether compensation is a legitimate function of the tort system, the economics of litigation dictates that lawsuits be brought against solvent defendants, and many potential defendants will be able to pay the judgments rendered against them only if they are insured. By the same token, the presence of insurance channels litigation against particular defendants. As Professor Baker observes, “liability insurance determines who is capable of being sued, for what wrongs, and for how much. The result is that tort law in action is shaped to match the liability insurance that is available.”⁷⁸ But the relationship probably goes even deeper. As Dean Syverud has observed, “[i]t may be that insurance *precedes* tort liability in the sequence—that insurance institutions cause some forms of tort litigation to come into existence, rather than the other way around.”⁷⁹ He cites “clergy malpractice” policies to illustrate a kind of coverage which was developed before such claims were asserted, which implies that some kinds of tort claims might never be made or recognized but for the presence of liability insurance.⁸⁰ This point is also commonly made with respect to the elimination of various immunities, which were often preceded by the introduction of liability insurance coverage for claims that would otherwise fall within the immunity’s protection.⁸¹

Beyond the implications of insurance on the question of who becomes a defendant, liability insurance affects how litigation is conducted and resolved. If the victim’s claim is covered, the liability insurer, as the insuring agreement both requires and allows, will provide a defense with an attorney of its choice, will exercise its privilege to settle the claim against the tortfeasor as it deems appropriate, and will (barring unusual circumstances) control the conduct of the defense. The rules for determining whether the insurer is required to defend come in two very different versions. Stated briefly, the “eight corners” rule requires the insurer to defend any time the plaintiff’s complaint alleges a claim which, if true, would be within coverage; the insurer cannot consider extrinsic evidence to escape the defense, just as extrinsic evidence is inadequate to impose the duty. The “potentiality” rule requires the insurer to defend whenever there is a potential for coverage, regardless of the complaint’s specific allegations.⁸² The choice of rule has significant ramifications for tort litigation; it affects whether the insurer takes defense

78. Tom Baker, *Insurance and the Law*, INTERNATIONAL ENCYCLOPEDIA OF SOCIAL AND BEHAVIORAL SCIENCES § 2.1. (Neil J. Smelser & Paul B. Baltes eds., forthcoming 2001) (manuscript at 6), available at http://papers.ssrn.com/sol13/papers.cfm?cfid=430916&cftoken=22383475&abstract_id=242026 (October 18, 2000).

79. Syverud, *The Duty to Settle*, *supra* note 1, at 1115.

80. *Id.*

81. See *infra* text accompanying notes 165-66.

82. See generally BARRY R. OSTRAGER & THOMAS R. NEWMAN, HANDBOOK ON INSURANCE COVERAGE DISPUTES 179-99 (10th ed. 2000).

costs into account when calculating the settlement value of the plaintiff's claim, whether the duty to settle attaches (which is relevant for another set of reasons, as discussed below), and whether insurance coverage disputes can be resolved earlier in the litigation, which in turn can have several effects on the resolution of the underlying tort claim.⁸³

A plaintiff's settlement strategies will often be a function of insurance; an offer at or near the policy limits places pressure on the insurer, which, if it acts unreasonably in denying a settlement offer, may be held liable for a judgment exceeding the policy limits. Therefore, it is often wise for the plaintiff to make a settlement offer in an amount that is decisively influenced by the available insurance coverage, in the hope of parlaying this pressure into a larger recovery in the future or perhaps inducing the insurer to accept a higher settlement offer to avoid the risk of incurring an excess judgment.⁸⁴

This last possibility—and many others like it⁸⁵—can pit the insurer and policyholder against each other. The policyholder, for example, may insist upon a settlement within policy limits to reduce the risk of an excess judgment, but the insurer, if it values the victim's claim at a much lower level, may be inclined to reject the settlement offer, try the case, and hope to defeat the plaintiff's claim. Of course, an error in the insurer's assessment will expose the policyholder to a threat of an excess judgment. Thus, the insurer and insured may find themselves at odds over settlement strategy—and this is just the beginning, for similar issues can exist when it comes to deciding how vigorously to contest the victim's claim, how many depositions to take, what motions to file, how many witnesses to call at trial, etc. At some point, the insurer will be obligated to appoint—or even to allow the insured to select— independent counsel, but this drives up the insurer's costs and makes settlement relatively more attractive. The plaintiff, of course, would be wise to exploit these tensions, hoping to parlay these conflicts into a higher settlement offer. In the absence of liability insurance, none of these strategies is available in the litigation of the underlying tort claim.

Just as the victim-plaintiff will want to exploit whenever possible the friction points in the policyholder-insurer relationship, the savvy victim will want to draft the complaint to bring the liability insurer into the picture. Thus,

83. For more discussion, see Ellen S. Pryor, *The Tort Liability Regime and the Duty to Defend*, 58 MD. L. REV. 1 (1999) (discussing the ramifications of the insurance defense obligation for the tort system).

84. For more on this dynamic, see Syverud, *The Duty to Settle*, *supra* note 1, at 1116-17.

85. Other examples include the insured's failure to meet defense counsel's and/or the insurer's expectations as to the insured's cooperation obligation, the disclosure of information by the insured inconsistent with coverage or other interests of the insurer, third-party claims where coverage is in doubt, third-party claims which mix covered and noncovered claims, the presence of multiple insureds with inconsistent interests, and the insured's ownership of compulsory counterclaims. For more discussion, see JERRY, *supra* note 20, § 114[d], at 807-19.

if the tortfeasor's injurious behavior appears intentional, the plaintiff will frequently allege the tortfeasor's negligence as one of the counts, taking advantage of the insurance law rule that whenever covered and excluded claims commingle in the same complaint, the insurer has a duty to defend all claims.⁸⁶ "Underlitigating" the case—*i.e.*, bringing a negligence claim when the tortfeasor's action appears intentional⁸⁷—makes insurance coverage possible, gives the plaintiff the chance to negotiate a settlement funded by the insurer, and provides nice opportunities for the plaintiff to exploit potential conflicts between the insurer and insured (the insured will prefer any resulting liability to be based on negligence, which supports coverage, whereas the insurer will prefer any resulting liability to be based on intentional wrongdoing, which is outside coverage), all to the end of negotiating a settlement. Under the same logic, if the plaintiff has, say, twenty-six non-covered contract-based claims against a third party, the plaintiff would be wise to attempt to articulate at least one negligence count in order to create the possibility that a liability insurer will be required to provide a defense to all twenty-seven claims in the "mixed action."⁸⁸

With all of liability insurance's interesting implications for the tort litigation process, it is easy to overlook liability insurance's implications for the *pre-litigation settlement process*. A significant percentage—probably in the vicinity of sixty to seventy percent—of civil lawsuits settle without adjudication,⁸⁹ because most victim's claims are fairly described as "small"

86. For more discussion, see Pryor, *supra* note 52, at 1729-35 (giving reasons why plaintiffs have incentives to plead cases involving only intentional wrongdoing as negligence actions).

87. *See id.* at 1722. "By underlitigating, I mean the plaintiff's choice to plead and prove negligence rather than or in addition to intentional tort theories when, absent insurance considerations, the plaintiff would either frame the case solely as an intentional tort claim or emphasize the intentional tort claim." *Id.*

88. For an example of such a situation, see *Buss v. Superior Court of Los Angeles*, 939 P.2d 766, 770 (Cal. 1997).

89. Some authorities place the percentage in the range of ninety to ninety-five percent. *See* Russell Korobkin & Chris Guthrie, *Psychology, Economics, and Settlement: A New Look at the Role of the Lawyer*, 76 TEX. L. REV. 77, 77 (1997) (citing authorities). "While it is true that most civil suits are settled, the figure is nowhere near the 90 to 95% figure that has passed into procedure folklore, and is more likely in the neighborhood of 60 to 70%." Janet Cooper Alexander, *Do the Merits Matter: A Study of Settlement in Securities Claims Actions*, 43 STAN. L. REV. 497, 525 (1991) (reviewing data and studies). The ninety to ninety-five percent figure is based on data showing the number of civil suits that do not go to trial, and some percentage of these—perhaps around fifteen percent—are terminated as a result of some form of adjudication, such as arbitration or a ruling on a motion. Another group of cases—perhaps around nine percent—involve settlements after a court's ruling on a significant motion. About "two-thirds of cases . . . settle without a definitive judicial ruling," but judges are involved in promoting settlement in many of these cases. Marc Galanter & Mia Cahill, "Most Cases Settle:" *Judicial Promotion and Regulation of Settlements*, 46 STAN. L. REV. 1339, 1339-40 (1994) (citing and

and “routine,” the percentage of claims that are resolved without the filing of a lawsuit or without the involvement of a lawyer is probably at least that high.⁹⁰ It has long been understood that the participation of an insurance company and its adjuster in the pre-litigation claims resolution process has significant ramifications for how formal tort law principles are applied and, consequently, on who is compensated for accidental loss.⁹¹ The range of influential factors is broad; among them are the attitudes of insurance adjusters and claims personnel, pressures inherent in the organizational structure, and the full range of variables that influence negotiation practices.⁹² That “law in action” outcomes depart from what formal rules might otherwise predict is a phenomenon hardly unique to tort law, but the liability insurer’s active involvement in the claims resolution process provides plenty of leavening for the tort liability mix.

Much more could be said about all of the above issues; most of these observations provide much of the grist for the insurance law course. But it will not work to leave the responsibility for exposing students to the torts-insurance connection solely to the insurance law instructors. Insurance law is not taught at every school (although the number of schools providing this offering appears to be increasing), and we believe it to be an elective in every law school curriculum where it is offered. Thus, if all law students are to understand that tort law’s answers are reshaped to some extent by the

discussing Herbert M. Kritzer, *Adjudication to Settlement: Shading in the Grey*, 70 JUDICATURE 161, 162-64 (1986)).

90. See H. LAURENCE ROSS, SETTLED OUT OF COURT: THE SOCIAL PROCESS OF INSURANCE CLAIMS ADJUSTMENT 67-70 (2d ed. 1980) (discussing data on claims frequency; “[m]ost claimants handle their claims directly with adjusters”).

91. See Fleming James, Jr., *Accidental Liability Reconsidered: The Impact of Insurance*, 57 YALE L.J. 549, 566 (1948) (“The settlement practices of insurance companies constitute another factor which has a great impact on the actual operation of tort law today. The vast majority of accident claims never get into any stage of litigation; only an infinitesimal proportion of them ever come to trial. The ‘law’ . . . then, consists in these practices.”); James & Thornton, *supra* note 1, at 431 (“Realistically viewed, the practices of the carriers have become just as much rules of law as the pronouncements of the courts interpreting traditional doctrines”); ROSS, *supra* note 90, at 233-43 (discussing “tort law in action” in pre-litigation settlement of insurance claims). A more tempered assessment was offered by Professor Allen Smith: “[I]nsurance company and claimants’ settlement practices usually disregard doctrinal refinements, but they do not make tort doctrine irrelevant.” Smith, *supra* note 1, at 667. But he still found the disjunction between tort law and claims processing to be significant: “[O]ur claims system is not the familiar tort process that is taught in the law schools and portrayed in the official mythology. Apparently this disparity between myth and reality is due largely to failure to recognize the ways in which liability insurance has changed the system.” *Id.* at 703.

92. ROSS, *supra* note 90, at 234 (“The reason the distribution predicted by knowledge of the formal [tort] law does not fit the observed distribution of claims settlements is that other factors influence the settlement process. . . . Among them are the attitudes and values of the involved personnel, organizational pressures, and negotiation pressures.”).

exigencies of the amount of insurance coverage, the terms of the insurance contract, and principles of insurance law, this message must be conveyed in the first-year torts course.

III. A "MICRO" PERSPECTIVE: TEACHING ABOUT INSURANCE IN TORTS

For the most part, first-year courses involve the study of particular cases and how insurance affects the results in these cases will rarely be obvious.⁹³ American case law is uniform in instructing factfinders not to take insurance into account when determining whether and to what extent a defendant is liable to the plaintiff.⁹⁴ The logic underlying this presumption is that insurance is irrelevant to the questions of whether the defendant owed a duty to the plaintiff and whether the defendant caused the insured's loss.⁹⁵ But, as examined in more detail in the prior section, it is beyond dispute that the widespread use of insurance has significantly shaped modern tort law and practice in multiple ways. Few argue that expansions in tort liability in the 1960s and 1970s were not influenced by the notion that some kinds of losses should be distributed through insurance mechanisms; thus, *whether* the particular defendant did in fact purchase insurance may have been irrelevant, but the extent to which one of the parties *could* have purchased insurance for the loss or liability in question was very relevant.⁹⁶ But because insurance is *supposed* to be irrelevant, it will rarely be mentioned as a rationale for the decision. Thus, the dynamic of the tort-insurance intersection will not be readily apparent in the results of particular cases and a thorough look is required to discern the nature of these relationships.

Assuming the torts teacher concludes that some insurance matters should be broached in the first-year torts course, a more pragmatic issue is encountered next. With much to do in a four- or six-hour torts course, precisely where and how is this material to be inserted in a course where most

93. For a discussion of this issue in the context of English case law, see CANE, *supra* note 1, at 441-43.

94. See CHARLES TILFORD MCCORMICK, MCCORMICK ON EVIDENCE § 201 (John W. Strong ed., 5th ed. 1999) ("A formidable body of cases holds that evidence that a party is or is not insured against liability is not admissible on the issue of negligence."); FED. R. EVID. 411 ("Evidence that a person was or was not insured against liability is not admissible upon the issue whether the person acted negligently or otherwise wrongfully. This rule does not require the exclusion of evidence of insurance against liability when offered for another purpose, such as proof of agency, ownership, or control, or bias or prejudice of a witness.").

95. The most obvious manifestation of this value inheres in the customary prohibition on even the mentioning of liability insurance in the presence of a jury. At the same time, however, one can question whether juries are immune from insurance considerations; this, of course, is a large question that, for the most part, will not be explored here.

96. See PROSSER & KEETON, *supra* note 1, at 594 ("[Insurance] is not to be considered in determining whether anyone is liable in the first instance."); CANE, *supra* note 1, at 456 (making same point in discussion of English law).

torts teachers already feel stretched to the limit? Fortunately, much bedrock tort law does not directly implicate insurance. A student's comprehension of the elements of various torts, the scope of various privileges and defenses, the definition of defamation and the scope of protected privacy interests, to take a few examples, does not depend on and is not materially benefited by examining insurance law concepts. But in many other parts of the course, insurance is in play and it is impossible to explore the implications of insurance in all areas where insurance law is influential to tort doctrine. With that significant caveat in mind, we offer a few suggestions for areas that can be enhanced by integrating insurance concepts into the discussion.

A. *Negligence*

A notable exception to the proposition that insurance often affects the theories and strategies of the parties, but is seldom mentioned by either litigants or courts, is the court's decision in *Ryan v. New York Central Railroad Co.*,⁹⁷ an 1866 New York case. In *Ryan*, the court not only mentions insurance but also takes insurance into account in formulating a substantive tort rule. In *Ryan*, the defendant railroad negligently maintained an engine that set fire to the railroad's woodshed, located one hundred and thirty feet from the plaintiff's house. Heat and sparks from this fire spread to the plaintiff's house, setting it on fire.⁹⁸ In the plaintiff's suit for the loss of the house, the court framed the issue as follows: "A house in a populous city takes fire, through the negligence of the owner or his servant; the flames extend to and destroy an adjacent building: Is the owner of the first building liable to the second owner for the damage sustained by such burning?"⁹⁹ The governing principle for resolution of the issue was a familiar one: "[E]very person is liable for the consequences of his own acts," meaning that every person is "liable in damages for the proximate results of his own acts, but not for remote damages."¹⁰⁰ The railroad's negligence was a given, but the following question remained: Was the damage to the house proximate or remote? The court answered that the damage to the woodshed and its contents was proximate, but "beyond that, it was remote."¹⁰¹ The formal basis for the holding was the court's assertion that the first building (the shed) catching fire could be anticipated or expected, but that the second building (plaintiff's house) catching fire was "not a natural and expected result" of the first fire.¹⁰²

97. 35 N.Y. 210 (1866).

98. *Id.*

99. *Id.*

100. *Id.*

101. *Id.* at 213.

102. *Ryan*, 35 N.Y. at 212.

On the surface this rationale appears fatuous. In 1854, New York was comprised of many wooden buildings located close to one another. Fire was an ever present danger. How could an intelligent New York City resident not “expect” that when one such building is set on fire, the fire will spread to a nearby building? The actual basis for the court’s decision is revealed in its policy discussion. The court explained that making the railroad liable for remote losses would impose upon it a crushing financial burden of full liability in circumstances where no amount of due care could prevent the massive losses:

To sustain such a claim as the present, and to follow the same to its legitimate consequences, would subject to a liability against which no prudence could guard, and to meet which no private fortune would be adequate. Nearly all fires are caused by negligence, in its extended sense. In a country where wood, coal, gas and oils are universally used, where men are crowded into cities and villages, where servants are employed, and where children find their home in all houses, it is impossible that the most vigilant prudence should guard against the occurrence of accidental or negligent fires.¹⁰³

Who, then, should bear the loss? One option would have the railroad purchase insurance on property adjacent to its rights-of-way and owned by others, covering the property for loss caused by the operations of the adjacent railroad. Whatever financial capacity the railroads might have to make this purchase, insurance law foreclosed this option, as the court recognized: “A man may insure his own house or his own furniture, but he cannot insure his neighbor’s building or furniture, for the reason that he has no interest in them.”¹⁰⁴ The reference to “interest” was, to be more precise, a reference to the insurance law’s “insurable interest doctrine,” which requires a contract of insurance to be based upon an insured’s legal interest in property upon which the insurance is procured.¹⁰⁵ In other words, the railroad could validly purchase a policy of insurance on its own engines, cars, buildings, etc., but the railroad could not purchase insurance on property owned by others, even if the

103. *Id.* at 216.

104. *Id.*

105. The insurable interest requirement originated in English statutory law in the mid-1700s. The immediate cause for two acts of Parliament, one with regard to property insurance in 1746 and the other with regard to life insurance in 1774, was the widespread practice of individuals purchasing insurance on property they did not own or on lives to which they had no relationship as a simple wager on the continued existence of property or the *cestui que vie*’s survival. The concern was not so much the gambling as it was the moral hazard, *i.e.*, the incentive the arrangement created for the owner of the policy to cause the loss of the insured property or the destruction of the insured life. In the United States, the insurable interest doctrine was first adopted by courts, although many states would later enact statutes requiring an insurable interest as a prerequisite to a valid contract of insurance. Currently, there are two distinct approaches to the insurable interest doctrine in property insurance: the legal interest test and the factual expectancy test. For more discussion, see JERRY, *supra* note 20, at 233-50.

proceeds of the insurance would be paid to the owners of property destroyed on account of the railroad's operation.

The insurable interest doctrine would not prohibit the railroad from purchasing insurance to cover its own liabilities to adjacent property owners damaged by the railroad's negligence, but liability insurance of this sort did not exist in 1854.¹⁰⁶ Thus, the issue for the court was whether the railroad should be required to indemnify those injured by its negligence, and the court's answer to this question was no:

To hold that the owner must not only meet his own loss by fire, but that he must guarantee the security of his neighbors on both sides, and to an unlimited extent, would be to create a liability which would be the destruction of all civilized society. No community could long exist, under the operation of such a principle. In a commercial country, each man, to some extent, runs the hazard of his neighbor's conduct, and each, by insurance against such hazards, is enabled to obtain a reasonable security against loss. To neglect such precaution, and to call upon his neighbor, on whose premises a fire originated, to indemnify him instead, would be to award a punishment quite beyond the offense committed.¹⁰⁷

The court's explicitly expressed concern was that the third-party indemnity obligation would be unbounded and that unbounded liability could not be afforded by business. The appropriate course, according to the court, would be for property owners to purchase first-party insurance to protect their interests in property adjacent to railroads.¹⁰⁸

Property owners would, of course, have good reason to purchase first-party insurance on their property regardless of their proximity to railroads. Many kinds of perils could cause damage to property, not the least of which was the property owner's own negligence.¹⁰⁹ Therein resided another rub for the railroad: if the railroad were liable in tort to the owners of adjacent property for damage to the property, the law of subrogation would turn first-party insurers, in their status as subrogees, into plaintiffs in tort actions against the railroads

106. *See supra* text accompanying notes 7-15.

107. *Ryan*, 35 N.Y. at 216-17.

108. It is interesting to speculate on whether the existence of a third-party insurance market would have changed the court's analysis. The court shows concern for overdeterrence; making the railroad liable for all remote losses would impose a liability on the railroad far in excess of the gravity of the railroad's negligent act or omission and cause the "destruction of all civilized society." *Id.* at 217. If, however, the railroad could have spread this liability risk through an insurance mechanism that involved the payment of a stream of certain, smaller premiums, the "punishment quite beyond the offense" issue would have been removed from the calculus; perhaps this would have changed the outcome. *Id.*

109. *See Adden v. White Mountains N.H. R.R.*, 55 N.H. 413, 415-16 (1875) (explaining that even when liability is placed by statute on railroad, it is prudent for adjacent property owner to have first-party insurance).

and pitting the insurance industry against the railroads was something to be avoided.

It is to be considered, also, that if the negligent party is liable to the owner of a remote building thus consumed, he would also be liable to the insurance companies who should pay losses to such remote owners. The principle of subrogation would entitle the companies to the benefit of every claim held by the party to whom a loss should be paid.¹¹⁰

Thus, the existence of first-party insurance became, in itself, a reason for declining to recognize a tort duty owed by the railroad to remote victims of the railroad's negligence.

With the advent of liability insurance in the 1880s,¹¹¹ the rationale for *Ryan*'s special rule of proximate cause disappeared, and the decision today has little effect.¹¹² Yet *Ryan* is a wonderful case to use in a torts course. It illustrates the kinds of policy considerations that might lead a court to arbitrarily declare which results are foreseeable and which are not. It also provides the professor with an opportunity to explore why the court believed that liability in *Ryan* would lead to the "destruction of all civilized society." This nicely leads into an exploration of the notion that some people are risk averse, that imposing liability on risk-averse people produces undesirable consequences and that properly priced liability insurance can neutralize those undesirable consequences.

A more contemporary excursion into the law of negligence is provided by *Kline v. 1500 Massachusetts Avenue Apartment Corp.*,¹¹³ an early case exemplifying the modern trend toward holding businesses liable for failure to protect persons on their premises against criminal attack. In *Kline*, a landlord of a large apartment building was held liable for failing to protect a tenant from a criminal attack in a common hallway on the premises.¹¹⁴ When the tenant first moved in the building, the landlord provided a doorman to protect residents, but discontinued that protection prior to the attack.¹¹⁵ The court believed that imposing liability on landlords would reduce such criminal attacks because the landlord was in a better position than the tenant to take necessary protective measures.¹¹⁶ Numerous recent cases have imposed liability for failure to prevent similar attacks, either in the defendant's building or on an adjacent parking lot, even in the absence of an undertaking. The

110. *Ryan*, 35 N.Y. at 217.

111. See discussion *supra* Part I.A.

112. *Brennan Constr. Co. v. Cumberland*, 29 App. D.C. 554, 559 (1907) (recognizing that *Ryan* has been rejected outside New York and is severely restricted in New York).

113. 439 F.2d 477 (D.C. Cir. 1970).

114. *Id.* at 478.

115. *Id.* at 479.

116. *Id.* at 480-81.

courts merely require a showing that the defendant negligently failed to take reasonable precautions against a sufficiently foreseeable criminal attack.¹¹⁷

In tort law, this line of cases presents a challenging and difficult issue. The question is, essentially, to what extent commercial enterprises should be encouraged to make investments in loss prevention. Businesses realize that even very large investments cannot prevent all third-party assaults on customers and that the marginal returns from such investments begin to erode fairly quickly as these investments are increased. Businesses also realize that it is very difficult to accurately predict whether a jury will find that any given set of precautions satisfies the business's due care obligation. A risk-averse firm might be deterred from providing socially useful services that subject it to the risk of liability for criminal attack unless it can insure against that risk.

Interestingly, this is an area where some insurers are not eager to cooperate with businesses that desire to transfer the risk of foreseeable liabilities. The Commercial General Liability (CGL) policy is the ISO's standardized form for commercial liability risks, and this form is widely used in the United States by firms of all sizes.¹¹⁸ Some insurers tailor certain aspects of the form for some customers, and some CGL policies exclude coverage for harm arising out of an assault and battery.¹¹⁹ This exclusion is particularly common in policies sold to taverns, restaurants and other businesses where alcoholic beverages are served and rowdiness might be anticipated from time to time.¹²⁰ Formulations of the exclusion vary. Some limit the effect of the exclusion to assaults or batteries committed by the insured or its employee; this language has a different range of operation than text purporting to exclude, for example, any claim against the insured "arising out of" an assault or battery. This latter formulation might be applied to exclude coverage for a claim that the insured negligently supervised a parking lot, which neglect contributed to one customer's assault upon another in a dispute over a parking place.¹²¹ If the landlord's policy in *Kline* contained an assault and battery exclusion, one could not dismiss the possibility that an insurer—and perhaps a court—would interpret and apply the provision to exclude liability insurance coverage, even though the exclusion might undermine tort policy by causing overdeterrence.

117. DOBBS, *supra* note 1, § 325, at 881-82 (citing cases).

118. HENDERSON & JERRY, *supra* note 74, at 536.

119. For more information about the exclusion and how courts respond to it, see Kimberly J. Winbush, Annotation, *Validity, Construction, and Effect of Assault and Battery Exclusion in Liability Insurance Policy at Issue*, 44 A.L.R. 5th 91 (1996).

120. For a case where the exclusion is implicated in the tavern setting, see *Capitol Indem. Corp. v. Blazer*, 51 F. Supp. 2d 1080 (D. Nev. 1999). This case is excerpted in HENDERSON & JERRY, *supra* note 74, at 611-17.

121. See, e.g., *Hickey v. Centenary Oyster House*, 719 So. 2d 421 (La. 1998) (customer shot by armed robber in the parking lot of a restaurant sued a private security firm and its CGL insurer).

From an insurance perspective, the logic behind such a broad exclusion is not readily apparent. It is reasonable enough for an insurer to further the policy inherent in the intentional act exclusion found in all policies by also excluding coverage for bodily injury or property damage caused by the assaults and batteries committed by an insured and its employees that commit intentional torts in the scope of their employment.¹²² It is not obvious, however, why a firm should be unable to insure the derivative consequences of wrongful acts by third parties not under the control of an insured or any of its employees. In other words, if the loss from the insured's point of view is unintentional and fortuitous, the liability for the loss should be insurable, just like most negligence liability risks.

Thus, as tort law places duties on businesses based on the assumption that commercial firms can transfer these risks to insurance markets, structural barriers in insurance markets may intercede to prevent tort law from achieving its risk distribution and deterrence objectives. The absence of insurance coverage may be followed by inefficient investments in loss prevention, or by the withdrawal of useful goods and services from the market. Again, the essential point is that whether tort law can achieve its underlying objectives cannot be ascertained without examining tort law's intersection with insurance law principles.

B. *Intentional Torts*

Many torts courses begin with an excursion through intentional torts. *Garratt v. Dailey*¹²³ is a classic in this area; it is included in most torts casebooks. The point of the case is to illustrate the two-pronged definition of intent. An actor intends a result if the actor either acts for the purpose of causing the result or acts knowing that the result is substantially certain to occur.¹²⁴ The case also illustrates that a very young child can be liable for an intentional tort as long as he has sufficient mental capacity to entertain the requisite intent.¹²⁵ In *Garratt* an adult sued a five-year old child for battery. The plaintiff attempted to prove that the defendant pulled the plaintiff's lawn chair out from under her as she began to sit down, causing her to fall to the ground.¹²⁶ The defendant's evidence indicated that he moved the chair before

122. Even this point is not beyond dispute. Many kinds of business establishments, particularly taverns and bars, can anticipate their employees being exposed to groundless tort claims for battery after acting appropriately to remove dangerously inebriated guests from the premises; it would seem that insurers should offer a product, or an endorsement to standard coverage, in the nature of "litigation insurance" to firms that can foresee this kind of potential liability.

123. 46 Wash. 2d 197 (1955).

124. *Id.* at 200.

125. *Id.* at 200, 202.

126. *Id.* at 198-99.

the plaintiff began to sit down and that by the time he discovered that she was attempting to sit down, it was too late for him to replace the chair.¹²⁷ The trial judge, sitting as trier of fact, accepted the defendant's version of the facts and entered a judgment for the defendant on the basis that there was no intent to injure.¹²⁸ The appellate court pointed out that the defendant could still be liable under the facts as found by the trial judge. This would be the case if, at the time the defendant moved the chair, he knew with substantial certainty that the plaintiff would attempt to sit in the place where the chair had been. The appellate court remanded for clarification of the findings to make sure that the trial judge had not overlooked this possibility.¹²⁹ On remand, the trial court reconsidered its findings and entered a judgment against the defendant for \$11,000.¹³⁰

Intentional tort cases have many implications for insurance worthy of discussion in a torts class, yet no torts teacher would want to discuss all of them in conjunction with the treatment of a single case, such as *Garratt*. While we discuss a number of insurance implications in conjunction with *Garratt* below, note that many of these implications can easily be raised with other cases.

The first and most obvious implication for insurance arising out of intentional tort cases is whether the judgment will be paid by an insurance company. If not, the corrective justice, deterrence, and compensation functions of tort law are likely to be frustrated. As noted earlier, many tortfeasors have no assets from which to collect a judgment, and this is particularly true of intentional tortfeasors. Infants, in cases like *Garratt*, are technically liable for their torts, but most infants have no assets and, in the absence of a statute, parents are not vicariously liable for the torts of their children. If the impoverished tortfeasor is uninsured, a judgment lien on her future earnings may, at least theoretically, deter her from antisocial conduct, and the message is still sent to others who are aware of the outcome. If the judgment is collected in the future, compensation and corrective justice goals are also achieved. Yet, most plaintiffs would not pursue a tort action unless there was some hope of collecting the judgment in the near future. Therefore, depending on the tortfeasor's personal resources, lack of insurance may undermine tort law's major policies. If, however, the tortfeasor has liability insurance, insurance law has varying answers that will affect significantly whether tort law's purposes are attained.

The most likely source of insurance coverage for an intentional tortfeasor is either her homeowner's insurance policy, if she is an adult, or her parent's

127. *Id.* at 199.

128. *Garratt*, 46 Wash. 2d at 199.

129. *Id.* at 201-02.

130. *Garratt v. Dailey*, 49 Wash. 2d 499 (1956).

homeowner's insurance policy if she is an infant.¹³¹ The problem in intentional tort cases is that such policies normally exclude coverage for bodily injury or property damage that the insured expects or intends.¹³² Thus, if the exclusion applies, the plaintiff in *Garratt* cannot collect the amount of her judgment from the parent's insurance company.

In insurance law, the meaning of the intentional act exclusion has been the subject of much litigation, and judicial attitudes toward the exclusion are not consistent. Construing the clause, courts generally define "intent" as requiring a purpose to cause or a desire to bring about injury, while "expect" is interpreted to require a subjective knowledge of a high probability that the injury or damage will occur.¹³³ Courts tend to divide over the degree to which the insured must be aware of all the consequences of his act, developing what are essentially three interpretations of what must be intended or expected by the insured before coverage is lost. A plaintiff's ability to recover from the insurance company in a case like *Garratt* depends on which of the three interpretations the court adopts. The majority of courts apply the exclusion if the insured intended both to act and to cause some kind of injury or damage.¹³⁴ Under the majority rule, it does not matter if the resulting injury differs from the injury that the insured intended to produce.¹³⁵ Under the majority approach the exclusion would apply in *Garratt* if the defendant intended to cause any injury, no matter how slight, and that a more serious or different kind of injury resulted than the insured intended or expected would not prevent the exclusion from eliminating the insurance coverage.¹³⁶ If, however, the defendant merely intended for the plaintiff to contact the ground in a humorous or objectively offensive manner, the exclusion would presumably not apply, and the plaintiff

131. Homeowners' policies contain not only property loss coverage for the insured's home and contents (subject to some limits and exclusions) but also liability insurance coverage for non-auto related liabilities that the insured might incur (again, subject to some limits and exclusions). A renter's policy typically contains similar liability protection. Such policies typically cover the named insured and the named insured's spouse if the spouse is a resident of the same household. Further, the definition of "insured" also typically covers residents of the same household who are relatives or who are under the age of 21 and in the care of the named insured, the named insured's resident spouse, or "any person named above." See, e.g., INS. SERV. OFFICE, INC., HOMEOWNERS 2 BROAD FORM, HO 00 02 04 91 (1990).

132. For example, in the Homeowners 2 Broad Form, the policy excludes liability coverage for bodily injury or property damage "[w]hich is expected or intended by the 'insured.'" *Id.*

133. JERRY, *supra* note 20, at 401.

134. *Id.* at 403.

135. *Id.* at 404.

136. The operative term in the typical liability form is "bodily injury." Courts have divided on whether the term "bodily injury" includes nonphysical or emotional harm. Most courts hold that "bodily injury" refers to physical injuries only and not to nonphysical or emotional harm, but emotional distress, which has physical manifestations normally constitutes "bodily injury." See generally Gregory G. Sarno, Annotation, *Homeowner's Liability Insurance Coverage of Emotional Distress Allegedly Inflicted on Third Party by Insured*, 8 A.L.R. 5th 254 (1992).

should be compensated under the insurance policy.¹³⁷ The plaintiff would be entitled to a judgment because the insured's conduct would still constitute a battery, and the insured would be liable for the unintended harm.

There are, however, two minority interpretations of the exclusion. First, a few courts require the insured to intend both the act and the specific harm that results from the act.¹³⁸ This minority rule tends to narrow the exclusion and expand the coverage. Unless the defendant in *Garratt* intended the bodily harm that actually resulted (a very unlikely situation because most young children would not foresee—let alone intend—the full extent of the harm the prank was likely to cause), the defendant's conduct would be covered by the policy, which would ultimately inure to the plaintiff's benefit. Under a second minority rule, some courts require a showing that, first, the insured intended the act and, second, the damages or injuries resulting from the act are the "natural and probable" consequences of the act.¹³⁹ Under this interpretation, it would be much more difficult to get around the exclusion in *Garratt*. The second minority rule expands the exclusion and narrows the coverage; indeed, under this approach, the exclusion can apply even if the defendant did not intend to cause injury, which eliminates coverage for negligently or accidentally inflicted harm arising out of an intentional tort not intended or likely to cause any harm.

Regardless of the interpretive approach followed in a particular jurisdiction, the exclusion gives plaintiffs an incentive to rely on theories that bring their cases within insurance coverage. If, for example, the plaintiff in *Garratt* were concerned that her battery claim was covered by the intentional injury exclusion, she might have alleged that by deliberately moving the chair, the defendant negligently created a risk of injuring the plaintiff.¹⁴⁰ As discussed earlier,¹⁴¹ it may be in the plaintiff's interest to "underlitigate" the case; the plaintiff's negligence theory has the advantage of causing the plaintiff's claim to fall squarely within the insurance coverage. Yet such a strategy must confront the extreme difficulty of proving that a very young

137. This result should follow from the "prank" cases which have been litigated under the intentional act exclusion. The typical fact pattern involves the insured playing a practical joke on another, which goes awry and causes injury. Sometimes the insured's judgment is extraordinarily poor and physical injury should be foreseen as a result of the conduct. The tendency in these cases, however, is for the court to find that while the act was intended, the injury was neither intended nor expected and therefore the tortfeasor's conduct is not excluded from coverage under the liability contract. See JERRY, *supra* note 20, at 407.

138. *Id.* at 404.

139. *Id.* at 403.

140. See, e.g., *Ghassemieh v. Schafer*, 447 A.2d 84, 89 (Md. Ct. Spec. App. 1982) (involving facts very similar to those in *Garratt*, but brought on a negligence theory; the court recognized that "the concepts of negligence and battery are not mutually exclusive."). See generally Pryor, *supra* note 52.

141. See *supra* notes 87-88 and accompanying text.

child acted negligently.¹⁴² Another possibility, in at least some cases where a child has committed a battery, is suing the parent for negligent supervision of the child. While this theory may invoke insurance coverage,¹⁴³ it also has the disadvantage of being very difficult to prove.¹⁴⁴ Yet, the plaintiff does not have to prevail on such alternative theories to take advantage of the defendant's insurance. Insurance policies place a duty on insurers to defend a claim brought against the insured, even if the claim is thought to be groundless or meritless, as long as the alleged claim is within the policy's coverage.¹⁴⁵ Thus, if the plaintiff in *Garratt* had alleged both negligence and battery theories against the child, the insurance company would have been required to defend the entire "mixed action."¹⁴⁶ The advantage of such alternative pleading is that the plaintiff can trigger the insurer's obligation to defend the insured against the tort claim,¹⁴⁷ thereby creating the possibility of negotiating a better settlement than if the defendant were the sole source of funds for a possible settlement.¹⁴⁸

As Professor Pryor has explained (and as discussed earlier),¹⁴⁹ underlitigating can subvert tort policies. As also previously discussed,¹⁵⁰ the use of liability insurance is consistent with the tort policies of deterrence and corrective justice as long as the price of insurance closely corresponds to the risks posed by the insured. When underlitigating causes an insurance company

142. RESTATEMENT (SECOND) OF TORTS § 283A (1965) (A child is held to the standard of "a reasonable person of like age, intelligence, and experience under like circumstances.").

143. Some courts treat a negligent supervision claim as being dependent upon excluded conduct—*i.e.*, another insured's intentional wrongdoing—and uphold insurers' denials of coverage on that basis. In other words, the policy is treated as excluding from coverage any claim "arising out of" an insured's intentional wrong; thus, a claim that a parent negligently supervised a child who committed an intentional wrong "arises out of" the excluded conduct (because the child is an "insured"), and this derivative claim is therefore excluded from coverage as well. The cases are not uniform, however. Compare *Jones v. Horace Mann Ins. Co.*, 937 P.2d 1360 (Alaska 1997) (motorized vehicle exclusion barred coverage for alleged negligent entrustment of snowmobile to child and alleged negligent supervision of child) with *Cambridge Mut. Fire Ins. Co. v. Perry*, 692 A.2d 1388 (Me. 1997) (daughter sued father for alleged sexual abuse and mother for alleged negligent supervision in failing to protect her from father; held, intentional acts exclusion did not bar negligent supervision claim).

144. The requirements for imposing a duty on the parent to control her child are set out in RESTATEMENT (SECOND) OF TORTS § 316 (1965).

145. JERRY, *supra* note 20, at 735.

146. *Id.* at 737-38.

147. In this situation, the insurer is almost certain to provide the insured with a defense under a "reservation of rights" to deny coverage at a later time—*i.e.*, in the event the insured loses the underlying tort suit and the insurer's obligation to indemnify moves to the fore. For more discussion, see JERRY, *supra* note 20, at 796-98.

148. *Id.* at 740.

149. See text accompanying *supra* notes 86-87.

150. See text accompanying *supra* notes 30-53.

to pay for harm that the insured intentionally caused, the insured's premiums will usually not be high enough to pay for this harm because the coverage is excluded from the policy.¹⁵¹ Because the premium the wrongdoer pays does not fully cover the cost of the harm he caused, the wrongdoer has neither been given the appropriate incentive to refrain from inflicting the harm, nor has he corrected the injustice that he caused.¹⁵² Professor Pryor suggests that while underlitigating completely subverts the policies of deterrence and compensation, it may represent a "second best" solution for the corrective justice policy.¹⁵³ This is because, in the absence of underlitigating, the victim will probably not sue the wrongdoer at all, thus allowing him to escape the civil justice system entirely.¹⁵⁴

To summarize, insurance law begins with the premise that non-fortuitous losses are uninsurable.¹⁵⁵ From this starting point logically flows the observation that no insurance coverage exists for conduct intended or expected from the insured's standpoint, but the meaning of "intended" and "expected" for purposes of applying the insurance policy exclusion is not necessarily the same as the meaning of "intentional" for tort law purposes. The possibility exists, then, that some intentional wrongs will be awarded insurance coverage, and that some acts that are negligent may be denied coverage in some situations and in some venues. The essential point to drive home to the students is that in the area of intentional torts, application of tort law principles alone will not provide a final answer on whether the objectives of tort law are fulfilled.

C. *Privileges and Defenses*

Insurance law students are frequently surprised to learn that courts are split on the question of whether the intentional act exclusion applies to intentional acts committed in self-defense or in the defense of others. Some courts have held that injury inflicted in self-defense is expected or intended under the exclusion,¹⁵⁶ but other courts disagree.¹⁵⁷ How a court resolves this issue usually has no bearing on the insurance company's liability for a judgment rendered against the insured.¹⁵⁸ This is because there will be no judgment to pay if the trier of fact determines that the insured acted in self-defense. If, on

151. Pryor, *supra* note 52, at 1747-48.

152. *Id.* at 1748.

153. *Id.* at 1750.

154. *Id.*

155. Even this seemingly simple and incontrovertible premise is more complex than it may appear at first glance, but this is largely an insurance law concern. For more discussion, see Pryor, *supra* note 52, at 1740-45.

156. JERRY, *supra* note 20, at 409.

157. *Id.*

158. *Id.* at 410.

the other hand, the trier enters a judgment against the insured because it finds that the insured did not act in self-defense, the insurance company would not have to pay the judgment because of the intentional act exclusion. The true significance of applying the intentional act exclusion to any intentional tort action where the insured asserts self-defense is that the insurance company becomes required to defend the action.¹⁵⁹ The policy argument for requiring the insurance company to defend is that most circumstances giving rise to the need for self-defense are fortuitous (the kind of event that can properly be insured against) and most insureds are willing to pay to insure against the costs of such litigation.¹⁶⁰ The practical effect of such coverage is that by bringing the insurance company into the litigation, the parties increase the chance of a settlement.¹⁶¹

Tort and insurance cases also differ in the way they treat diminished mental capacity. An insane person is liable for her intentional torts as long as she entertained the requisite intent.¹⁶² A majority of insurance law cases, however, hold that the intended or expected act exclusion does not apply to cases where the insured lacked mental capacity.¹⁶³ In such jurisdictions insurance companies will pay both the cost of defending intentional tort actions against insane persons and the cost of judgments rendered against them. The majority approach represents good policy. It is consistent with the purpose of the intentional act exclusion (to deny insurance protection for intentionally inflicted harm) because the insured is incapable of abiding by reasonable standards.¹⁶⁴ The approach also furthers the tort policies of corrective justice and compensation by providing the means by which the insured can pay for the victim's loss.

D. Immunities

The abrogation of assorted immunities of liability during the late twentieth century was one of the significant tort developments of that period. In many of the cases so holding, the availability of insurance was mentioned as one of the reasons justifying abrogation.¹⁶⁵ One prominent treatise, in arguing that the presence of liability insurance had little to do with this trend, marshals a

159. *Id.*

160. *Id.*

161. See *supra* notes 86-88, 147-48 and accompanying text.

162. *McGuire v. Almy*, 8 N.E.2d 760, 763 (Mass. 1937).

163. JERRY, *supra* note 20, at 410-11.

164. *Id.* at 411.

165. For more discussion, see KEETON ET AL., *supra* note 1, at 595 n.74 (citing examples); GREEN ET AL., *supra* note 2, at 645-46 ("It is commonly thought that one of the principal effects of liability insurance is evidenced in the gradual narrowing of all the various immunities from liability . . . there would seem to be more than a coincidental connection between [liability insurance and abrogation of immunities].").

lengthy compendium of authority indicating that insurance was not a pivotal consideration in the abrogations.¹⁶⁶

Regardless of the role that insurance played in the abrogation of immunities, it is clear that it plays a significant role in litigation between formerly immune parties. Some states, for example, have statutes waiving sovereign immunity only to the extent that the defendant governmental entity has liability insurance.¹⁶⁷ Most intra-family litigation falls into two categories: cases involving accidents where insurance is likely, and cases of sexual or other deliberate abuse, where the nature of the conduct triggers the intentional act exclusion and eliminates the coverage.¹⁶⁸ Gaining access to insurance proceeds is the only plausible explanation for most intra-family tort suits in the first category. In *Heath v. Swift Wings, Inc.*,¹⁶⁹ for example, a pilot and three of his passengers were killed in a plane crash. The litigation was brought by the estates of two of the passengers (the pilot's spouse and their child) against the pilot (their husband and father), claiming that the negligence of the pilot caused the crash.¹⁷⁰ In the absence of very unusual circumstances, there would be no incentive to bring this litigation unless the pilot had liability insurance that would pay any judgment obtained by the plaintiffs. This is a very useful point to make while teaching such a case because it helps students to think about the real world context in which such litigation is brought.

Most state courts permit the award of punitive damages.¹⁷¹ This is an amount of money, in excess of compensatory damages, designed to punish or deter tortfeasors.¹⁷² These are very different purposes. Punishment is designed to cause suffering, while deterrence is designed to give incentives that will induce people to take appropriate precautions.¹⁷³ Punitive damages are available only in cases of serious misconduct, as where the tortfeasor intentionally inflicts serious harm or recklessly imposes a very high risk of such harm.¹⁷⁴

Whether punitive damages should be insurable is an interesting question with subtle policy implications.¹⁷⁵ All courts agree that public policy prohibits

166. See KEETON ET AL., *supra* note 1, at 595-96.

167. DOBBS, *supra* note 1, § 268, at 717.

168. *Id.* § 280, at 756; see also JERRY, *supra* note 20, at 407-09.

169. 252 S.E.2d 526 (N.C. Ct. App. 1979).

170. *Id.* at 527.

171. DOBBS, *supra* note 1, § 381, at 1062.

172. *Id.* § 381, at 1063.

173. *Id.*

174. *Id.* § 381, at 1065.

175. Whether punitive damages should be insurable has received much attention in insurance law scholarship. See, e.g., Baker, *supra* note 1; Polinsky & Shavell, *supra* note 37, at 931-34; Alan I. Widiss, *Liability Insurance Coverage for Punitive Damages? Discerning Answers to the Conundrum Created by Disputes Involving Conflicting Public Policies, Pragmatic Considerations and Political Actions*, 39 VILL. L. REV. 455 (1994).

insuring against punitive damages for intentional torts,¹⁷⁶ a position that is clearly correct for reasons previously discussed.¹⁷⁷ Liability insurance is appropriate only for fortuitous, and not intended, losses. A two-thirds majority of courts permit insurance for punitive damages arising out of reckless or grossly negligent conduct.¹⁷⁸ To the extent that punitive damages are used as a deterrent, the majority rule, which permits insurance against punitive damages for unintentional torts, appears correct. Since deterrence is an economic concept, the insights of economists with respect to this issue are informative. Two leading law and economics scholars, A. Mitchell Polinsky and Steven Shavell, argue both that punitive damages have an appropriate deterrence role to play, and that such damages ought to be insurable.¹⁷⁹

Economic analysis demonstrates that under a negligence rule, actors are induced to use appropriate precautions if they know that they will be held liable for all the harm that they cause in the event that they use inadequate precautions.¹⁸⁰ Holding wrongdoers liable for less harm than they cause will induce them to take too few precautions, and holding them liable for more harm than they cause may possibly induce them to take too many precautions.¹⁸¹ Because punitive damages are awarded in addition to compensatory damages, they could distort deterrence if awarded in cases where defendants pay for all the harm that they cause.

Many negligent tortfeasors, however, do not pay for all the harm they cause. For example, studies of medical negligence in the United States show that only one claim is filed for every five to ten negligently inflicted injuries.¹⁸² Negligent tortfeasors can escape liability for a variety of reasons such as the difficulty of proving an element of the plaintiff's case or because the plaintiff's damages are too small to finance the cost of a lawsuit.¹⁸³ A tortfeasor that pays

176. JERRY, *supra* note 20, § 65, at 472.

177. See *supra* notes 124-55 and accompanying text.

178. JERRY, *supra* note 20, § 65, at 475. Even states that prohibit insurance for punitive damages make an exception in cases where a principal is held vicariously liable for punitive damages awarded solely because of the culpable conduct of an agent. *Id.* at 476-77. This exception is clearly justifiable because the principal is being held strictly liable in such cases.

179. Polinsky & Shavell, *supra* note 37.

180. *Id.* at 883-85.

181. For a detailed explanation of why this is true, and for a discussion of the effect of the amount of damages on activity levels, see Polinsky & Shavell, *supra* note 37, at 883-85.

182. Philip G. Peters, Jr., *The Quiet Demise of Deference to Custom: The Role of the Jury in Modern Malpractice Litigation* 52 (Sept. 6, 2000) (unpublished manuscript, on file with author) (citing PATRICIA M. DANZON, *MEDICAL MALPRACTICE: THEORY, EVIDENCE AND PUBLIC POLICY* 19 (1985) (a California study showed one claim for every ten negligently injured patients) and David M. Studdert et al., *Negligent Care and Malpractice Claiming Behavior in Utah and Colorado*, 38 *MED. CARE* 250, 254 (2000) (a Utah study showed one claim for every 5.1 negligently injured patients)).

183. Polinsky & Shavell, *supra* note 37, at 888.

full damages in some cases and escapes liability in other cases will be underdeterred. Awarding punitive (or extra) damages in the cases where the defendant is held liable can correct the underdeterrence problem by restoring proper incentives. Polinsky and Shavell explain the nature of the problem and the appropriate solution in the following passage:

[I]njurers will sometimes be able to escape liability for harms for which they should be held responsible. The consequences of this possibility are clear: if damages merely equal harm, injurers' incentives to take precautions will be inadequate and their incentive to participate in risky activities will be excessive. Suppose that there is only a one-in-four chance that an injurer will be found liable for a \$100,000 harm, for which he would have to pay damages of \$100,000. On average, then, the injurer will pay \$25,000 when he causes the harm—only a fraction of the harm caused. If the harm could have been prevented each time by taking a \$50,000 precaution, the injurer will not have an adequate incentive to take the precaution, because the precaution cost will exceed his average liability cost by a substantial margin. Moreover, because the injurer will pay only \$25,000 on average for a \$100,000 harm, he will engage in the risky activity to an excessive degree. If the injurer is a firm, the price of its product will rise by an amount reflecting only one-quarter of the harm caused, leading consumers of the product to buy more of it, and thereby cause more harm, than is socially desirable.

To remedy these problems of underdeterrence, damages that are imposed in those instances in which injurers are found liable should be raised sufficiently so that injurers' average damages will equal the harm they cause. In the example in the preceding paragraph, in which the chance of being found liable for having caused a \$100,000 harm is only one in four, damages should be raised to \$400,000. Then, on average, the injurer will pay \$100,000 when he causes the harm—on average, every four times he causes harm, he will be found liable once for \$400,000. Equivalently, his total damages will tend to equal the total amount of harm that he has caused.¹⁸⁴ As we emphasized above, making injurers liable for the harm they cause will induce them to take proper precautions and participate appropriately in risky activities.¹⁸⁵

When punitive damages are properly used to further deterrence, they serve exactly the same function as compensatory damages.¹⁸⁶ Therefore, tortfeasors should be allowed to insure against punitive damages for exactly the same

184. If the injurer does not engage in an activity repeatedly, but, say, only once, the injurer obviously will not pay for the harm done, even approximately: he either will pay \$400,000 in this one instance (more than the \$100,000 harm he caused) or will escape liability altogether. However, the injurer's expected damages—the damages he will have to pay if he is found liable, multiplied by the probability of being found liable—equal the harm of \$100,000 (because he has a one-in-four chance of being found liable and made to pay \$400,000).

185. Polinsky & Shavell, *supra* note 37, at 888-89.

186. *Id.* at 932.

reasons that they should be permitted to insure against compensatory damages.¹⁸⁷

The substantive tort rules determining when punitive damages are awarded and in what amount are poorly designed to implement the approach to deterrence described by Polinsky and Shavell.¹⁸⁸ Courts award punitive damages based on culpability rather than on the likelihood that a tortfeasor will always be held liable for the harm she caused. When punitive damages are awarded, the amount is based on such factors as the level of the defendant's culpability and the amount of her wealth, not on the discrepancy between the amount of harm caused and damages paid.¹⁸⁹ Under the Polinsky and Shavell theory, for example, punitive damages would be desirable in medical malpractice cases because studies show that only about two percent of medical negligence leads to malpractice claims, and only about nineteen percent of the most seriously injured malpractice victims receive compensation.¹⁹⁰ Yet, courts seldom award punitive damages in such cases because they usually do not involve aggravated negligence. In short, the substantive law of punitive damages is much better designed to achieve retribution than deterrence.

To the extent that punitive damages are used to punish, allowing their insurability is probably undesirable. Insurance would not be objectionable if the goal of punitive damages were to impose punishment according to the magnitude of risk created by the tortfeasor, and if insurance premiums properly reflected the risk each tortfeasor created.¹⁹¹ As previously discussed,¹⁹² however, it is very unlikely that insurance premiums can be perfectly responsive to risk. Furthermore, charging a tortfeasor a premium that is too low undermines retribution because the insurance provides the tortfeasor with a subsidy by other less culpable insureds.¹⁹³

E. Procedural Rules

The California case of *Jess v. Herrmann*¹⁹⁴ nicely illustrates how insurance coverage influences courts in applying procedural rules affecting tort liability.

187. *Id.*

188. *Id.* at 897-98.

189. *Id.* at 900.

190. Russell A. Localio, *Relation Between Malpractice Claims and Adverse Events Due to Negligence, Results of Harvard Medical Practice Study III*, 325 THE NEW ENG. J. MED. 245-51 (1991).

191. Schwartz, *supra* note 32, at 328. Professor Schwartz argues that under these circumstances insurance enhances retribution. Without insurance, most wrongdoers escape punishment because the risk they create does not cause an injury. With insurance, each tortfeasor pays the correct amount, in the form of an insurance premium, without regard to whether their risky conduct causes a loss. *Id.* at 328.

192. See *supra* notes 30-39 and accompanying text.

193. Schwartz, *supra* note 32, at 327.

194. 604 P.2d 208 (Cal. 1979).

Jess involved application of California statutes concerning setoff in a comparative negligence case.¹⁹⁵ In *Jess* both the plaintiff and defendant were injured in an automobile accident.¹⁹⁶ Each party asserted a negligence claim against the other, and the jury found that both parties were negligent.¹⁹⁷ Because California employs a pure comparative negligence scheme, each party obtained a verdict against the other party, and each verdict was reduced by the amount of the claimant's fault.¹⁹⁸ The question for the court was whether the normal setoff rule should be applied, so that the smaller judgment should be subtracted from the larger judgment, resulting in only one recovery (a diminished recovery by the holder of the larger judgment).¹⁹⁹ The court held that setoff should not apply because both parties were fully insured.²⁰⁰ Thus, each party recovered their respective judgment, and each judgment was paid by the other party's insurance company. The court stated that in "a comparative fault setting, the appropriate application of setoff principles cannot be determined in the absence of a consideration of the parties' insurance status."²⁰¹ Setoff is normally a rule of convenience that "eliminat[es] an unproductive exchange of money between . . . the parties,"²⁰² but the calculus is different in a comparative negligence context where both parties are fully insured. The court observed that in this context setoff does not operate as "an innocuous accounting mechanism or as a beneficial safeguard against an adversary's insolvency but rather operates radically to alter the parties' ultimate financial positions. Such a mandatory rule diminishes *both* injured parties' actual recovery and accords both insurance companies a corresponding fortuitous windfall at their insureds' expense."²⁰³ Several other courts,²⁰⁴ as well as the Uniform Comparative Fault Act,²⁰⁵ also take insurance into account in determining whether setoff should apply in the comparative fault context.

III. FINAL THOUGHTS

The conclusion that insurance has had—and will continue to have—a profound influence on tort theory and process seems, at least to us, beyond

195. *Id.* at 209.

196. *Id.*

197. *Id.*

198. *Id.*

199. *Jess*, 604 P.2d at 209.

200. *Id.* at 211-12.

201. *Id.* at 210.

202. *Id.* at 209-11.

203. *Id.* at 211-12.

204. *Stuyvesant Ins. Co. v. Bournazian*, 342 So. 2d 471, 473 (Fla. 1976); *Miller ex rel. Grindell v. Amundson*, 345 N.W.2d 494, 496-97 (Wis. Ct. App. 1984).

205. UNIFORM COMPARATIVE FAULT ACT § 3, 13 U.L.A. 348-49 (1977) (amended 1979).

serious dispute. Moreover, that insurance can either further or frustrate tort law's underlying objectives is equally apparent. Sometimes the impact of insurance on tort theory or process is obvious, and at other times the impact is subtle and indirect. Sometimes insurance takes a prominent and explicit role in a court's formulation of a substantive rule. At other times insurance considerations lurk in the background, providing the unspoken motives for many of the parties' tactical decisions, including who to sue, what claims to assert, and what strategies to employ in the litigation. From the nearly infinite number of illustrations that could be offered to illuminate the tort-insurance relationship, we have selected several substantive and procedural contexts that can be used to explore more deeply the importance of taking the effects of insurance into account in teaching torts. We are convinced that students will acquire a deeper understanding of torts if they are aware of the underlying insurance considerations that motivate courts and litigants alike.

We are tempted, however, not to stop there. Our focus has been to examine the effect that liability insurance has on the tort goals of achieving corrective justice, appropriate deterrence and compensation. While most tort scholars today deemphasize compensation or loss spreading as a free-standing goal of the tort system, it is undeniable that tort law does compensate some individuals. It is also undeniable that much of the expansion of tort liability in the last forty years occurred because courts desired to implement loss spreading principles. A question worth considering is how successfully the tort system spreads losses in light of these innovations. This question cannot be answered by examining tort law by itself or tort law as it is affected by liability insurance. In a broader context, tort law works with a wide variety of private and public insurance mechanisms—including health, disability, and life insurance; first-party automobile insurance coverages; Medicare; Medicaid; the Social Security Disability and Social Security Income programs; Workers Compensation systems in the fifty states; and a number of federal programs, ranging from the Veterans' benefits programs, the Black Lung Benefits Program, and more—to compensate victims of loss.²⁰⁶ When the boundaries of the inquiry are defined as "loss compensation," tort law's compensatory scheme is dwarfed many times over by these other compensation mechanisms. One cannot even begin to come to terms with this big picture without thinking about private and social insurance mechanisms.²⁰⁷ Only by looking at the big

206. For an illuminating survey of these programs and their lack of overall coherence, see Abraham & Liebman, *supra* note 1.

207. One angle on this relationship that might be explored in either a torts or insurance law course can be raised by asking the following question: if first-party insurance mechanisms are so important, should some persons have a tort duty to procure insurance for the benefit of those over whom they have some measure of responsibility? For example, it would be tortious for a high school (be it the administration, the athletic department, or the coaches) to send football players onto the practice field for a contact scrimmage without helmets, an indispensable piece of injury-

picture can one evaluate what legitimate role, if any, tort law can play in compensating for loss.

It is, of course, naive to think that any first-year law school course can even begin to approach a meaningful study of these diverse systems of loss compensation. We suggest, however, that at some point in the torts course students should at least be alerted to the general contours of the big picture. And it is here that exploration of the tort-insurance intersection may have some of its greatest value: by insisting that first-year law students reflect upon the impact of insurance law on tort doctrine and practice, one demonstrates that acquiring an understanding of the substantive principles in a first-year course is only a first step in a life-long effort to appreciate the rich doctrinal relationships that permeate the entirety of the American legal system.

preventing equipment. Is it not just as senseless for the school to send its players onto the field, where the risk of serious, disabling injury is ever-present and well-known, without another piece of equipment—a policy of first-party insurance against the effects of disabling injury? The answer given by courts is no. *See Wicina v. Strecker*, 747 P.2d 167, 173-74 (Kan. 1987); JERRY, *supra* note 20, at 220-21. The reason why the law gives this answer provides an entry point for a discussion of tort duties, first-party compensation mechanisms, liability insurance, individual responsibility and communitarian values.