THE INSURANCE IMPLICATIONS OF ADMINISTRATIVE COMPENSATION SCHEMES

Kenneth S. Abraham*

Administrative compensation schemes are increasingly being proposed¹ and adopted² as alternatives to the tort system. The product and process-related injuries³ covered by these schemes vary greatly; but two of their features fit them neatly within the subject of this Symposium. First, because environmental liability cuts across product and process categories, many of the issues posed by these schemes—even those that do not deal directly or explicitly with environmental liability—are relevant to the environmental-injury compensation problem. Second, the insurance implications of these schemes are a useful lens through which to view their strengths and weaknesses. Consequently, as a way of understanding the issues that would be posed by administrative efforts to compensate the victims of environmental injuries, I shall focus in this paper on the insurance implications of administrative approaches to the compensation of product and process injuries.

I. THE ISSUES

Three major issues tend to trouble the framers of administrative compensation schemes that are designed to deal with product and process injuries. First, the events to be made compensable

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³ I use this term to refer to physical injuries and diseases associated with industrial, commercial, and professional products, processes and services, including the sale of consumer products and pharmaceuticals, the delivery of health care, and the disposal of chemical waste.
must be defined; second, a series of equity issues must be resolved; and third, a suitable method of funding the scheme must be devised. As I hope will become clear, I am skeptical about the prospects for satisfactorily using third-party insurance schemes, modeled on workers’ compensation, or employing compensation “funds”, because third-party schemes cannot at this stage of their development effectively resolve these three issues. For this reason, I believe that concentrating on the expansion of health and disability coverage in first-party and social insurance policies to fill the gaps in the protection available to the victims of product and process injuries, including the victims of environmental exposures, is a more promising course to take. The following sections discuss the scope of the problem.

A. Defining the Compensable Event

Defining the events to be compensable under an administrative scheme appears at first glance to be a technical problem, but in fact this task is substantive to the core. One of the principal issues currently troubling the tort system’s effort to compensate the victims of product and process injuries is the difficulty of proving causal connections between the activities of defendants and the injuries suffered by plaintiffs. Any definition of the compensable event under an administrative scheme must also confront this problem, either by making a decision about causal requirements at a high level of generality, or by importing the same kinds of causal inquiries now troubling the tort system into the administrative scheme. Both approaches, however, are likely to create insurance problems; the first because it might produce an exceedingly expensive system, and the second because it would replicate the uncertainties that have recently thrown the market for insurance against tort liability into disarray.

For example, general formulas governing compensability tend to be overinclusive and therefore to raise the cost of the system.

4. By third-party, I mean insurance that covers insurers against liability to others; in contrast, first-party insurance covers victims against their own losses.
6. For discussion of these uncertainties, see Abraham, Making Sense of the Liability Insurance Crisis, 48 Ohio S. L.J. 399, 404-09 (1987).
7. See Rabin, Environmental Liability and the Tort System, 24 Hous. L. Rev. 27, 49
The Black Lung experience is the paradigm example of this threat, having developed from a $110 million program in 1970 to a $1.7 billion program in 1980. Even this sum pales in comparison to the projected cost of more broadly applicable administrative schemes. One estimate put the cost of the program proposed by the Superfund Section 301(e) Study Group—designed to compensate the victims of exposure to hazardous waste—at $29 billion per year.

To avoid such overinclusiveness and concomitantly high cost, the definition of the compensable event must employ distinctions between compensable and noncompensable conditions that are likely to be difficult to apply at the borderline. The result will be disputes about compensability that produce some of the very problems that the new scheme was designed to avoid. On the other hand, a comparatively underinclusive definition can be devised, but in that case the argument for retaining the tort system for events not included is strong, and the new scheme will end up addressing only a small percentage of the difficulties it was designed to solve.

The alternative to a general definition of compensability, specifically designated compensable events, or "DCEs," is likely to encounter similar problems. Either the DCEs will be overinclusive and expensive, or underinclusive and merely complement rather than replace the tort system. In short, with the exception of a limited range of injuries that might be easily isolated and carved out of the tort system, an administrative scheme is not likely to have the technical capacity to define in simple, workable fashion the events to be compensable under the scheme. For example, the workability of schemes recently created in Virginia to deal with birth-related neurological injuries, and both in North Carolina

10. Refer to note 1 supra.
14. See North Carolina Childhood Vaccine-Related Injury Compensation Program,
and at the Federal level to deal with the side effects of childhood vaccines, is yet to be demonstrated.

Apart from this central problem, several other issues are likely to arise in connection with any effort to define the compensable event. First, some proposals heavily rely on the use of presumptions of causation to solve the problems I have just described. Presumptions, however, may not always have sufficient specificity to be useful. Factual variations in cases in which there are several possible causes of the claimant’s injury or disease are likely to be great: How many cigarettes per day did the claimant smoke? For how many months was he exposed to benzene? What was the level of contamination of her drinking water during the years she claims exposure? Presumptions are unlikely to resolve the individual issues of causation that will arise in such cases. To borrow Karl Llewellyn’s metaphor, presumptions can chip a golf ball onto the green, but they cannot putt it into the hole. Yet the current difficulty and unpredictability of “putting”—reaching accurate decisions in individual cases—are precisely what most trouble the tort system and the liability insurance function that accompanies it. There is not much point in merely shifting these problems from one forum to another.

Second, it is difficult to define a compensable event before one becomes aware of the existence of a set of injuries or diseases that might be included. That is, it is difficult to anticipate specific problems that might warrant administrative compensation. Very general definitions of compensability can be anticipatory, but these are likely to be allocated to the jurisdiction of a permanent bureaucracy that will not boldly seize problems and solve them when they arise. The Veteran’s Administration was not bold in dealing with the Agent Orange problem (though its stance may or may not have been correct); workers’ compensation has not effectively handled the problem of occupational disease; and it seems improbable that a standing bureaucracy would have dealt well with the asbestos claims had they been presented to it in the early


1970s. Consequently, administrative compensation schemes tend to be established after a problem is recognized and has begun to afflict victims and trouble the tort system. The ad hoc creation of such schemes, however, is likely to generate strategic behavior, to raise serious equitable concerns,\footnote{Refer to notes 23-24 \textit{infra} and accompanying text.} and to pose very troubling questions about the applicability of preexisting liability insurance policies to the new administrative liabilities.

Finally, whether a scheme should be created at the federal or state level must be determined. Some of the problems that might be addressed by administrative compensation schemes are sufficiently national in character to justify a federal attempt at solution. Injuries and diseases caused by exposure to improperly disposed hazardous waste are especially compelling examples. From the insurance viewpoint, however, there is a great advantage to be gained through a state-by-state approach. Since each such approach will vary in its particulars, insurers or the other parties who finance the provision of compensation will in effect be able to diversify their risk across a number of different schemes in different states. In contrast, the chance that actuarial calculations made in connection with a new federal scheme applicable to all fifty states would be inaccurate would make insuring or otherwise financing such a scheme a much more risky proposition.

\textbf{B. Equity}

The creation of administrative compensation schemes that in some sense preexist discovery or recognition of the kinds of claims they will compensate is much like a bargain between potential victims and potential injurers. Because neither actual victims nor actual injurers know who they are, the creation of such schemes may be a reasonably fair trade of one set of rights and responsibilities (a cause of action in tort or tort liability) for another (a right to administratively awarded compensation or an obligation to finance the administrative scheme). As I suggested earlier, however, administrative compensation schemes are unlikely to be created \textit{ex ante}, and unlikely to work satisfactorily even if they are in place when a new set of compensation problems arises.

On the other hand, the attempt to create administrative compensation schemes \textit{ex post} generates different problems. Under
such circumstances, the hypothetical bargain between potential victims and potential injurers that creates a scheme *ex ante* is replaced by the need for a real political bargain, because at least some victims and injurers know their identities.\(^{20}\) Some of these victims will have viable tort claims and may oppose establishment of a compensation scheme that deprives them of or limits their tort claims. To accommodate their objections, a two-tier system may be necessary, in which victims are entitled to choose between the administrative and tort routes to compensation, or in which payment by the former simply offsets payment by the latter.\(^{21}\)

If a two-tier system were created, this concern for equity would of course render the total cost of compensation greater than it would be if an exclusively administrative approach were taken. Victims with strong tort claims could elect to bring tort actions, while those with weak claims would seek administrative compensation. This version of adverse selection would tend to raise the cost of the entire system dramatically; tort liability might become more predictable, but insuring against administrative liability would be made more difficult. On the other hand, if administrative compensation were simply treated as a collateral source without precluding the institution of any tort claim—thus, for example, mirroring the current relationship between worker’s compensation and products liability—yet another problem could surface. Victims then might use such compensation to “finance” their tort claims, settlement pressures would decrease, and the costs of the two-tiered system would be even less predictable and, therefore, even less insurable.

The need for a real political bargain regarding creation of administrative schemes would be affected by injurers’ incentives as well. If few victims have viable tort claims, then none will oppose creation of an alternative compensation scheme. To the extent this is the case, however, injurers are likely to oppose the scheme, because they have little to gain from its creation and a great deal to lose. Moreover, the liability insurers of enterprises potentially subject to assessment or liability under administrative schemes might

\(^{20}\) In addition, attorneys who have begun to specialize in tort claims that are potentially limited by any proposed scheme may oppose its establishment. In the analogous area of legislative tort reform, plaintiffs’ attorneys have organized opposition. Montford & Barber, *1987 Texas Tort Reform: The Quest for a Fairer and More Predictable Texas Civil Justice System*, 25 Hous. L. Rev. 59, 83-85 (1988).

\(^{21}\) See, e.g., SUPERFUND SECTION 301(e) STUDY GROUP, *supra* note 1, at 193-205.
also oppose their creation if these insurers stood a chance of being held liable for any such charges.

The exposure of liability insurers under preexisting policies would depend on the nature of the scheme. Most liability insurance policies insure against all sums which the insured shall become liable to pay because of bodily injury or property damage arising out of the activity insured.\textsuperscript{22} If the administrative charges assessed against an enterprise were interpreted as a sum which it was "liable to pay because of . . . bodily injury . . .", then the lion's share of financing the system during its early years could be imposed on the insurers of such enterprises. Undoubtedly this prospect would evoke serious opposition to the establishment of an administrative scheme from the insurance industry.

Aside from these conflicts of interest between victims and among victims, injurers, and liability insurers, the creation of an administrative scheme may raise even more basic questions of equity. The tort system's provision of compensation to some and denial of compensation to others has usually been justified on the ground of its deterrence capacity. If an administrative scheme surrenders most of the tort system's effort to promote deterrence—as I suggest in the next section it probably must do—then the scheme's focus is subject to attack on equitable grounds.\textsuperscript{23} For example, why compensate the victims of exposure to improperly stored hazardous waste on a no-fault administrative basis, but deny such compensation to the victims of other dangerous activities? Why award compensation to those suffering the side effects of childhood vaccination, or to children suffering birth-related neurological defects, but deny it to the victims of exposure to hazardous waste?

If the only answer that can be given is that, as a technical matter, defining the compensable event is feasible for certain kinds of injuries but not for others, then the victims who are left without a right to administrative compensation and with very weak or nonexistent tort claims are likely to be unsatisfied. It is therefore no surprise that the administrative schemes that have actually been created in recent years focus on the compensation of children, whose receipt of special treatment seems least vulnerable to criti-


\textsuperscript{23} Rabin, supra note 7, at 46.
C. Funding

Different approaches to administrative compensation are financed in the ways I shall later describe in my analysis of the three models available to provide such compensation. In this section I make some comments about the funding of administrative compensation schemes in general.

The central point to recognize here is that the method of funding adopted reveals the underlying function of any individual scheme. For example, if enough is known about the causation of a particular kind of injury or disease that is made administratively compensable, then funding the scheme through assessments against the enterprises responsible for these injuries or diseases will be feasible. The question then becomes, what benefit is derived from shifting away from the tort system? If causation can be determined on a case-by-case basis, then the administrative scheme can create deterrence much as the tort system did, by funding itself through differential ex ante assessments against causally responsible enterprises. Its only major advantage over the tort system will be its capacity (if it has that capacity) to cut down the administrative costs incurred by the tort system.

Under such circumstances, however, an administrative scheme is unlikely to be created, for the tort system probably will have been working comparatively well. Rather, administrative schemes are likely to have appeal mainly in the range of cases that are not handled well by the tort system. The tort system has great difficulty, for example, in cases posing the problem of the indeterminate defendant. Yet only under special conditions could an administrative scheme deal with such cases by assessing the responsible enterprises in proportion to the amount of harm their activities threaten to cause, for rarely would there be enough infor-

24. Moreover, although these schemes were created ex post in one sense—the problems they compensate were well recognized when the schemes were created—they are ex ante in a more important sense. Because the schemes apply prospectively, there is no preexisting set of victims being granted a special right. Rather, in effect potential victims insure themselves against the risk of suffering an injury compensable under the new schemes, because they, or their parents, are consumers of the products or services that are associated with these injuries.

mation available to fine-tune such assessments.

Consequently, the amount of deterrence generated by a scheme would be minimal,26 for the same reason that liability insurance premiums cannot currently be fine-tuned to deal with such cases in a way that promotes deterrence through the threat of tort liability; predicting the threat to health or safety posed by certain products or processes is a highly uncertain enterprise. In short, an administrative scheme could provide compensation in cases involving indeterminate defendants, but its funding mechanism would reflect the same kinds of problems that the tort system had faced before it was supplanted.

Thus, whenever an administrative scheme has the capacity to fine-tune its assessments to optimize deterrence, it is not likely to be needed, because the tort system is probably working fairly well. If a scheme that might be needed cannot fine-tune its assessments, it is likely to raise the problems of equity I discussed earlier, for it will not be able to justify itself on deterrence grounds. Only in that rare middle ground, when for special reasons the tort system is failing but an administrative scheme could do the same job more effectively, is such a scheme likely to succeed.

The most likely case for such success involves the indeterminate defendant whose degree of responsibility is clear, but whose responsibility in individual cases is not. Cases involving “signature” diseases caused by generically identical products such as DES and asbestos insulation fall into this category. A fund could assess all DES or asbestos manufacturers in proportion to the amount of harm their products had caused, although it could not determine which manufacturer had harmed which claimant. These are precisely the kinds of cases, however, that the tort system can handle equally well—or equally poorly, depending on one’s viewpoint—through such doctrines as market share liability. An administrative scheme would simply apply market share liability through funding assessments against potentially responsible enterprises instead of through the imposition of tort liability on virtually the same basis.

II. THE MODELS

In this section I move from a general discussion of the issues

posed by administrative compensation schemes to a focus on three models available for implementing such schemes. Here these issues arise in the context of the three models: workers' compensation; compensation funds; and first-party insurance.

A. Workers' Compensation

Workers' compensation is a third-party insurance scheme under which employers are liable for the work-related injuries suffered by their employees. Although workers' compensation is a useful model for dealing with certain product and process injuries, it is in many ways an unlikely model for handling environmental injuries, because it embodies the comparatively precise causation requirement that the injury be work-related. This allows workers' compensation insurance to be carefully experience-rated, and permits its funding structure to promote deterrence in much the same way as the tort system. Only environmental injuries that were traceable on a regular basis to particular enterprises could be handled effectively by a third-party scheme resembling workers' compensation.

For example, consider the difficulty of defining the compensable event under a workers' compensation type of scheme governing health care, product, or environmental injuries. In each case the compensable event could either be defined through a general formula, or through designation of itemized occurrences that would be automatically or presumptively compensable. A general formula, such as "injuries caused by the provision of medical care," "injuries caused by a defective product," or "injuries caused by exposure to hazardous chemicals," would in all probability generate the kinds of disputes at the administrative level that I described earlier. Although constructing a DCE system covering medical and certain product-related injuries might be feasible, such a system would be less feasible for environmental injuries and diseases, because the identity of the enterprises or individuals responsible for such harms tends to be far less determinate.

Moreover, setting a price for insurance coverage against liability imposed under any of these formulas would be speculative. The extent to which any given individual or firm might be responsible for such injuries would be very difficult to predict, as would the leniency or stringency with which claims would be evaluated and awards made. Thus, although the transaction costs of a streamlined administrative system might be lower than in tort, the
problems of projecting the expected cost of substantive liabilities might not be significantly different.

Nonetheless, one important lesson can be learned from workers’ compensation. The common features of all such schemes are the elimination of or limitation (through scheduling by category) on the right to recover for noneconomic loss, and use of a nonfault liability standard that expands the number of claimants entitled to recovery. Because proof of eligibility and the amount of loss is in most cases merely a formality, the system can be operated by an administrative body. Liability under any system that eliminates or schedules the right to recover noneconomic damages and limits litigation is considerably more insurable than under the tort system, because variance in award levels and litigation cost is very limited and predictability is enhanced.

In sum, there are serious obstacles to the construction of an administrative compensation scheme dealing with product and process injuries based on the workers’ compensation model. These difficulties do not necessarily doom the prospects for developing a workable system, but as yet, no proposal has emerged which promises to solve the insurability problems such a scheme would encounter. Because such a system is based on the identifiability and liability of individual enterprises, many of the insurance problems that it poses would be analogous to those posed by the tort system’s jurisdiction over liability for product and process injuries, such as environmental exposures.

B. The Compensation Fund Model

An administrative system need not, however, be based on the workers’ compensation model, which holds the enterprise that causes a claimant’s injury responsible for paying the claimant compensation, either directly or through liability insurance. A contrasting model is the compensation fund. Such a fund is financed through assessments charged the enterprises that cause or contribute to the range of injuries made compensable. The fund is then responsible for compensating eligible claimants, and there is no effort to impose individual responsibility for particular injuries on particular enterprises or their insurers.

Structuring a system in this way might circumvent some of the problems of the workers’ compensation model, though it would raise others. A fund would face many of the same problems of defining the compensable event as does a workers’ compensation
model. The definition adopted may itself provoke costly borderline disputes; scientific knowledge may limit the list of compensable events so narrowly that a tort cause of action for unlisted events must be preserved; or an overinclusive definition or list of compensable events may render the system extremely expensive. In addition, by relieving enterprises of individual liability, a fund approach converts the problems of insurability faced by private insurers under tort or workers' compensation systems into prediction problems for the administrators of the fund.

These prediction problems arise because the fund must calculate the total financing needed to support it, by predicting the aggregate amount of liability that it will face. If it charges all enterprises subject to assessment a level premium, then its task is easier than that of the private insurer, which must calculate expected loss enterprise-by-enterprise. Such an approach is merely a risk pooling arrangement without the risk allocation that typically is also a component of private insurance. But if the fund attempts to retain some of the deterrence capacity of the tort or workers' compensation models by risk classifying its assessments, then it will have posed for itself the same problems insurers face in attempting to calculate expected loss when liability insurance finances the system.

A third variation—level assessments \textit{ex ante} but an \textit{ex post} subrogation right in the fund that is enforceable against individual enterprises when their responsibility can be proved—would solve many of the fund's prediction problems, but create new ones for private insurers. Instead of calculating premiums for primary liability to a claimant, they would have to calculate premiums for subrogation liability to the fund.

In sum, the creation of third-party administrative compensation schemes requires a choice about the location and uses of uncertainty. The uncertainty that currently troubles liability insurers can remain their burden under a workers' compensation model, perhaps with some reduction through limitation on the amount of compensation available; uncertainty can be shifted from private insurers to the administrators of a compensation fund that attempts to promote deterrence through differential assessments; or this uncertainty can be avoided by surrendering the effort to create safety incentives through the imposition of individual liability or the use of risk-calibrated assessments to finance the fund. None of the alternatives is terribly satisfactory, because each strives to isolate for
compensation a set of injuries or diseases whose cause is difficult to
determine. The consequence is over- or underinclusiveness, and
the accompanying difficulty of assessing costs in proportion to
responsibility.

C. First-Party Insurance

In contrast to the two third-party administrative compensa-
tion models discussed above, there is already in place an extensive
first-party system that compensates the victims of product and
process injuries, among others. More than eighty percent of the
population is covered by some form of health insurance,27 and a
smaller but significant portion of the population also is covered by
disability insurance or some other form of wage-loss protection.28
There are a number of ways to shift the locus of compensation for
product and process injuries away from the tort system and toward
greater reliance on first-party insurance. The ramifications depend
on the nature of the move.

1. Targeted Coverage. The first approach would be to con-
struct a separate no-fault system of first-party insurance targeted
at product and process injuries, or at some subset such as environ-
mental exposures. In theory, the principal advantage of such an
approach over tort liability would be its greater simplicity. In fact,
however, it probably would pose many of the same problems en-
tailed in the administrative compensation schemes I have just ex-
amined. It would require separate definition of the compensable
event; it would have to choose between level premiums and risk-
based assessments; and its relation to the tort system, to the extent
that system continued to exist, could create borderline issues and
counterproductive incentives.

The principal advantage of such a system over existing forms
of first-party insurance would be its ability to employ risk classi-
27. See Health Insurance Association of America, Sourcebook of Health Insur-
ance Data 5 (1984-85).
28. Most workers injured on the job are protected against wage loss by workers' com-
penstation. A permanently and totally disabled adult who has contributed to social security
Additionally, about 24 million people are covered by private long-term disability insurance.
See Health Insurance Association of America, supra note 27, at 16.
fication, however, could be more theoretical than real. How refined such a risk classification scheme could be is unclear. Given the difficulty of estimating causal probabilities when injurers are responsible for compensation, there is no reason to suppose that such estimates could be easily made if victims were responsible for their own compensation through payment of insurance premiums. Yet that is exactly what would have to be done for the new first-party insurance to create safety incentives for potential victims. Quite possibly the risk categories employed would replicate those of existing forms of first-party insurance, in which age, sex, and family health history are major determinates of rates for individually-sold coverage. In such a case the new system would be largely redundant.

Nor would the mechanics of marketing such coverage be easy to devise. Certain classes of product and process injuries occur in the context of contractual relations; the sale of first-party insurance as an incident of these contracts would sometimes but not always be feasible. In any event, because other product or process injuries—particularly those that involve environmental exposures—occur entirely outside a contractual context, some other vehicle for marketing such coverage, whether purchase was optional or mandatory, would be required. Thus, although use of a targeted first-party no-fault insurance system might circumvent some of the problems that a third-party system would face, it could not circumvent them all, and there are other serious obstacles in the path of such an approach.

2. Broad-Based Existing Coverage. A different approach would place greater emphasis on existing forms of first-party insurance simply by removing certain classes of injuries or causes of action from the jurisdiction of the tort system. For example, suppose that a strong state-of-the-art defense were erected in products liability, a regulatory compliance defense were introduced into environmental liability law, or operators of waste disposal sites were simply immunized from tort liability for diseases caused by exposure to the waste. First-party insurance (and whatever social insurance was available) would then be left to cover the costs associated with these injuries. There are no “technical” insurance problems implicated in such an approach. First-party and social insurance often provide reimbursement for such losses now. When a tort action is also brought to recover for these losses, first-party insurers
may or may not be reimbursed out of the plaintiff’s recovery, but the first-party system handles these losses quite comfortably.

Several other problems, however, are posed by this approach. First, because the purchase of first-party insurance is voluntary, not everyone would be insured against losses caused by injuries for which there is tort immunity. Second, because the limits of the coverage that is now purchased provide less protection than the “full” coverage of tort liability, many victims would receive less than full indemnity for their losses. Finally, the incentive effects of the threat of tort liability for the injuries in question would be removed and replaced by an increased incentive on the part of victims to avoid suffering these injuries. Avoiding a net decrease in safety would require careful allocation of compensation responsibility between the first-party and tort-liability systems.

Methods of attacking each of these problems would transform the comparatively simple, voluntary health and disability insurance model now in place into a more complex, more heavily regulated system. The most straightforward, but also the most radical, solution would be to create a mandatory first-party insurance program. There is precedent for a mandatory insurance requirement in both the automobile and workers’ compensation fields. The convenient focal points for enforcement of these requirements that exist in both these fields, however, are not so readily available here. A mandatory insurance purchase requirement might be enforceable through employers, but another method of enforcement would be required for the unemployed.

In addition, the terms of the required coverage would have to be determined. Any ceiling on the amount of coverage required—and there must be a ceiling if mandatory coverage is to be affordable—necessarily assures victims less protection than they would have been afforded for injuries previously compensable in tort. Although purchase of coverage in excess of the ceiling would be optional, inevitably some seriously injured victims would not be compensated for all their medical costs or lost wages.

29. The existence of such a cause of action depends on the scope of the insurer’s right of subrogation, which is in turn a feature of what I have elsewhere called the problem of “coordinating” insurance coverage. See K. Abraham, Distributing Risk: Insurance, Legal Theory, and Public Policy 133-72 (1986).

30. See, e.g., S. 1265, 100th Cong., 1st Sess. (1987). This bill, introduced by Senators Kennedy and Weicker, would require employers to provide minimum health benefits to the vast majority of all workers in the United States.
In one sense the prospect that the system would not automatically assure victims full indemnity even for their economic losses might be viewed as a disadvantage. But in another sense this difference between a mandatory first-party system and tort liability could be viewed as an advantage. In fields where victims and injurers stand in a direct or indirect contractual relation with each other—products liability, for example—tort law’s assurance that successful victims receive full indemnity for their losses tends to produce an income-regressive effect. A portion of the price of every product includes a premium to cover the risk of liability for injuries caused by the product; although this is a level premium, high-income victims receive a disproportionate share of protection, because they are fully covered in tort for their lost wages. In effect, low-income potential victims subsidize high-income potential victims in tort.\footnote{See Priest, The Current Insurance Crisis and Modern Tort Law, 96 Yale L.J. 1521, 1558-60, 1585-86 (1987).} Because the purchase of disability coverage above a specified ceiling would be optional under a first-party system, this income-regressive effect would be substantially reduced.

Finally, the incentive effects created or dissipated by shifting coverage of certain kinds of injuries out of the tort system and into a first-party approach would have to be carefully considered. Because of the very different ways in which first- and third-party insurance classify risks, relieving potential injurers of the threat of liability would not always reduce safety incentives, but sometimes this would be the result of such a move. Similarly, limiting tort liability would not always create greater safety incentives on the part of victims, although that would be the effect in some cases. Other things being equal, therefore, the cases that should be shifted from the tort to a first-party insurance system are those in which the combination of potential injurers’ and potential victims’ incentives is more nearly optimal after the shift.

What are these cases? One approach would be to seek an answer in the market. The abolition of certain features of tort liability might result in the allocation of certain compensation obligations to the first-party market, and the retention of others in the third-party system through contract. For example, in such fields as medical malpractice or products liability, direct or indirect contractual relationships governing loss might evolve between product or service providers in place of the previously mandatory tort rules.
The terms of sale might vary depending on the amount of contractually provided protection against personal injury purchased from the seller, and on such other risk-related characteristics of the purchaser as income level, age, or experience in using the product. The risk of losses not covered by such compensation contracts would be left for the first-party market or shouldered by victims themselves. This possibility of varying compensation obligations or prices so as to distinguish high- and low-risk potential victims does not exist under nonwaivable tort liability rules.

In situations where victims’ information about the risk of loss is considered insufficient to support such an approach, and in fields such as many forms of environmental exposure in which injuries occur outside the range of any contractual relationship, a more collective decision allocating liability obligations would be required. From the standpoint of potential injurers’ incentives, the prime candidates are the kinds of injuries whose frequency and severity are most difficult to predict. Insurance against liability for these injuries consequently is most difficult to price, and tends therefore to result in relatively level premiums being charged to different enterprises. Because the incentive effects produced by this kind of risk classification are minimal, the diminution in incentives resulting from the abolition of liability for this category of injuries probably would be marginal. Thus, the long latency injuries associated with many environmental torts, forms of products liability imposing retroactive strict liability, and aspects of joint and several liability might fall into this category.

Caution should be exercised in assessing this hypothesis, however, since it is based on what might be called a static conception of the incentive effects of the threat of liability. A more dynamic conception would take into account the possibility that the threat of even strict liability can create research incentives that might be lost by shifting the focus of compensation to a first-party system. Moreover, even apart from these incentives, increases in scientific knowledge about long latency diseases might in the long run render these forms of liability more easily insurable. The shift of


liability out of tort in appropriate cases should therefore be accomplished in a manner that would not erect artificial barriers to the return of these cases to the tort system at the proper time. For example, strict adherence to traditional rules governing proof of negligence and causation in such cases might be more effective in this regard than a wholesale rule (such as a statute of repose) immunizing defendants from liability in long latency cases.

The other side of the coin is the incentive for the victim to avoid injury. The starting point for any analysis of this incentive is that, apart from other factors, it is in victim's self-interest to avoid injury. The right to a tort recovery may cut in the other direction in some cases, by diminishing at the margin the potential victim's incentive to avoid injury. It may even be that in some cases this effect is dramatic. In considering whether and where to attempt to neutralize this effect by restricting tort liability, however, it is important to recognize that victims' first-party insurance will shelter them from the effects of their carelessness in much the same way as the potential for tort recovery. First-party insurance can employ devices to minimize this moral hazard, but these are likely to be only partially effective.

First-party risk classification, for example, is not necessarily a promising tool for use in controlling the risk of most product and process injuries. The comparatively refined risk classification employed by first-party automobile insurance is the exception and not the rule. Incentive-promoting risk classification in life, health and disability insurance is extremely crude in comparison to liability insurance classification. Individual health and disability insurance premiums are keyed only to age, sex, and, sometimes, geographic territory. The vast majority of health and disability insurance, moreover, is sold to groups. Group coverage is classified on the basis not only of the age, sex and place of residence of those in the pool; it also tends to be experience-rated by group. But the group based classification attenuates any safety incentives that might otherwise operate at the individual level. Perhaps most importantly, first-party health, disability and life insurance cover far more than product and process injuries. Because the component of any premium attributable to the probability that a victim would

34. The difference is that in general first-party insurance benefits would be more frequently available than tort recoveries, but would provide victims only with their out-of-pocket losses.
suffer such injuries is likely to be small, the effect of premium differentials on the victim's incentive to reduce the risk of these injuries is likely to be correspondingly diluted.

A shift from tort liability to first-party coverage is therefore unlikely, through risk classification, to increase victims' incentives to avoid product and process injuries. On the other hand, because deductibles and coinsurance can be easily incorporated into first-party insurance, their use can have this effect. These forms of victim risk retention can also help to reduce the costs incurred by victims after they suffer injury. However, deductibles and coinsurance are already widely used, yet medical costs continue to grow; potential victims have a strong self-interest in avoiding injury, regardless of the amount and source of compensation later available to them; and recovery in tort is hardly so certain that victims can count on full reimbursement of their losses after injury. Consequently, the extent to which first-party risk retention might create safety incentives superior to those now generated by the threat of tort liability is very uncertain.

In sum, a major transformation in the nature of first-party risk classification would be required before first-party insurance could be relied upon to replace any important elements of risk control now accomplished through the threat of tort liability. The advantages of reduction in the scope of tort liability would probably lie elsewhere: in reducing the enormous transaction costs of the tort system; in permitting potential injurers and victims to fashion their own risk-optimizing compensation relationships through contract; in reducing unnecessary post-injury expenses; and in rendering more insurable those features of tort liability that would remain.

III. Conclusion

All this leads me to the conclusion that if there is to be increased insurance for the victims of product and process injuries, including environmental exposures, then that insurance will have to come through greater governmental involvement in the provision of private and social insurance. Compensation funds are an unsuitable device for dealing with the problem of undercompensation, and purely voluntary private insurance can deal with it only unsystematically. To assure compensation, government might have to mandate the provision of first-party health and disability insurance by employers to workers and their families; or the more dras-
tic step of providing substantially more social insurance than is now available under existing programs for health-care expenses and wage losses might be required to accomplish the compensation goal.

Although the issues associated with the effort to increase the availability of these forms of insurance are daunting, my conclusion at least has the virtue of focusing attention where it should be—not on the technical problems posed by programs that would compensate discrete subgroups of the population for their injuries, but on the role that government might play in the provision of insurance against the general consequences of injury and disease.