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WAR DAMAGE INSURANCE

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If the United States becomes engaged in a new major war, we must expect that enemy aircraft will attack our cities and industry with nuclear weapons of mass destruction. That we cannot wholly prevent such attacks from being launched or intercept them before enormous damage may have been inflicted upon us is a matter of common knowledge. In these circumstances, *passive defense*—actions designed to minimize the consequences of bombing on the assumption that the enemy will have at least partial success in getting his planes and bombs through to the targets—becomes a vitally needed supplement to our active defense weapons.

People tend to think of atomic bombs as absolute weapons, pulverizing whole cities at one blow, overwhelming all possible defenses. While the effects of such weapons are in fact enormous, it does not follow that we are helpless in devising protective measures. For example, much of the destruction in the past has been due not to the atomic blast itself but to the general conflagration which followed; fire-resistant construction and strengthening of city fire departments may yield great returns by reducing this latter risk. In addition, shielding can be of great utility in protecting vital machinery, and the reduction of flying glass hazards equally vital for the protection of personnel.

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* The author would like to express his appreciation to A.P. Lerner, H.J. Barnett, P.A. Samuelson, and C.J. Hitch for criticisms received in discussions of this problem dating back to early 1951.

Despite these considerations, as of this moment practically nothing has been done in the way of passive defense. There are several sound arguments which may partially explain this neglect. First of all, there is the question of alternative uses of the money and resources which might be expended on passive defense—perhaps it would be better to spend that money on bombers or on tanks. Secondly, even if it is generally agreed that something should be spent on passive defense, we can come to no concrete decision until we have some idea how far to go in this direction. Finally, the proponents of passive defense have possibly harmed their case by laying excessive emphasis upon relocation, especially dispersal, which is only one of several methods of reducing vulnerability, and by no means always the best.

It is the contention of this paper that at least a partial way out of the present impasse concerning passive defense would be to offer *war damage insurance* to protect property-owners from the chance distribution of losses due to enemy action. It will be shown that an appropriate method of insuring property against war damage can be expected, over a period of years, to encourage purely *private* actions which will, aside from any governmental measures, tend to reduce the physical and economic vulnerability of our cities and industry to enemy bombing. This crucially important effect seems never to have been noted in any of the public discussions of war damage insurance.[1] The desired effect can be achieved by providing the war damage insurance according to a schedule of differential rates—allowing, e.g., relatively cheap insurance to property located in safe areas, possessing bomb-resistant structure, and built of noninflammable materials; and only relatively expensive insurance to property located in dangerous areas, not of sound construction, and susceptible to fire. The subject of this paper is of particular urgency because, as will be shown, alternatives now under consideration would have a positively harmful effect on vulnerability.

The overall objective of such an insurance program is to induce socially desirable private behavior through the mechanism of the price system. Under this proposal, private calculations of profit and loss in terms of differential insurance costs will minimize the role of administrative fiat in encouraging the vitally needed reduction of vulnerability to bombing. Lest hopes be raised too high, it should be pointed out immediately that a number of qualifications make this proposal no short-cut to national safety.

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1. Except for a letter to the *New York Times*, July 29, 1951, signed by Professors E.S. Mason, P.A. Samuelson, J. Tobin, and C. Kaysen, which argues in the same direction as does this paper.

(1) The desired objective will not be attained in the short run; a definite improvement may be attained in perhaps ten years, but hardly in one or two. (2) It follows from (1) that, at least for urgently needed improvements, administrative fiat cannot be entirely dispensed with. (3) The argument along welfare lines which is used in this paper is only correct to a rough approximation, since the insurance premiums to be charged will be far from perfect estimates of risk. (4) In addition, there are administrative problems which must not be minimized, as well as serious political objections on the part of interested groups.[1a] These difficulties will be discussed in detail below. While they undoubtedly weaken the case for the proposal made here, it will also be shown that no available alternative—including doing nothing—is free from objections which, in the author's opinion, are even more damaging.

THE BACKGROUND

The term "war risk insurance" is frequently used to refer to several different types of insurance coverage: (1) insurance of ships and cargoes in war zones, (2) life insurance where enemy action in war is the cause of death, (3) re-insurance of carriers of workmen's compensation insurance where injury or death due to enemy action is suffered while on the job, and (4) insurance against property losses due to enemy action. In this paper, we shall be discussing only item (4), property insurance—hence the term "war damage insurance," rather than the broader "war risk insurance."

The subject is limited in this way in order to keep the paper within reasonable bounds, and there is no intention to minimize the importance of other types or war risk insurance. Insurance against death or injury due to enemy action in war is a particularly important and pressing problem, especially since an insurance program can be designed to encourage measures tending to reduce human casualties as well as property damage. Such a program could be combined and administered jointly with the program of war damage insurance proposed here. This type of insurance raises, however, various special difficulties which it was thought best to leave aside at this time.

1a. Regional objections to dispersal of war plants have been a stumbling-block for passive defense proposals in the past. As a matter of fact, dispersal (in view of its enormous cost) seems less promising in many (perhaps all) instances than less radical alternatives like shielding machinery. While war damage insurance would offer a cheaper rate to safer areas, it would also give credit to these alternative measures. It is hoped, therefore, that regional objection will be less intense than it was to dictated dispersal programs.

Both the United States and Great Britain had war damage insurance programs in effect in World War II. In each case the program did not become effective until after war had begun, and so did not have time to bring about a more favorable passive defense situation.[2] Besides these two, a number of other nations had war damage insurance or indemnity programs. An indemnity program is one of government compensation for war damage without any prepayment insurance feature. France and Germany both had plans of the indemnity type.[3]

The steadily worsening international situation, especially after the opening of hostilities in Korea, led to a demand in the United States for a new program of war damage insurance. A number of bills to reinstitute the World War II program were introduced in both the Eighty-first and Eighty-second Congresses, though none has yet become law.[4] From our point of view, their most important characteristics were: (1) As in the World War II program, the financing of the proposed War Damage Corporation was restricted to $100 million of capital stock to be subscribed by the RFC and an advance of not more than $1 billion from the same agency; and (2) The Corporation was directed to establish uniform rates for each type of property according to an estimate of risk. The House report on H.R. 9802 in the Eighty-first Congress interpreted "uniform rates" to mean uniform with respect to geographical location. These bills cannot be considered satisfactory since, as will be shown: (1) Financial resources limited to $1 billion would be quite inadequate, and (2) The restriction to geographically uniform rates would weaken the favorable effect on vulnerability which an insurance program could bring about.

During 1951, the Budget Bureau, on behalf of the executive agencies, opposed all war damage insurance legislation. The Bureau proposed that, instead of a war damage insurance measure, Congress pass an act authorizing the President simply to grant compensation up to the amount of $22 billion to indemnify those suffering losses from enemy action.[5] The

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2. The American program is described in *Encyclopedia Americana*, 1950 ed., XXVIII, 677. For the U.K. program, see *The Economist*, CIL (December 15, 1945), 833; and *Monthly Labor Review*, LIII (August 1941), 371-73.

3. Comparative data and analysis of the war damage insurance or indemnity programs of various countries are available in two studies by the United States Chamber of Commerce. They are entitled: "War Damage Indemnity" (September 1950), and "Analysis of War Damage Indemnity Laws" (October 1950).

4. War Damage Corporation Act of 1951, Hearings Before a Subcommittee of the Committee on Banking and Currency, U.S. Senate, Eighty-second Congress, First Session (U.S. G.P.O., 1952).

5. *Hearings*, pp. 171 ff., 211 ff.

proposal of the Bureau has the considerable advantage of administrative convenience, since little need be done until the bombs fall. It will be shown, however, that simple compensation programs of this type tend actually to discourage private actions which would reduce vulnerability, thereby *increasing* the over-all national risk. In the author's opinion, if the harmful effect on vulnerability of the Bureau's proposal can be shown, this should be considered a fatal objection to the proposal. In its criticisms of war damage insurance, the Budget Bureau totally missed the favorable effect on vulnerability of insurance and the harmful effect of their own proposal. It is remarkable that, so far as we have been able to discover, even the *proponents* of insurance failed to note this effect in the *Hearings*.

VULNERABILITY AND DIFFERENTIAL RATES

In order to influence vulnerability in a favorable sense, it is proposed here that as far as possible war damage insurance rates be based on the risks involved in insuring different types of property. For example, certain locations will be safer than others; certain types of construction will be more resistant to blast and others less; and some materials will be less likely than others to burn and to ignite other structures and materials. In all these cases, it would be desirable to insure the safer property at a relatively low rate, and the poor risk at a high rate. This obviously makes sense from an insurance point of view, though a Federal War Damage Corporation would not have to be bound by ordinary commercial insurance practice.

Rates and incentives. What is more important is that such a schedule of differential rates will, through the price system, tend to encourage voluntary private actions in the direction of reducing vulnerability to bombing. For every possible step in this direction, an appropriately reduced insurance premium would (ideally) be offered. Clearly, rational self-interest would lead to the adoption of all measures such that the private cost of change is less than the private gain in terms of reduced premiums. When these conditions apply, we may say that, at least as a first approximation, the social cost of change (diversion of resources) is less than the social cost (the risk of destruction) of maintaining the status quo. While movement in the opposite direction (the abandonment of protective measures where the cost of maintaining them is greater than the gain in terms of insurance premiums) is also theoretically possible and will undoubtedly occur to some extent, it is not believed that this will be very important in practice—always assuming that the premiums are correctly adjusted. Underlying this opinion is the belief—based on empirical observation—that our economy has not as yet taken sufficiently into account the new bombing risks. The insurance program should, therefore, lead on balance to a net reduction of

vulnerability. As a matter of fact, wherever the costs of maintaining protective measures are greater than fair insurance differentials received, there is a *prima facie* case in favor of abandoning those measures on the ground that the social cost exceeds the social gain.

It may then be asked: Would not the absence of insurance lead to exactly the same result? The answer to this question is yes—in principle—but only under the assumption that the government's policy will be *not to offer compensation for war damage.* In the author's opinion, in the absence of an insurance program, it will be politically impossible for the government not to compensate for damage.[6] Simple compensation without insurance tends to discourage private efforts designed to reduce vulnerability, since those making the expenditures involved do not gain relative to those who leave their property in a highly vulnerable condition. In fact, simple compensation will encourage the abandonment of any protective measures of nonzero cost as already exist. In terms of the effect on vulnerability, therefore, war damage insurance will be superior to simple compensation. Whether or not it would be superior to no insurance combined with a policy of *not* compensating is a much more doubtful question. Since the combination of no insurance with no compensation is considered close to impossible politically, the question is more or theoretical than practical importance.

The two main feasible methods for spreading the burden of loss are, then, a simple program of government compensation or a scheme of war damage insurance.[7] It should be noted that partial compensation, being a compromise between simple compensation and no compensation at all, would have consequences for vulnerability intermediate between the harmful effect of the former and the favorable effect of the latter. The improvement with respect to vulnerability, however, is purchased at the expense of the inequity of forcing unlucky individual property-owners to bear the uncompensated fraction of losses due to enemy action.

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6. In the Budget Bureau proposal already mentioned, simple compensation was put forward as an alternative to insurance. The inequity of the fortuitous distribution of losses is so generally recognized that the only practical question seems to be weather to spread risk through an insurance program or without such a program.

7. Differential insurance rates are not the only method for achieving the desired effect. An appropriately differentiated special "passive defense tax" might be levied, or there could be differentiated compensation schemes in which the proportion of loss to be redeemed for various types of risks might be announced to property-owners in advance, to encourage them to reduce vulnerability. These proposals, unlike simple compensation, would all work in the right direction. They have been rejected on grounds of administrative or political impracticality.

Participation: Voluntary or compulsory? Should the insurance coverage be completely voluntary? A compulsory insurance program would solve many difficult problems. In particular, there need be no worry about adverse selection of risks (the tendency of poor risks to take out insurance and of good risks to self-insure), because no one has the option of remaining outside the insurance program. In addition, under a compulsory program it would be possible to make better estimates and projections of the inflowing revenue and better guesses of the probable liability. Perhaps most important of all, universal coverage (not achievable under a voluntary plan) would entirely eliminate the problem of demands for compensation sure to arise after bombing on behalf of those who have failed to take out insurance.

The chief argument against compulsion, of course, is that the latter is always undesirable in principle and might prove unacceptable to the American people in this case. It is possible that some compromise may be adopted, applying the compulsory principle to certain classes of risks and leaving others in the voluntary category. In the remainder of this paper it will be assumed (unless otherwise specified) that a purely voluntary program is in effect. Even in this case, it will be argued, the insurance program will have a beneficial effect.

Structure of rates. According to the arguments developed above, rates should be based on the risks involved in order to achieve the desired effect on vulnerability. The over-all levels of rates should reflect the over-all degree of risk, and relative rates should reflect relative riskiness of different properties. In this section, we shall emphasize relative rates as between properties of differing degrees of risk. The absolute level of rates will be discussed in connection with the financing problem.

What type of actions do we wish to encourage? These fall roughly into three general categories concerning location, construction, and other protective measures. With respect to location, we frequently hear demands for the utmost in the way of dispersal of cities and industry. Even aside from the costs involved, it is by no means clear that dispersal is always wise from the point of view of defense. For example, if a certain limited area could be made invulnerable, it might well be best to concentrate our vital facilities within that area. In general, the advantages in the way of concentrating the defense must be weighed against the increase in attractiveness of the target resulting from concentration. In practice, we would probably like to spread vital facilities far enough apart so that only one at a time would fall within the lethal area of a single bomb—but it would be quite doubtful whether we should want to encourage a general migration to the Great American Desert. Popular belief seems to be that

dispersal necessarily means relocation in some remote part of the country, whereas mere spreading out of industrial concentrations into the neighboring countryside may be more desirable from the defense point of view.[8]

As far as construction is concerned, it is quite clear that we would wish to encourage the building of new structures and the improvement of existing ones so as to increase the number which will survive the blast and fire dangers associated with atomic bombing. In the book, *The Effects of Atomic Weapons,* prepared under the direction of the Los Alamos Scientific Laboratory, design suggestions for new buildings and for improving existing buildings are made.[9]

In addition to location and construction, we would wish to encourage certain protective measures, both individual and community-wide, which could greatly ameliorate the vulnerability situation. The improvement of municipal fire-fighting organizations (with special attention to the protection from the bomb explosion of the organization itself and of the water supply) and the construction of adequate firebreaks are examples of such measures.

To reflect the degree of risk and to influence behavior appropriately, the rate structure should take all these factors into account.[10] It appears that, for large properties at least, the presently existing schedules of fire insurance rates can be used as a starting point. This is possible because fire is one of the chief agents of destruction. It is also convenient, as it is likely that the detailed administration of the plan will have to be handled largely through private fire insurance companies (as in the World War II program). In addition, some account would have to be taken of the blast risk as well as of the fire risk. Secondly, and far more importantly, the differential *bombing* risk (depending upon enemy strategy) would have to be superimposed upon the pure fire risk dependent on chance factors.

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8. See National Security Resources Board Document No. 66, "National Security Factors in Industrial Location," July 22, 1948.

9. Los Alamos Scientific Laboratory, *The Effects of Atomic Weapons* (September 1950), pp. 376-86.

10. They should not be revised, however, to take into account the pattern of active defenses. The theoretical justification for this position (there are practical justifications as well) is that the active defense which must be provided for highly vulnerable areas confers an unearthed benefit on a special group at a cost to the entire nation. If we lower insurance premiums because of the active defense provided, we lessen the incentive to undertake those vulnerability-reducing measures which would tend to remove the need for active defenses in the area concerned.

Setting the insurance rates will involve judgment and, therefore, the differential rates will not have the ideal effects on incentives which could be claimed for the true rates. Nevertheless, we believe that this is a case where judgment would have to go very far astray to produce really perverse effects on incentives, which is all we need be afraid of. We shall not get optimality, but we can expect improvement.[11]

The practical effect. The question might well be asked: Will the effect of the proposed program be substantial enough to produce a noticeable reduction in the nation's vulnerability to bombing? It must be remembered, first of all, that the proposal made here aims at a long-run effect—it will not make the United States invulnerable tomorrow. Even granting this, it might be thought that insurance differentials will be only a very small element in the whole complex of factors which influence a firm's decision to locate, for example, in one city or another. Similarly, a typical person will not be inclined to change his place of residence merely because he can get cheaper war damage insurance on his household goods in a different locality.

Arguments of this sort fail to take into account the fact that changes in economic circumstances always influence only persons and firms on the margin. It is not an effective argument to say that a typical firm will not be influenced to move solely by insurance differentials. The *typical* firm may not be induced to move, but there will be some firms, perhaps atypical, who were close to the margin of moving anyway. The extra inducement of the insurance will, for such firms on the margin, be sufficient to swing the balance toward change. In fact, if any firm is not induced by profit-and-loss calculations to move, there is a *prima facie* case in favor of the proposition that it *should not move,* since the economic advantages of its present site remain dominant even considering the bombing risk. Furthermore, as we have pointed out, relocation is not the only way, and probably not the most effective way from the national point of view, of reducing vulnerability to bombing; effective and less costly methods of protection will also be encouraged by the insurance differentials.

It will be cheaper, in general, to incorporate vulnerability-reducing features in new construction than to add them to already existing buildings.

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11. Space limitations prevent an adequate discussion of this problem, but in support of the above view it should be noted that a considerable body of experience has been accumulated by this date (in actual warfare or experimentation) on such risk elements as the blast and heat effects of atomic and conventional explosives, strength of structures, inflammability of materials, etc. Nor would the element of judgment involved here be unique, since private insurance rates for fire, theft, and other contingencies also are ordinarily based on informed judgment.

This is especially clear for drastic changes like relocation, which may require abandonment of such plant, fixtures, and machinery as cannot conveniently be moved. Therefore, it is to be expected that the most powerful influence of the differential insurance rates may be upon the location and construction of new facilities for expansion or for replacement of worn-out or obsolete equipment or plant. In 1951, gross private domestic investment amounted to $59.1 billion.[12] In addition, there was a substantial amount of investment under the auspices of federal, state, and local governments. It is evident that an enormous amount of new investment will, over a number of years, be subject to the influence of the differential insurance rates.

The costs of change. The various risk-reducing measures to be encouraged by the proposed insurance program all involve certain social costs. These costs are of two types: the direct cost of making the change (e.g., abandoning a still useful plant in a vulnerable area), and the continuing cost either in terms of direct outlay (as in maintaining fire-protection equipment) or loss of economic efficiency (e.g., producing at a safer but economically inferior location). The question before us now is the consideration which should be given to such costs as an argument against attempting to influence vulnerability through an insurance program. This objection is, in a sense, opposite to the above argument that the program may not have *enough* effect. Assuming that the insurance rates can be made to reflect the risks, it is maintained that this argument should be given no weight whatsoever.

The reason for this assertion, which may seem extreme, is simply that the existence of the threat of atomic bombing has changed the peacetime situation with respect to the economic efficiency of, say, one location as against another. In all economic calculations from now on, the threat of bombing is a factor which should be given weight. The insurance program does not influence vulnerability by *creating* a new set of incentives; rather, it *reflects,* by inserting the new data into the price system via an insurance mechanism, the situation already created by the threat of bombing. The costs of change represent the normal adaptation of the economy to a changed situation and, presumably, would not be undertaken unless they were less than the costs of maintaining the status quo in the face of the changed situation.

The problem of equity. There is a possible objection on equity grounds to a war damage insurance program embodying a schedule of differential

12. *Survey of Current Business* (March 1952), p. S-1.

rates based on the risk of loss through bombing. After all, it might be argued, is it fair to charge, for example, safer rural properties lower insurance rates than more dangerous urban ones? Aren't the armed forces supposed to protect the entire country, and don't city dwellers pay their share of taxes?

The counter-argument here is the same as the answer to the objection about the costs of change: differential insurance rates proportioned to risks do not *create* any inequity which may exist, they merely *reflect* it. The "inequity" here is that vested interests are disturbed by the new threat of bombing; they are so disturbed in the absence of any insurance at all. Whether or not there is insurance, a man with vulnerable property is in a poorer position than a man with safe property, although property values may not yet have changed to take this fully into account. We could, of course, attempt to restore the previous status of vested interests by providing insurance either free or without rate differentials according to risk. Aside from the harmful effect on vulnerability which such a program would entail, it could not wholly succeed in restoring the status quo. To the extent that transactions exchanging properties have already taken place at values reflecting the new pattern of risks (reports have been made in the press that the threat of bombing has been a factor in the rise of prices of farm land relative to city properties), the gains and losses occasioned by the changed pattern of risk have already been realized, and the attempt to restore the status quo will result in windfall losses and gains to new owners.

Furthermore, as long as the insurance plan remains voluntary, it is hard to see what valid objection can be brought on equity grounds. The government is not *imposing* a new set of property values; it is rather offering a simple business proposition: does or does not the property-owner want insurance at rates reflecting risks? Assuming that the rates are correctly set—and that is not in question here—is there any justification for a man with a poorly-built house demanding as cheap insurance as a man with a well-constructed house? If the rates failed to discriminate against the poorer risks, the owners of safer properties might well have equally valid grounds for complaint. So long as the program is voluntary, either has the option of not taking out insurance.

THE FINANCING PROBLEM AND AVERAGE PREMIUM

An attempt will be made to give the roughest sort of guess as to the probable liability of a war damage insurance program. The term "probable liability" is used as opposed to "potential liability"; the latter is the entire value of policies issued, while the former is an estimate of the damage likely to be suffered in actuality by policy-holders. In order to have an

average rate level reflecting the degree of risk, the probable liability must be corrected by a factor representing the probability of war, and then divided by the total of policies outstanding. The result of this calculation is the average annual premium.

Since we only want orders of magnitude, we shall simply guess here at figures of $800 billion in March 1952 dollars of potential coverage,[13] a 10 per cent damage level,[14] and a 10 per cent risk of war occurring in a given year.[15] Then to get an approximately correct effect on incentives, rates should be set capable of accumulating one-tenth of a fully paid-up fund in the given year. (We wish to set the rates *as if* we were accumulating such a fund; whether or not to establish a reserve fund is a separate problem.) One further modification is that, for reasons to be explained later, at a 10 per cent damage level it will only be desirable to compensate at the rate of 90 per cent for losses.

This calculation would require $7.2 billion to be paid in during the given year. (No adjustment for interest is made.) Since the figure for total wealth insured is $800 billion, this implies an annual premium of 0.9 per cent of value on the average. The rate could conceivably go up to almost 10 per cent for property whose complete destruction was certain in the event of war and, on the other hand, would be essentially zero for exceptionally safe property. It will be noted that the fiscal problems involved in handling such collections will be of the first magnitude.

These problems are in one respect mitigated but in others made worse by the probability that the plan will be, as discussed here, voluntary rather than compulsory. The fact that no one needs to sign up will mean that the potential liability, the probable liability, and the required premium income will all be less by an unknown but probably large factor. This will reduce

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13. This figure assumes full participation of eligible property in the plan. It was arrived at by using $502.4 billion as the value of reproducible tangible assets in the United States in 1946 (in R.W. Goldsmith, "A Perpetual Inventory of National Wealth," *Studies in Income and Wealth*, vol. XIV, published by the National Bureau of Economic Research, p. 18), other types of property being considered uninsurable. A March 1952 figure was arrived at by the rough device of assuming that this element of national wealth was in the same proportion to current gross national product at that date as it was in 1946. The exact figure derived by this procedure was $807.7 billion.

14. Such a figure seems too high for the current situation, but as atomic stockpiles of potential enemies mount it becomes more reasonable.

15. While guessing at this figure for each year is particularly dubious, such a procedure is implicit in our recurrent budgetary decisions on national defense; for example, deciding to what extent we should invest in increasing productive capacity for the future as an alternative to building up military stocks today involves much the same estimate of probabilities.

the magnitude of the financial problem, but will leave the average rate required as high as before. In fact, the element of adverse selection will tend to raise the average rate required.

The chief problem connected with a voluntary insurance program, however, is the fact that people will be tempted to speculate on the probability of war. That is to say, they may not take out insurance until the international situation becomes very threatening—especially since the premium rates will necessarily be rather high. In theory, the check on this should be variation of rates over time to take account of the changing risks. Another check, and one that might well be very effective, would be the granting of policies which do not become effective except after a waiting period of perhaps a year or six months. Such a provision would make speculation on the probability of war very dangerous, since one would have to guess about the situation six or twelve months from now, and not about the very immediate future. These and other devices should enable the War Damage Corporation to hold down speculation on the probability of war (adverse selection in respect to time) to a tolerable level.

The loss figures shown above assume complete coverage. Let us say that only 50 per cent of potential coverage is written. This may come about because some property-owners fail to take out policies or because some or all policies may be written with a coinsurance feature (where the insured continues to bear part of the risk, only a fraction being covered by the insurance policy). If the rate remains about the same,[16] annual premium income will be about $3.6 billion, reflecting potential liability of $400 billion and probable liability of about $36 billion.

The proposed War Damage Corporation Acts of 1950 and 1951 would have given the Corporation resources of $1.1 billion. These figures show that, unless our estimates are wildly in error, the scope of the program was completely misconceived. In fact, a single bomb in certain highly valuable and concentrated areas might create valid damage claims in excess of a billion dollars.

The Budget Bureau's simple compensation proposal referred to earlier called for authority to expend up to $22 billion for compensation purposes. This figure corresponds to our $80 billion of probable damage to the entire economy, if we can assume that the Budget Bureau figure represents an estimate of over-all national loss. Without an extensive study, it cannot be decided whether our guess or the Budget Bureau's estimate (if it is such) is

16. The element of adverse selection will tend to increase, while coinsurance tends to decrease the rate required.

likely to be closer to the truth.[17] Accepting the Budget Bureau's figure for probable damage while retaining our other assumptions would reduce the annual premium income with full coverage and the average rate of premium required by a factor of about four—that is, to about $2 billion and 0.2 per cent of value, respectively. This lower premium rate would certainly make the insurance more palatable, though less powerful in reducing vulnerability. The lesser effectiveness of lower rates is not necessarily an argument against them, for the optimal effectiveness depends on the unknown true degree of risk.

At this point the reader may quite justifiably be worried. We have made blind guesses at the over-all probable loss and the probability of war, but will anything better than a blind guess ever be possible? If not, we might set rates so as to push people into less vulnerable situations ten times too fast relative to the true risks, or else not one-tenth fast enough![18] This objection is undoubtedly a serious one and it further weakens—to the vanishing point, some will think—the force of the welfare arguments used initially.

Nevertheless, we must always view the problem in terms of the alternatives, and especially the leading alternative—simple compensation. If we do not move fast enough, we are at least going in the right direction, while simple compensation would be pushing us in the wrong direction. We might indeed move too fast, but in view of all the administrative and political pressures in favor of the status quo, the danger of moving very much too fast seems quite slight.

It should perhaps be noted that any attempt to reduce vulnerability, whether or not through an insurance program, would face the same difficulty of deciding how quickly the change should take place. In fact, some estimate of the probability of war and the over-all risk of loss is implicit in all decisions relevant to national defense. The necessity of setting an over-all level of risk for war damage insurance would only force this estimate to be made explicitly.

Reserves and compensation. We cannot here enter into a discussion of proper reserve and compensation policy, but it will be useful to make clear what the fundamental objective of this policy should be. Without extended argument, we shall assert that the objective—which we shall call the

17. It will be remembered that our figure was based on 10 per cent damage, an estimate which was considered high for the immediate future but possibly low for the more distant period.

18. There is a further complication in that the true risks are not constant but depend on enemy strategy, which may well be affected by our decisions on passive defense.

Equitable Principle—should be to restore the *relative* position of those who lose property by the bombing so that they are no worse off than the nation as a whole. Since the bombing will reduce the real national wealth, the restoration of the *absolute* position of those who lose property would mean an actual gain for them relative to the rest of the community. It follows from the Equitable Principle that the proportion of actual loss compensated should be I minus the over-all proportionate loss of national wealth; if, for example, 10 per cent of the national wealth is destroyed in the bombing, the real value of the compensation should be at the rate of 90 per cent of the real value of the loss. This calculation assumes that money and other claims to wealth are not destroyed, or else that such assets are separately insured under a parallel program, as they were in World War II.

An ordinary insurance company must have a reserve fund in order to maintain solvency in periods when cash outgo may exceed cash income. For war damage insurance, in the period before war comes there will be only income and no outgo; should war occur, however, outgo is likely to exceed income by far. If, therefore, the War Damage Corporation is to operate on sound insurance principles, it might seem absolutely necessary that the Corporation build up a reserve fund to meet its future liabilities. However, there is a fundamental difference between liabilities of private individuals or corporations and liabilities of the government, and so it does not necessarily follow that the War Damage Corporation—an instrument of the federal government—must or even should follow sound business practice appropriate for a private insurance company. By its taxing power and its ability to create money, the government is in a position to call into existence assets to meet its own liabilities. With respect to war damage insurance, this means that after the bombing the government can create purchasing power in favor of those who have lost property in the bombing or can tax the rest of the population so as to achieve the Equitable Principle of restoring the relative position of the former—without accumulating any reserve at all.

Whether it would be wise to conduct the insurance program without a reserve can only be determined by an exploration of the likely consequences of the several different possible policies, which cannot be done within the limits of this paper. We may merely mention that, in the absence of a reserve, the appropriate procedure to redistribute the remaining national wealth would involve a capital levy. In all probability, a very considerable inflation would be unavoidable. To the extent that a reserve exists, of course, assets will be available for meeting compensation claims without calling on the general credit of the government.

THE PROPOSED PROGRAM AND ALTERNATIVES

There are a number of possible actions the government might take which are not alternative to the insurance program and so are not precluded by it. These actions include making some specified reduction of vulnerability a condition for the granting of government contracts, certificates of necessity for accelerated tax amortization, or priorities and allocations under the defense production program. Such direct measures will be appropriate where special circumstances (e.g., new construction of a facility in a highly critical industry) make reliance upon the milder generalized pressure of the insurance program insufficient. The Committee Staff of the Congressional Joint Committee on the Economic Report has proposed the use of such devices.[19] Unfortunately, the report proposed them only in connection with dispersal, which is only one of the aspects of the vulnerability problem. Because of the dangers involved in arbitrary *ad hoc* decisions varying from case to case, direct intervention should probably be limited to special situations concerning critical industries.

Even after all qualifications are made, this review indicates, in the opinion of the author, that a great opportunity to influence vulnerability in a favorable direction will be lost if we fail to provide a suitable type of insurance for war damage. In the absence of such a program, political realities will probably require compensation for damage. The expectation of compensation will encourage a socially harmful type of behavior with respect to vulnerability.

On the other hand, even if we do offer an insurance program, the effect on vulnerability may not be favorable unless rates are proportioned to risk. Such differentiation of rates was done only in the most perfunctory fashion in the World War II program. At that time, the fault was not important because (1) the risk was not very great, and (2) the effect on vulnerability can be only a long-term one, and the insurance program was not put into effect until after war had begun. Nevertheless, the element of adverse selection, which always appears when rates are not properly proportioned to risk, was very conspicuous in the World War II program.[20] For a prospective future war, neither of the factors mitigating the failure to differentiate will apply. The risk of damage due to enemy action is liable to

19. Eighty-second Congress, First Session, Joint Committee Print, "The Need for Industrial Dispersal."

20. A tabulation of the policies issued shows a highly disproportionate amount of policy coverage in the coastal states (the most vulnerable regions) as opposed to, say, the Midwestern States. See *Encyclopedia Americana* (1950 ed.), XXVIII, 677.

be great, while on the other hand war may not come for a number of years or may not come at all. Therefore, we have both a great need for insurance and an opportunity to introduce it early enough to have a large effect on vulnerability. This effect will not be achieved unless considerable care is exercised in establishing rates according to risk, and this will not be done unless the connection between the insurance and the vulnerability problem is recognized by the federal government. Such has not been the case up to the present time.

Finally, it should be recognized that the financing problem will be of an entirely greater order of magnitude than it was in World War II. This problem merits the close attention of those responsible for fiscal policy and for the over-all behavior of the economy. The results may be positively dangerous if the program is narrowly conceived as only a special form of insurance, and left solely in the hands of a small agency with purely insurance responsibilities.

A NEW OLD LOOK AT TERRORISM INSURANCE: JACK HIRSHLEIFER'S *WAR DAMAGE INSURANCE* AFTER FIFTY YEARS

Peter Siegelman[*]

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INTRODUCTION

The "shelf-life" of most social science is depressingly short. The community rarely pays attention to articles that are more than a few years old because most theories, findings or techniques are only relevant for a short while—if at all. There are rare exceptions, of course: path-breaking pieces whose status as classics warrants the continued attention of scholars decades after they were published. But it is even more rare to find a fifty year old article that: (a) seems to have been almost completely forgotten; (b) was

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intellectually so novel that it reads like an introduction to many of the major trends of the next fifty years; and (c) speaks directly and cogently to a policy issue of immense current importance. *War Damage Insurance*,[1] published by Jack Hirshleifer in 1953, is precisely such an article, and I am thrilled to be able to bring it to the attention of those modern readers who (like me, until a few weeks ago) do not know of its existence.

In this brief comment, I will approach the article in two ways: first, I want to situate the piece in the context of the fifty years of economic thinking that followed it. I will argue that the article foreshadows many of the most important insights in economics between 1950 and today. For instance, economists now take concepts of moral hazard and adverse selection for granted in analyzing insurance markets—and virtually every other kind of market as well. Hirshleifer's 1953 article is one of the earliest serious treatments of these ideas. That is more than enough for any paper, but the article anticipates other important intellectual developments as well, including the analysis of "Public Choice" or imperfections in governmental policy-making. The only puzzle is why this article has not achieved the classic status it deserves. I briefly consider this question.

My second goal is to consider the substantive content of Hirshleifer's analysis in the aftermath of the economic policy problems posed by the terrorist attacks of September 11, 2001. Here, I will claim that much of the article is as relevant today as it was fifty years ago, although I will also point out some qualifications and implementation problems that are likely to present themselves.

I. A VERY BRIEF OVERVIEW

The article begins by noting while that the threat of (limited) nuclear attack can be countered by various *military* means, there are also precautions that *civilians* can take that will lessen the damage caused by an attack if one does occur.[2] (These include mitigation efforts such as building stronger buildings, dispersing development outside of large cities that are especially vulnerable to attack, installing better fire-prevention systems, and so on). The concern of the article is to devise a system that will provide the proper incentives for civilian precautions or mitigation efforts.[3] Almost all of what Hirshleifer had to say about the threat of limited nuclear attack fifty years ago

1. Jack Hirshleifer, *War Damage Insurance*, 35 REV. ECON. STAT. 144 (1953), 9 CONN. INS. L. J. 1 (2002).

2. *Id.* at 144, 9 CONN. INS. L.J. at 1.

3. *Id.*

is relevant to the threat of terrorist attack today, yet another way in which the article is eerily *au courant.*

Hirshleifer begins by noting that if there were an attack on one or two cities, the political system would inevitably respond by providing substantial aid for the rebuilding of the affected areas.[4] Knowing this response, forward-looking decision-makers will alter their behavior accordingly. They will take fewer precautions—exercise less "care"—than they would in the absence of a predicted bailout because precautions are costly and they know that much of their losses will be recouped from the government, regardless of the level of precautions they take.[5] In other words, when they know that compensation will be forthcoming in the event of an attack, builders will have less reason to locate outside of large cities, or to install fire-prevention equipment, because these steps are all costly and yield no real benefit, since the government will compensate them for any losses they sustain. As a result, buildings will be more clustered together, and less structurally sound, than would be optimal.

To solve the problem of inadequate incentives to take care, Hirshleifer proposes a system of government-provided war damage insurance, in which insureds pay premiums that reflect their actual risk of loss, and are compensated—in the event of loss—out of the premiums collected.[6] Under this system, buildings located in large cities that are the most likely targets of attack (or those built without substantial fire-prevention infrastructure) would be charged higher insurance premiums, which act as both an incentive and a signal. Lower rates in safer areas would give decision-makers a reason, at least at the margin, to locate away from large cities—lower insurance costs outside of major metropolitan areas. Put another way, premium differentials would signal which actions are appropriate, because interested parties could compare premiums for various designs or locations, and thereby obtain an

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4. *Id.* at 144, 9 CONN. INS. L.J. at 1-2.

5. As we will see, this is a standard moral hazard problem that arises from the incompatibility of insurance and incentives. Of course, some losses will not be "insured" by a government bailout, and firms will still have an incentive to take precautions that reduce such losses. However, the *overall* incentives to take care are reduced by a bailout program that eliminates any part of the total cost of an attack. In other words, if a firm expects to have uninsured losses to personnel of one hundred and uninsured losses to property of seventy-five, it will have more reason to take more precautions than if it expects only the former, with the latter being covered by the government.

6. Hirshleifer, *supra* note 1, at 147-52, 9 CONN. INS. L.J. at 7-15. The design of the system is given considerable attention, and I will discuss it in detail below.

implicit estimate of the hazards involved in whatever choice they are considering.[7]

II. LOOKING BACKWARD

Hirshleifer's piece was far ahead of its time. Reading it today, one can see that it anticipated many of the most important and interesting results in economics over the next fifty years, many almost as an aside.

A. Public Choice

Consider first the issue of Public Choice or endogenous policy-making. At mid-century, most economists believed that the appropriate role of government was to correct various forms of market failures, which classically included externalities (e.g., pollution), failures of competition (monopoly), or the provision of public goods that markets would under-produce (e.g, national defense). The paradigm for doing economics was relatively simple: (1) identify a market failure (pollution); (2) show how governmental intervention could solve the problem (by taxing or regulating pollution); and (3) go home satisfied with a day's work well done.

Economists have since come to realize, however, that government may not act as a benign and omniscient social planner—that it may not do exactly what we would like it to do. Instead, policy will often reflect the political agendas of those in charge, rather than economists' efficiency-minded solutions. As such, it may not solve the problems to which it is ostensibly addressed, and will sometimes create *new* inefficiencies. This insight has blossomed into a whole sub-field of economics—Public Choice—and has been widely influential.[8]

Hirshleifer makes the Public Choice point almost offhandedly. The article begins with the insight that providing compensation after the occurrence of a

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7. *See* Goran Skogh, *The Transaction Cost Theory of Insurance: Contracting Impediments and Cost*, 56 J. RISK & INS. 726 (1989). Skogh notes that large corporations are often bigger and more diversified than the insurers to whom they sell risks. Their demand for insurance is thus not plausibly based on risk-transfer. Instead, insurance is desired because of the specialized loss-control services that come with it, and because premiums provide information on avoidance costs. Because their job is to monitor and price risks, insurance companies are ideally positioned to acquire and disseminate this information.

8. The pioneering work in economics is George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. 3 (1971). Other early contribution in this genre include Gary S. Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 Q. J. ECON. 371 (1983); Sam Peltzman, *Toward a More General Theory of Regulation*, 19 J. L. & ECON. 211 (1976); Richard Posner, *Taxation by Regulation*, 2 BELL J. ECON. 22 (1971).

disaster is so politically attractive that the government will invariably find it impossible to resist. As Hirshleifer puts it, "in the absence of an insurance program, it will be politically impossible for the government not to compensate for damage[since] . . . the inequity of the fortuitous distribution of losses is so generally recognized . . . ."[9] Hence, although a policy of *no* compensation for war damages or terrorism would provide the proper incentives for care or mitigation,[10] such a "no compensation" policy is not feasible because policy-makers always find it in their interests to provide compensation.[11] Politics, not economic theory, drives policy outcomes.

Suppose, however, that policy makers were more interested in efficiency and incentives than Hirshleifer gives them credit for. Imagine that the federal government, aware of the perverse incentives created by compensating victims of terrorist attacks, went so far as to announce that it will not pay any compensation in the event of a future attack. Even so, the Public Choice problem is likely to reassert itself. The reason is an application of a classic problem first explicitly analyzed by Thomas Schelling, that of

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9. Hirshleifer, *supra* note 1, at 146-47, 9 CONN. INS. L. J. at 6. Hirshleifer has long been interested in the limits of economic analysis in policy-making, and the important role of "political" factors. In a famous assessment of water policy, he concluded that policy makers had completely ignored the advice of economists and instead embarked on grossly inefficient schemes for pricing and allocating water when much better alternatives were available. He ended the article by suggesting that "the agenda for economists, at this point, should place lower priority upon the further refinement of advice for those efficient and selfless administrators who may exist in never-never land. Rather, it should focus on devising institutions whereby fallible and imperfect administrators may be forced to learn from error." Jack Hirshleifer & J. W. Milliman, *Urban Water Supply: A Second Look*, 57 AMER. ECON. REV. 169, 178 (1967).

10. This point foreshadows an important insight in the economics of negligence law: in a world where the only productive precautions can be taken by victims, optimal care requires a rule of no-liability. The reason is that when victims face the full costs of an accident, they will necessarily reap the full benefits of every dollar they spend on prevention or mitigation, and will thus have an incentive to spend up to the point where the marginal dollar of precaution just covers its expected savings in accident costs. *See, e.g.*, ROBERT COOTER & THOMAS ULEN, LAW & ECONOMICS 272-75 (2d ed., 1997).

11. Hirshleifer's recommendations are also an interesting example, again (slightly) ahead of its time, of so-called "second-best theory," a general equilibrium analysis of policy choices when the government is not able to choose the optimal policy instrument. *See* Richard G. Lipsey & Kelvin Lancaster, *The General Theory of Second-Best,* 24 REV. ECON. STUD. 11 (1956). Here, the first-best policy might be to refuse compensation to everyone, but that strategy is ruled out by the political context; in the presence of such constraints on government behavior, insurance is second-best.

"commitment."[12] This problem occurs whenever long-run and short-run interests diverge and there is no way to bind one's self now to take the optimal policy in the future.

Consider the policy of paying ransom to hostage-takers. Governments will always find it in their interest to declare resolutely that they will not pay ransom. It is of course the right thing to say, because if kidnappers are certain that no ransom will be paid, they will not find it attractive to take hostages in the first place. The problem is that once hostages are taken, everyone knows that the government's short-run interests lie in not letting its citizens languish in captivity: it is simply too damaging politically, and the rewards for freeing the hostages are too great, for any government to ignore.[13] Hence, even if the government initially promises *not* to pay ransom, its promise is not credible because when the future ultimately comes around, it will not be in its interest to keep its promise. Knowing all this, kidnappers will see through the promise not to pay ransom, and hostages will continue to be taken.

Schelling's analysis highlighted the strategic value of "hands-tying" or commitment devices.[14] In the hostage situation, for example, the President might state explicitly that if he were ever found to have negotiated with terrorists, he would immediately resign from office. Hearing this, kidnappers might then believe that the President would indeed refuse to negotiate with them, since the personal cost of his doing so would be too high. This kind of self-imposed constraint on future behavior can, as Schelling saw, be used to sustain promises that are otherwise not credible.

While Schelling should be credited for naming and analyzing this kind of commitment problem, Hirshleifer deserves recognition for implicitly suggesting that governmental provision of insurance can serve as a kind of

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12. THOMAS C. SCHELLING, THE STRATEGY OF CONFLICT (1960). Schelling's book has achieved classic status—its ideas are still discussed today, even though it was published more than forty years ago. Interestingly, Hirshleifer has himself explicitly addressed these issues in recent work. *See* Jack Hirshleifer, *Game-Theoretic Interpretations of Commitment*, Ch. 4., *in* RANDOLPH M. NESSE, EVOLUTION AND THE CAPACITY FOR COMMITMENT (2001).

13. This is precisely the behavior of President Reagan in the so-called Iran-Contra affair: while denying that he was negotiating for the release of the American hostages held in Iran, the administration was in fact making a deal for their release. *See, e.g., The Iran-Contra Report; Key Sections of the Document: The Making of a Political Crisis*, N.Y. TIMES, Nov. 19, 1987, at A14.

14. The myth of Ulysses, who wanted to hear the Sirens' deadly song, is a paradigmatic example of strategic self-constraint. Jon Elster, ULYSSES AND THE SIRENS: STUDIES IN RATIONALITY AND IRRATIONALITY (1984). Ulysses had his crew tie him to the mast, plugged up their ears with wax, and sailed past the Sirens' cave. Only by thus binding himself and his men, could Ulysses listen to the Sirens' song without perishing.

commitment or hands-tying device that could reduce the problem of suboptimal policy choice.[15] By announcing a program of premium-based insurance, the government effectively increases the cost of paying gratuitous compensation, making a promise not to do so more credible than it would otherwise be. The rationale seems to be that insurance inherently offers a link between compensation and premiums: only those who have paid for their insurance have a legitimate claim to receive compensation. Thus, governmental provision of insurance could act as check on the temptation to hand out compensation indiscriminately and at no cost to its recipients.[16]

In sum, Hirshleifer not only recognized early on that there are such things as predictable policy failures, but also saw that an insurance program can be used to overcome them by committing the government not to do the wrong thing when the time comes.

B. Moral Hazard

Another important theme in Hirshleifer's article is moral hazard, which can be crudely described as the tendency of insureds to reduce their own precautions as more of their losses are covered by insurance. Moral hazard is now an essential part of the game-theoretic or analytical toolkit of economists; it is used to understand any situation in which one party can take actions that are unobserved by another and which affect the payoffs to both. Insurance markets are only one example, since this kind of asymmetric information is present in virtually every strategic interaction.[17] Indeed, it is hard to overstate

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15. *See* Hirschleifer, *supra* note 1.

16. Although Hirshleifer does not explore this issue in any detail, we might ask why this should be so. The "discipline" provided by insurance—its role as a commitment device to check excessively generous compensation—seems to have both a political and moral dimension. Politically, it is easier to deny compensation for the uninsured if there are many who have *purchased* their insurance and could be mobilized to oppose the free provision of something they had to pay for. But the prophylactic effect of insurance also has a *moral* aspect: it seems less as inequitable or wrong to deny compensation to a victim who had a chance to purchase insurance, but turned it down, as it does to leave someone to suffer the random bad luck of being a victim of an enemy attack when no insurance was available. The former can be said to have assumed the risk of the misfortune in a way that the latter cannot, and seem to have less claim to our sympathies as a result.

17. The canonical reference is Kenneth Arrow, *Uncertainty and the Welfare Economics of Medical Care*, 53 AMER. ECON. REV. 941 (1963). Arrow stresses the importance of the "moral" dimension to moral hazard in his reply to Professors Pauly's comment on this article. *See The Economics of Moral Hazard: Further Comment*, 58 AMER. ECON. REV. 537 (1968). *See also* Tom Baker, *On the Genealogy of Moral Hazard*, 75 TEX. L. REV. 237 (1996), which surveys the intellectual history of this term.

the importance of moral hazard in contemporary economic theory—it has become one of the central concerns in the discipline.

Although he does not mention it by name, Hirshleifer clearly recognizes that moral hazard is likely to occur when (everyone believes that) the government will compensate all war damages. Why bother to reinforce your building or move your business to a less desirable location if the government will fully compensate you for your losses in the event of war? It is precisely this notion that leads Hirshleifer to conclude that "simple compensation programs . . . tend actually to discourage private actions which would reduce vulnerability, thereby *increasing* the overall national risk."[18] Although this may not be the first serious discussion of the incentive effects of insurance, it does appear to be one of the earliest treatments of this issue in mainstream economics.

Economists have mixed views about insurance. On the one hand, insurance is welfare-enhancing because most people are usually risk-averse. This means they prefer to reallocate wealth from "no accident" states of the world (where wealth is high and the marginal utility of wealth is low) to those states where an accident *does* occur, wealth is diminished, and the marginal utility of wealth is therefore higher.[19] Insurance is nothing more than a mechanism for "shipping" wealth from good times (when the marginal dollar is worth relatively less) to bad times (when it is worth relatively more).

On the other hand, the provision of insurance will rarely leave the behavior of the insured unaffected. The typical conclusion of economists is that insurance is the enemy of incentives. Full insurance, by definition, implies that the insured suffers no risk of bad consequences, and therefore has no reason to undertake costly precautions that lower the probability (or cost) of the adverse event being insured against.[20]

Hirshleifer's paper offers a novel twist on this insight, suggesting that insurance can *support* or reinforce incentives, at least when the choice is between appropriately-priced fee-based insurance and free compensation.[21]

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18. Hirshleifer, *supra* note 1, at 146, 9 CONN. INS. L. J. at 5 (emphasis in original).

19. Hirshleifer pioneered this vocabulary for analyzing insurance. *See* J. Hirshleifer, *Investment Decision under Uncertainty: Applications of the State-Preference Approach*, 80 Q. J. ECON. 252 (1966).

20. An extreme version of this insight is illustrated by the joke about two Vermont farmers. The first tells the other: "I just bought fiah and flood insurance on my bahn." The second pauses, and then says, "I understand about the fiah, but how do ya' staht a flood?"

21. Economists are famous for believing that nothing is ever really free. Compensation for victims of terrorist attacks has to come from somewhere, and assuming it is financed out of tax revenues, there are significant distortionary effects to be reckoned with. Indeed, the

C. Adverse Selection

Like moral hazard, adverse selection is another concept originally borrowed from the insurance literature which has had a profound influence on mainstream economics, especially in game-theoretic analysis of strategic interactions.[22] The basic idea is that adverse selection is likely to occur whenever:

> (a) one party (A) offers to transact with another (B), and B can choose to accept or reject A's offer;
> (b) B has information about the value of the transaction to A that A does not have; and
> (c) B is most likely to accept A's offer when B's information is "bad" (i.e., *adverse*) to A.

For example, imagine a stylized world in which there are only two kinds of used cars, "good" (worth 100 to the seller and 110 to the buyer) and "lemons" (worth 20 to the seller and 22 to the buyer), each of which comprise half of the total. Owner/sellers know the true quality of their car, but buyers do not, and cannot verify the quality. The average car is worth 66 to the buyer; but at a price of 66, the only cars that owners will be willing to part with are the lemons. At any price above 100, all cars will be put on the market, but of course buyers are guaranteed to lose-out on average, since they will be spending 100 for something with an average value of 66. Knowing all this, buyers will never agree to offer more than 22, and thus, the only cars that can be sold are the lemons. This is true even though each car is worth 10 percent more to a buyer than to its owner. Bad cars have driven good cars out of the market.[23] I was able to find only twelve cursory mentions of the phrase "adverse selection" in the economics literature before 1953, none of which contained anything like a sustained analysis of the problem. Hirshleifer's discussion of adverse selection in the market for war damages insurance is thus a candidate for the first significant treatment of this topic in the

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conventional wisdom is that the true economic cost of raising one dollar in tax revenues is roughly thirty cents. I ignore these considerations in the rest of the paper.

22. The concept is now deeply entrenched in economic analysis. The 2001 Nobel prize shared by George Akerlof was awarded largely on the basis of his article, *The Market for 'Lemons:' Quality Uncertainty and the Market Mechanism*, 84 Q. J. ECON. 488 (1970), which offered the first formal model of adverse selection.

23. This is a simplified version of Akerlof's story. Akerlof, *supra* note 22, at 489-90. Of course, we can expect that institutions will develop to handle this kind of problem, including warranties by sellers, dealers with a reputational interest in selling high-quality cars, inspection services, and so on. Nevertheless, the example is compelling on its own terms.

economics literature. Even if it did nothing else, this would be quite an achievement for any article!

Why would adverse selection be an issue in war damages insurance? Hirshleifer gives three reasons. First, when participation in the insurance pool is voluntary, there will be a "tendency of poor risks to take out insurance and good risks to self-insure . . . ."[24] This in turn would make it more difficult to establish appropriate premiums, since the actuarially fair (break-even) rate for those who sign up for insurance will necessarily be higher (but by an unknown amount) than for the population as whole.

This is (by now) a standard analysis of adverse selection in insurance markets, and while it is substantially ahead of its time, I find Hirshleifer's second reason to be even more interesting. He argues that mandatory "universal coverage (not achievable under a voluntary plan) would entirely eliminate the problem of demands for compensation sure to arise after bombing on behalf of those who have failed to take out insurance."[25]

Once again, we have an intriguing mix of political economy and moral theory. It is not just that universal coverage prevents the good risks from dropping out of the pool *ex ante*, as in the standard adverse selection story. Rather, Hirshleifer recognizes that victims of substantial random catastrophes have an ethical claim on the rest of us for compensation, so that there can also be *ex post* adverse selection (with negative incentives for future behavior). Thus, even if we want to deny compensation to those who are injured on efficiency grounds, we find it (appropriately) difficult or impossible to do so because we do not wish to turn our backs on people who have been injured in this way.

Finally, there is a potential problem of adverse selection with respect to time, which could occur because when participation is voluntary, "people will be tempted to speculate on the probability of war. That is to say, they may not take out insurance until the international situation becomes very threatening . . . ."[26] This is an unusual type of adverse selection, which to my knowledge is not widely discussed in the literature. Hirshleifer cleverly proposes several techniques for resolving this problem, including time-varying insurance premiums and a mandatory waiting period of six to twelve months between the time insurance is purchased and the time when it would take effect.

I find it interesting that, in spite of his perceptive analysis of the adverse selection problems that would plague voluntary war damage insurance,

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24. Hirshleifer, *supra* note 1, at 147, 9 CONN. INS. L. J. at 7.
25. *Id.*
26. *Id.* at 151, 9 CONN. INS. L. J. at 13.

Hirshleifer seems to prefer a voluntary plan to compulsory insurance. At least he assumes in the remainder of the article that participation will be voluntary. It is hard to know whether this reflects an actual commitment on his part to freedom of contract (absence of coercion), or whether he is simply making a kind of *a fortiori* argument: war damage insurance is such a good idea that it can succeed even if we choose a method of implementation that is subject to seriously adverse selection problems.

D. Why Isn't This Article a Classic?

I haven't done justice to all of the article's provocative ideas. For example, Hirshleifer suggests, "[w]ithout extended argument," that the objective of war damages insurance should be

> to restore the *relative* position of those who lose property by the bombing so that they are no worse off than the nation as a whole. Since the bombing will reduce the real national wealth, the restoration of the *absolute* position of those who lose property would mean an actual gain for them relative to the rest of the community. It follows . . . that . . . if, for example, 10 percent of the national wealth is destroyed in the bombing, the real value of the compensation should be at the rate of 90 percent of the real value of the loss.[27]

This is a novel and interesting idea at many levels. It is now standard to think about co-insurance requirements as a deterrent to moral hazard: they require the insured to keep part of the risk of loss, and thus offer at least some incentive for him to take care. That a portion of an insured's loss that would be uncompensated under Hirshleifer's fairness criterion might therefore also have a desirable incentive effect.[28]

Given all this, I am puzzled that the article does not seem to have the reputation it deserves. Maybe I am just idiosyncratic. But I suspect the answer is two-fold. First, although it draws on and develops many deep and important ideas, the article does so in order to further the analysis of a real policy problem. Hence, it might have been easy to overlook its insights because they are so clearly in the service of the problem at issue, and are not trumpeted or even highlighted in any way. Moreover, there is no formal

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27. *Id.* at 152, 9 CONN. INS. L. J. at 15.

28. Moreover, the emphasis on the *relative* economic position of those who suffer losses resonates with all kinds of debates in political theory, as well as with a growing literature in economics on the importance of relative standing and relative preferences. *See, e.g.*, ROBERT FRANK, CHOOSING THE RIGHT POND: HUMAN BEHAVIOR AND THE QUEST FOR STATUS (1985).

model deployed—the insights are developed entirely verbally. And economists tend to place a high value on formalism, sometimes almost as an end in itself.

A second explanation is that the topic of how to mitigate the effects of bombing (either from nuclear war or terrorism) is a rather morbid one, as we now know all to well. Even economists probably preferred not to think about the loss of major cities to a nuclear attack, just as most of us now prefer not to dwell on the risks of terrorism. I suspect the article's reputation may therefore have suffered because of its unpleasant subject matter.

Pathbreaking as it was, I think the article suffers from another problem, at least in the eyes of non-economists. Viewing compensation for war damages, or damages from terrorism, as a purely economic problem seems to me to miss something important about the way most people think about the issue. The reason is that collectivizing the harms from war damages by compensating victims out of governmental revenues has "expressive" as well as economic consequences.[29] In other words, voluntarily compensating victims by spreading or "socializing" the risk *says something* about us as a country, as a culture, and as a foe of whoever is attacking us. What it says is that the country is united, that an attack on one is an attack on all, and that we will willingly share the harms from any attack, even though many of us are unaffected in any direct or material sense.

This sense of unity is an important thing to convey, for many reasons. Most obviously, it is important to say because it is true, as the hundreds of impromptu shrines and memorials around New York City in the wake of September 11th attest: people *do* care about each other. The message may also have important strategic consequences: if anyone thinks they can blow up New York and that Californians or Iowans will not care, the willingness of Californians and Iowans to compensate victims is proof that this is not true. If instead of voluntarily-provided compensation, we substitute a kind of pay-as-you-go insurance system, in which the victims only get out what they have (in expected value terms) already put in through their premiums, the expressive element of compensation is now largely missing. This may be a serious drawback, both from an expressive *and* strategic perspective.

III. LOOKING FORWARD

Instead of looking backward at the last fifty years of economics, I now want to address the issue of whether *War Damage Insurance* remains a useful

29. Thanks to Gideon Parchomovsky for this significant insight.

piece of public policy analysis in today's environment—one in which the United States is once again under threat of attack, this time from terrorists. I conclude that it does, with some caveats.

A. Public Choice and Compensation

As noted earlier, a key assumption underlying Hirshleifer's argument for the government's provision of insurance against property loss due to war (or terrorism) is that in the absence of such insurance, the political system will nevertheless find it impossible to avoid providing significant compensation to owners of damaged property.[30] Fully-covered insureds will then have improper incentives to take care (moral hazard), especially if their coverage is provided for free. One benefit of a *formal* fee-based insurance scheme is thus that it can forestall the provision of *gratuitous* compensation that would distort or eliminate any incentives to mitigate the harms from terrorism.

The case for government-provided insurance is therefore most convincing when the political system will inevitably decide to compensate a substantial fraction of all losses—the greater is coverage, the smaller are incentives to undertake mitigation. Hirshleifer implicitly makes the assumption that the politically-motivated "loss-replacement rate" will be close to 100 percent.[31] Fortunately, there was never a nuclear attack on the United States that would have put the governmental response to the test.

But the recent terrorist attacks do provide a test of Hirshleifer's "Public Choice" assumption about governmental behavior. We should thus look at the governmental compensation provided in response to the September 11th attacks, and ask how generous it actually was. If it replaced only a small fraction of the property losses, the case for fee-based insurance as a device that will commit the government *not* to hand out gratuitous benefits after an attack seems less compelling.

What do we know about the governmental response? The Congressional Budget Office (CBO) estimated that Congress authorized about $40 billion of additional emergency supplemental appropriations in the immediate aftermath of the attacks.[32] Of this amount, CBO suggests that roughly $10.2 billion will

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30. Hirschleifer, *supra* note 2, at 149, 9 CONN. INS. L. J. at 10.

31. Hirschleifer, *supra* note 2, at 146 n.6, 9 CONN. INS. L. J. at 6 n.6.

32. CONG. BUDGET OFFICE, THE BUDGET AND ECONOMIC OUTLOOK: FISCAL YEARS 2003-2012, Chapter 7, Box 7-2 (Jan. 2002) [hereinafter OUTLOOK]. The $40 billion comes from the 2001 Emergency Supplemental Appropriations Act for Recovery from and Response to Terrorist Attacks on the United States (Pub. L. No. 107-38) and the Department of Defense and Emergency Supplemental Appropriations for Recovery from and Response to Terrorist Attacks on the United States Act, 2002 (Pub. L. No. 107-17).

go to New York City, "providing both support to business and individuals and support to state and local governments."[33] Aid to victims' families could add another $6 billion to this amount over nine years.[34]

It is very difficult to know how much of this money can or will be used to compensate for (potentially) insurable property losses, as opposed to other economic losses (e.g., from disruptions to business activity), or as pure compensation to families of victims. But suppose we assume, generously, that the entire $10 billion will be paid to compensate property losses. We might then crudely estimate the total property losses from the attacks at $20 billion.[35] By this rough estimate, governmental compensation seems to have replaced only about one-half of the property losses. The one-half figure is probably too high, since not all of the governmental aid will likely compensate property losses, and these losses are likely to be larger than $20 billion.[36]

Imagine now that you are a private decision-maker, considering what kind of precautions to take against terrorism. For this stylized example, we will collapse all of your precaution decision to one variable—where to locate your new office building—although there are of course many other margins on which precautions can be taken. On the one hand, you expect that losses from terrorism are more likely to occur if you locate in New York than in, say, Dubuque. On the other, you figure that if a terrorist threat does indeed materialize, you can count on the federal government to pick up some fraction φ of your losses, which we can term the replacement rate. If φ were equal to one, all losses would be covered, and you would have no reason to care about them at all—this is the extreme version of moral hazard. But for a

33. OUTLOOK, *supra* note 32 at 118.

34. *Id.*

35. Immediately after the attacks, the Global Disaster Information Network, on the basis of a sophisticated actuarial model of New York City property values, estimated that the property losses from the attacks would be in the range of "$7 to $11 billion, including building, contents, and direct business interruption losses generally associated with property claims. . . . [This excludes] contingent business interruption, aviation, casualty, and liability losses for this disaster." World Trade Center Disaster, RMS Special Report (Sept. 18, 2001), *at* http://www.gdin-international.org/wg/wtc.pdf (last visited Nov. 9, 2002). More recently, the ISO estimated that *insured* property losses from the attack stood at $16.6 billion as of March 11, 2002. *See* http://www.iso.com/studies_analyses/study018.html (last visited Nov. 9, 2002).

36. On the other hand, I have ignored funds provided by state agencies and by private entities; I suspect that most of these funds were not designated to replace lost property, however.

replacement rate of 1/2, you will absorb 50 cents of each dollar of loss, what amounts to a fifty percent coinsurance rate.[37]

Table one lays out a stylized example that develops this comparison, assuming arbitrarily that the probability of attack is 10 percent in New York and 6 percent in Dubuque. Suppose there is no governmental compensation, (and no insurance at all), so $\varphi = 0$, as in column one. Expected wealth is 4.4 percent higher if Dubuque is chosen over New York since the probability of attack is lower in Iowa. If instead the government were to replace 50 percent of each dollar lost, as in column two, Dubuque would still dominate New York, but its relative advantage shrinks by more than half, to only 2.1 percent.[38]

Of course, this example does not prove that everyone should move from New York to Dubuque. What it shows is that in a world in which no compensation is forthcoming, those for whom the benefits of staying in New York *apart from the risk of attack* are less than four should (and will) move; the threshold for staying falls to two when the government compensates half of all losses. Hence, someone at the margin (for whom the benefits of staying are, say, three) will move if there is no compensation, but will stay if they expect compensation to be provided.

In sum, even if the government only compensates one-half of all losses due to terrorism, there might still be a significant diminution of incentives to choose the less-risky location or undertake other mitigation expenditures. However, this is not the end of the story.

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37. Of course, φ is uncertain—you can never be sure if the government will compensate forty percent or sixty percent of your loss, or more, or less. But this uncertainty should either have no effect, or should serve to reduce the "effective" expected compensation rate if one is risk averse.

38. Dubuque has a lower standard deviation of wealth as well as a higher mean than New York. With no compensation, Dubuque clearly dominates (unless the firm is risk-loving, which seems highly unlikely). Introducing a fifty percent compensation rule lowers the standard deviation of wealth by an equal percentage amount in both New York and Dubuque. Hence, unless firms are extremely risk averse, the relative variability induced by a move from no compensation to fifty percent compensation should be of only second-order importance in the choice of where to locate.

Table 1: Incentive to Locate in New York and Dubuque Under Various Insurance/Compensation Schemes

	Assumptions			
Asset Value	100			
Prob. of Total loss, NYC	10%			
Prob. of Total loss, Dubuque	6%			
	Policy Regime			
	No Compensation	"Free" Gov't Compensation	Perfectly Priced Insurance[a]	Imperfectly Priced Insurance[b]
"Replacement Rate, φ"[c]	**0**	**50%**	**100%**	**100%**
Expected Wealth, NYC	90	95	90	92
Std. Dev. of Wealth	30	15	0	0
Expected Wealth, Dubuque	94	97	94	92
Std. Dev. of Wealth	23.8	11.9	0	0
% Incr. in Expected Wealth from Move to Dubuque	4.4	2.1	4.4	0
% Decr. in Std. Dev. of Wealth From Move to Dubuque	20.8	20.8	0	0

[a]Premiums are actuarially fair for each city.
[b]Premiums are actuarially fair for the country as a whole, but do not reflect city-specific risks. Fifty percent of firms are located in New York and fifty percent in Dubuque.
[c]Share of lost wealth that will be compensated by the government.

B. Insurance and the Incentives for Mitigation

Suppose that the alternative to "free" governmental compensation (for fifty percent of losses) is actuarially fair insurance for one hundred percent of losses, with premiums based on city-specific risks. I call this "perfectly-priced insurance," in the sense that the premiums perfectly reflect the risks in each location. In this case, shown in column three, the premiums would be ten in New York and six in Dubuque, and expected wealth would be the same as in column one of table one (although of course the standard deviation of wealth would be zero under full insurance). Hence, full insurance with appropriate pricing of risks would maintain (almost) all of the inter-city incentives of a no-insurance world.[39] That is, the savings in insurance premiums from moving to Dubuque under full insurance (with perfect pricing) would just equal the savings in expected wealth from moving if there were no insurance at all.

What happens, however, if we are unable to set premiums at the city level? Suppose we instead assume a single actuarially-fair premium is charged for the country as a whole (and further that there are equal numbers of firms in the two cities). Participation is mandatory, so there are no adverse selection concerns. Thus, per table one, the average risk for the country as a whole is eight percent, and every firm is charged a premium of eight percent, regardless of location.

When there is full insurance and a single premium for all risks, regardless of location, Dubuque would no longer have *any* advantage over New York at all. By contrast, even free governmental compensation for fifty percent of loss preserves at least *some* of Dubuque's appropriate advantage over New York. This is all a long-winded way of saying something quite simple. When $\varphi < 1$, so that the government does not replace one hundred percent of each dollar of loss, the superiority of a premium-based insurance system depends critically on how accurately the government can price risks.[40] If Dubuque and New York risks are priced the same—a single rate for the entire country—then the free fifty percent compensation provides *better* incentives for mitigating the harm of terrorist attacks than pay-in-advance insurance does. If each city's risk is priced separately and accurately, then insurance provides the superior

39. Full insurance does slightly diminish Dubuque's advantage over New York, since full insurance eliminates any variance in outcomes in either city, and Dubuque has a smaller variance than New York in the absence of any insurance. Assuming firms are approximately risk-neutral, this should be a small effect, however.

40. Hirshleifer acknowledges the importance of accurate pricing of risks, e.g., Hirschleifer, *supra* note 1, at 153, 9 CONN. INS. L. J. at 17, but does not consider the possibility of less than full compensation and the problems it poses for choosing the best insurance scheme.

incentives for mitigation. Whether "free" partial compensation offers better incentives for mitigation than "pay-in-advance insurance" then turns out to be an empirical question, one that depends critically on how accurately the government can price the risks in each location.[41]

C. Can the Government Price Accurately?

The obvious question then becomes, how accurately do we think the government can price risks? We need to think about two kinds of inaccuracies in pricing, which we can loosely term actuarial and political.

Hirshleifer acknowledges that there are all kinds of actuarial problems with setting rates. It is very difficult to estimate the probability of a terrorist attack, how it varies by city or region (or even by block), the likely damage it will cause (by type of building), and so on. But he claims that even partial steps to price insurance along these dimensions, even if inaccurate, will *inevitably* be better than what amounts to free insurance.[42] He is right—but only if we assume that there will be full coverage in the absence of premium-based insurance.

Moreover, there are further difficulties in pricing that Hirshleifer does not explicitly acknowledge, difficulties that are essentially "political" in nature. For many of the same reasons that the government would be under pressure to provide free compensation to those who suffer property losses in the absence

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41. Hirshleifer's comments suggest that he is aware of the problem, but since he assumes that there will inevitably be full compensation ($\varphi = 1$), he minimizes its importance.

> If . . . [premiums are not set accurately enough], we are at least going in the right direction, while simple compensation would be pushing us in the wrong direction. We might . . . [set premiums with too large a differential across risks], but in view of all the administrative and political pressures in favor of the status quo, the danger of [encouraging too much mitigation] seems quite slight."

Hirshleifer, *supra* note 1, at 151, 9 CONN. INS. L.J. at 14. When comparing partial compensation to inaccurately priced insurance, however, the incentive effects are not so clear.

42. *See* Hirshleifer, *supra* note 1, at 148, 9 CONN. INS. L.J. at 9.

> Setting the insurance rates will involve judgment and, therefore, the differential rates will not have the ideal effects on incentives which could be claimed for the true rates. Nevertheless, we believe that this is a case where judgment would have to go very far astray to produce really perverse effects on incentives, which is all we need to be afraid of. We shall not get optimality, but we can expect improvement.

Id. "Nor would the element of judgment involved here be unique, since private insurance rates for fire, theft, and other contingencies also are ordinarily based on informed judgment." *Id.* at n.11.

of insurance, there will likely be intense political pressure to modify or homogenize rates across risk categories. To see this, one need only imagine the reaction of New York's Senators if the War Damages Insurance Corporation were to set rates for New York at sixty-six percent higher than in Dubuque. It is likely that there would be considerable public outcry at such "discriminatory" behavior, and substantial political pressure to narrow the rate differentials between the two cities. But this would have precisely the effect of diluting the incentives for mitigation that the insurance program was designed to protect.

Part of what makes Hirshleifer's proposal so attractive is that he adopts a technocratic solution to what is in large part a political problem. But—ingenious as it is—there is no reason to think that insurance pricing would be any less subject to political influence than the decision to provide compensation in the first place. Insurance does not provide a point of leverage "outside the system," from which its vulnerability to political manipulation can be overcome. Instead, the politicization of compensation would likely be transformed into the politicization of rate-setting, with the same attenuating effect on incentives to undertake harm-reducing activities that Hirshleifer so cogently and presciently identified. At the very least, therefore, a successful insurance program would have to be carefully designed so that it could operate with minimal political interference, although this raises obvious concerns about non-democratic discretionary decision-making.

D. Private Insurance?

I want to turn, finally, to a question that Hirshleifer does not address—why do we need a *governmental* insurance program?[43] Could we rely on private anti-terrorism insurance to provide the appropriate signals about how to mitigate the harms of terrorism and to spread these risks fairly and effectively?

Although relying on private markets has some obvious appeal—at least to an economist—the prospect does not seem promising in this situation, for two reasons.

First, private markets may not be able to solve the Public Choice problem, the fact that the political system will likely respond to any terrorist attack by

43. There has been a dramatic increase in the relative size of the insurance sector since Hirshleifer wrote. Insurance carriers' share of GDP rose six-fold, from 0.3 percent in 1950 to 1.69 percent in 2000, according to the BEA National Income and Product Accounts. The industry is now vastly more sophisticated, with much greater access to reinsurance markets and other methods of spreading risks, which might explain why Hirshleifer did not consider private insurance fifty years ago.

offering substantial compensation to victims. One of the important reasons Hirshleifer favors government-provided insurance is that it helps commit the government not to provide blanket compensation, for reasons discussed earlier.

Wouldn't a viable private market in anti-terrorism insurance forestall some demands for governmental compensation, for the simple reason that many victims' losses will be covered already? Perhaps so, but the story is more complex than this because the demand for private insurance will be greatly reduced if everyone knows the government will bail out those who are injured. Why buy insurance when you can get (at least partial) compensation for free from the government? To the extent that the problem lies precisely with the government's response to the problem, private insurance is likely to be ineffectual.

More generally, there are a whole set of additional reasons to be skeptical about private provision of catastrophe insurance, of which anti-terrorism insurance is a close cousin.[44] First, catastrophic risks (hurricanes, earthquakes, terrorist attacks) are not statistically independent as are, for example, automobile accidents. Hence such risks are hard to diversify-away. The same terrorist attack (or earthquake) will likely cause damage to a substantial number of any company's insureds at the same time, so adding more insureds does not protect against this risk in the same way that adding another automobile policy does. Of course, there are means for laying-off parts of such risks, including the use of reinsurance markets, but there are problems here as well.

Second, the potential losses due to terrorism are large, highly uncertain, and difficult to describe statistically. Who knows whether the probability of another terrorist attack in the next year is one percent, five percent, or twenty-five percent? Under these conditions, insurers might justifiably not want to be on the hook for such large and highly variable damages. Finally, there are important difficulties in accumulating the large pools of cash necessary to provide insurance for substantial disasters, as Jaffe and Russell persuasively argue.[45]

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44. There is a large and growing literature on this subject. *See generally* THE FINANCING OF CATASTROPHE RISK (Kenneth A. Froot, ed.) (1999). A provocative article on a theme similar to Hirshleifer's is Harold Kunreuther, *Mitigating Disaster Loss through Insurance*, 12 J. RISK & UNCERTAINTY 171, 171-87 (1996).

45. *See* Dwight M. Jaffee & Thomas Russell, *Catastrophe Insurance, Capital Markets, and Uninsurable Risks*, 64 J. RISK & INS. 205 (1997), or more recently, Dwight M. Jaffee & Thomas Russell, *Extreme Events and the Market for Terrorist Insurance, available at* http://www.nber.org (last visited Nov. 9, 2002). A case for public provision of anti-

CONCLUSION

War Damage Insurance anticipated many of the most interesting and important developments in economics over the following fifty years, and it did so in an accessible and cogent fashion. As if that were not enough, the topic of insuring against substantial attacks on the U.S. is once again of tremendous current importance. While it may not have the last word on these issues, I cannot imagine a better place to begin thinking about the economic issues involved than with Hirshleifer's article. It deserves to be acknowledged as a classic contribution to economic analysis.

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terrorism insurance, based on the externality that results when my precautions shift the risk of terrorism to someone else, is made by Darius Lakdawalla and George Zanjani, *Insurance, Self-Protection and the Economics of Terrorism*, National Bureau of Economics Research, Working Paper 9215 (Sept. 2002) (on file with the author).

WAR DAMAGE INSURANCE REVISITED

Jack Hirshleifer

My special thanks to Professor Peter Siegelman for reviving and commenting on my ancient article, and to the editors for asking me to offer some additional thoughts. Although Professor Siegelman has undoubtedly gone overboard somewhat as to the merits of that old paper, I cannot find it in my heart to condemn him for doing so.

I will provide a few descriptive remarks here as to the earlier background work on war damage insurance, and then comment briefly on possible implications for the topical issue of terrorism insurance.

My 1953 paper,[1] and a 1955 article in the *Columbia Law Review* that followed up some of the ideas,[2] were written in the age of nuclear scarcity. Not only were atomic bombs rare and costly, but potential enemies had only minimal capacities for delivering them across the oceans to our borders. These conditions passed away all too rapidly. Fission and then fusion bombs grew frighteningly in numbers and destructive capability, and the Soviets soon developed long-range bombers and then ballistic missiles for delivering them. In the face of such threats, it became conventional wisdom that passive forms of defense—protecting populations by shelters or dispersal, shielding vital factories and other economic assets, improving community police and fire responses, and so forth—could have no substantial mitigating effect. So such efforts were abandoned. In fact that belief and that abandonment were never entirely warranted. Under a number of quite reasonable scenarios, passive defenses might have saved millions of lives and untold amounts of wealth even in an age of nuclear plenty. But those possibilities were thrown overboard by our adopted national strategy of exclusive reliance upon MAD—"mutual assured deterrence." That is, upon retaliatory attack in place of defense.

Suddenly, we now find ourselves in a situation where defenses can certainly make a real difference. The terrorist threat is bounded; it is something that can be grappled with. What we have to contemplate are thousands of casualties—or at the very extreme, numbers in the low millions. Bad enough, but nuclear war might have killed or disabled numbers in the nine digits, indeed very conceivably a majority of our population. Even a

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1. Jack Hirshleifer, *War Damage Insurance*, 35 REV. ECON. STAT. 144 (1953), 9 CONN. INS. L. J. 1 (2002).

2. Jack Hirshleifer, *Compensation for War Damage: An Economic View*, 55 COLUM. L. REV. 180 (1955).

very serious terrorist attack would not threaten national survival. Government, law, and the social order will continue to function. So although atomic war was so "unthinkable" as to seemingly paralyze our capacities for sensible defensive adaptations, that need not be the case here. We can step back and evaluate the pros and cons of possible mitigatory steps, one of which is terrorism insurance.

The second point I want to make concerns the magnitude of the pent-up demands for catastrophe insurance. In World War II the Federal War Damage Corporation issued over 8,000,000 policies with a maximum contingent liability of $140 billion, an enormous sum for those days.[3] The program earned a nice profit for the government and private co-insurers, since only around $1,000,000 in claims had to be paid out.[4] Or consider the ongoing National Flood Insurance Program (NFIP), for which only properties located in flood plains are eligible.[5] As of December, 2000 the total coverage was over $567 billion.[6] Judging by data published on the web, it seems the NFIP has also been earning a profit. The premium rates have been high enough to cover claims by a good margin, except possibly in very bad flood years.[7] These indicators suggest there will be intense demand for terrorism insurance, if and when the administrative obstacles can be cleared away.

I want now to take a swipe at an argument sometimes encountered—the supposed "impossibility" of war insurance or terrorism insurance. The U.S. General Accounting Office, for example, as quoted in an excellent article by Professor Kunreuther, stated that "insurers and reinsurers have determined that terrorism is not an insurable risk at this time."[8] It is possible to set up a list of perfectionist requirements for an insurance business: that risks ought to be objectively quantifiable, that they need to be independent of one another, that adverse selection and moral hazard should not exist, and that there ought to be lots of historical experience for working up actuarial tables. That's the kind of hidebound thinking responsible for past assertions that "airplanes will never

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3. *Id.* at 183.

4. *Id.*

5. Federal Emergency Management Agency, Insurance: Introduction to the NFIP, *at* http://www.fema.gov/nfip/intnfip.htm (last modified June 27, 2002).

6. Federal Emergency Management Agency, Insurance: Total Coverage by Calendar Year, *at* http://www.fema.gov/nfip/cy00cov.htm (last modified June 27, 2002).

7. Douglas Clement, *After the Flood*, FEDGAZETTE, Nov.1, 2001, *available at* 2001 WL 12750002.

8. Howard Kunreuther, *The Role of Insurance in Managing Extreme Events: Implications for Terrorism Coverage*, BUS. ECON. Apr. 1, 2002, *available at* http://www.findarticles.com/cf_dls/m1094/2_37/86851405/print.jhtml.

get off the ground" or "blitzkrieg attacks will never work—the Maginot Line is impregnable." The insurance business never has and never can meet such ideal conditions—as only one important example, think of long-term care insurance. What *is* necessary is that insurer and insured both have confidence that valid claims can be met—not absolute 100% confidence, but enough confidence to warrant the one side in selling and the other side in buying policies. To support such confidence government always needs to be involved, whether to a relatively minor degree as in ordinary life insurance or in more major ways as in flood insurance. Terrorism insurance will certainly require a major government role, yet not quite so total a role as in war damage insurance.

Let me turn to the central point of the 1953 paper. Public discussions typically fail to appreciate the distinction between simple compensation and contributory insurance. (Simple compensation is of course free insurance). As emphasized by Professor Siegelman, my paper had argued—on the basis of observation and intuition, rather than analysis—that in the absence of a functioning pre-existing insurance program, demands for gratuitous ex-post compensation would be politically impossible to resist.[9] So there is going to be either insurance or gratuitous compensation. Back in World War II every major belligerent (except Russia) had one or the other type of program: contributory insurance in the U.S. and the U.K., simple compensation in Germany and France.[10] And bringing matters up to date, Professor Siegelman has described the compensation arrangements undertaken after the 9/11 events.[11]

Why not simple compensation? The problem is that rational anticipation of gratuitous compensation subverts private incentives to self-protect. With regard to terrorist threats, self-protection could have many forms: personal immunization against disease, relocation of places of residence or business properties, and—perhaps the most important—community-level improvements in police and fire and medical services. As an alternative to anticipated gratuitous compensation, terrorism insurance would encourage a whole range of self-protective steps on the part of individuals, businesses, and communities. Of course, insurance availability by no means excludes national defense measures on the part of government. Nor do I want to necessarily

9. Hirshleifer, *supra* note 1, at 146-47, 9 Conn. Ins. L.J. at 6.

10. *See* U.S. CHAMBER OF COMMERCE, 81st CONG., WAR DAMAGE INDEMNITY, (Comm. Print 1950).

11. Peter Siegelman, *A New Old Look at Terrorism Insurance: Jack Hirshleifer's War Damage Insurance After Fifty Years*, 9 Conn. Ins. L.J. 19 (2002).

endorse each and every possible mode of private loss prevention or loss mitigation as cost-effective. Nevertheless, in aggregate and over the years, such decentralized actions could significantly reduce national vulnerability.

I now want to offer, without extended argument, a few thoughts on the principles that should underlie a terrorism insurance program.

1. Should private insurance companies be permitted to offer insurance on their own, or should the government be a co-insurer, perhaps the major underwriter? I believe that private companies should be permitted to offer terrorism insurance on a competitive basis, subject to government regulation and standards. Especially in early years of the program before reserves have been accumulated, government backing—along the lines of Federal deposit insurance—will probably be required.

2. Should rates be proportioned to estimates of the risk, or should they be nationally uniform? Yes, proportioned to risk, as estimated by private insurers.

3. Granted that terrorism insurance is offered, should the government subsidize premiums? I do not see my way clearly on this, since arguments might be made either way. Private self-protection and collective military defense are substitutes, to a degree. Since the latter is difficult and expensive in many dimensions, private activity warrants encouragement. This argument militates against subsidy since financial protection through insurance is, on the individual level, a substitute for actions that would physically reduce vulnerability. On the other hand, private strengthening of any particular site against terrorist assault might merely divert attack to other sites. If so, the social benefit of private protection is less than at first appears—a consideration that favors a degree of insurance subsidy.[12]

4. Even with an insurance program, after losses are suffered there would surely be demands for relief of the "improvidents" who chose to forego insurance. Should such benefits be paid? Yes, there will be such demands, and to some extent they will surely be responded to. And indeed should be, in my opinion. But relief is quite a different matter from restitution founded upon contractual insurance. As explained by Professor Siegelman, the fact that relief is more like charity than like lawful entitlement would reduce both

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12. The social benefit does not fall to zero, since the reduced availability of inviting targets raises raiders' costs and risks of attack and so may to some extent discourage attacks entirely. DARIUS LAKDAWALLA & GEORGE ZANJANI, INSURANCE, SELF-PROTECTION, AND THE ECONOMICS OF TERRORISM 2-6 (Nat'l Bureau of Econ. Research, Working Paper No. 9215, 2002), *available at* http://www.nber.org/papers (last visited Nov. 9, 2002). And even if the only effect is diversion, there is a gain whenever terrorists have to shift from their prime targets to secondary choices. *Id.*

the incentive to make claims and the willingness to accede to them.[13] So I do not believe that the prospect of post-disaster relief to uninsured parties would unduly subvert the incentive to insure.

I will call a halt here. Since I have not intensively searched the literature, it may be that all these ideas are already quite familiar to analysts and practitioners in the field. Still, for what they may be worth, I offer them in the hope that some of the suggested lines of reasoning may turn out to be useful.

13. *See* Siegelman, *supra* note 12.

PREFACE

François Ewald

Tom Baker offered me the opportunity to introduce this special issue of the Connecticut Insurance Law Journal, which is devoted to the dramatic events of September 11, 2001. I accept his kind offer with feelings of friendship and solidarity for the American people. The quality of these articles permit me to limit myself to four remarks regarding the philosophy of insurance.

Americans and the rest of the world experienced September 11th as a break with the past, which abruptly reoriented American foreign policy and gave birth to the new strategic doctrine of pre-emptive war. From an insurance perspective, this event belongs to a long line of great catastrophes, which test the capacity of insurance arrangements. Somewhat paradoxically, if September 11th belongs to this catalog of great events in the history of insurance, it is not exceptional, as the article of Robert Jerry[1] demonstrates. The difference in perspective between the emotion of the victims and the definition of a new strategic watershed does not arise from any sort of indifference of those involved in the insurance industry; rather, it reveals something about the nature of insurance: *insurance exists, even in the case of the most menacing risks, to reduce the importance and dimension of events and to lessen the significance of a catastrophe so that it may not simply mean stoppage or interruption of life.* Everything, even the worst of events, is eventually destined to find its place in insurance's grand order.

It appears that insurance companies, even if they have encountered a considerable shock, have done their job (a political task of the first order). They have contributed to stopping the terrorist enterprise, to the extent that the goal of terrorism is to introduce fear, anguish, and dread that stymies activity. During periods of calm, insurance is often criticized for not doing enough. September 11th revealed the true *political* nature of insurance. This is what the contributions of Larry Stewart, Daniel Cohen & Karen Marangi[2] admirably bring out. This is why the American government, with business otherwise halted, so quickly put in place measures to assure the continuation of the insurance industry—insurance of airlines and insurance of the injuries and damage caused by the terrorist attack—despite the size of the shock they

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1. Robert H. Jerry, II, *Insurance, Terrorism and 9/11: Reflections on Three Threshold Questions*, 9 CONN. INS. L.J. 95 (2002).

2. Larry S. Stewart, Daniel L. Cohen and Karen L. Marangi, *The September 11th Victim Compensation Fund: Past or Prologue?*, 9 CONN. INS. L.J. 153 (2002).

faced. To be or remain insured is a fundamental pre-condition of the possibility of economic activity. The existence of entire segments of the economy depends on its insurability. Insurance thus reveals itself for the first time for what it is: a primary public good.

However, it is at the moment that insurability is a condition of economic activity that it becomes problematic by reason of the size and wide variety of losses that are associated with our current levels of economic development. The scope of these losses, in effect, is less a function of the nature of events (natural catastrophes or terrorism) than of economic development and of the standard of living of the populations concerned. Contemporary insurability problems are not exogenous to the worlds of economics and insurance. September 11th gave sustenance to the idea that we have, as a result of these mega-catastrophes, entered upon a new age of insurance. Terrorism does not put a stop to insurance by the size of the possible losses it inflicts, but by reason of the impossibility of anticipating their frequency. This is an age that has heralded the birth of new programs and types of insurance that go beyond state intervention. It is indeed one of the consequences of September 11th that the federal government has intervened in the coverage of assassinations (terrorist attacks). Some dogmatically criticize this intervention. Risk is always politically defined and this intervention arguably unnecessarily, or unjustifiably, alters the definition. But it is true that by a single stroke, September 11th, and our reaction to it, have almost exploded the theory of insurance.

Somewhat paradoxically then, while insurance seems to have been able to contribute to reducing the importance of September 11th, it also seems to have come under pressure to change its methods. This is shown particularly by governmental indemnification of individual victims' losses. Richard Campbell,[3] Linda Mullenix & Kristen Stewart,[4] and Larry Stewart, Daniel Cohen & Karen Marangi,[5] in describing the problem of fixing the proper levels of this indemnification, have not hesitated to ask whether, given that this pattern of indemnification is not the first and will inspire others on other occasions, what is the future of this method of covering broadly felt risks? In fact, for dealing with these broad risks, special indemnification arrangements

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3. Richard P. Campbell, *The September 11th Attack on America: Ground Zero in Tort and Insurance Law*, 9 CONN. INS. L.J. 51 (2002).

4. Linda S. Mullenix and Kristen B. Stewart, *The September 11th Victim Compensation Fund: Fund Approaches to Resolving Mass Tort Litigation*, 9 CONN. INS. L.J. 121 (2002).

5. Stewart, Cohen & Marangi, *supra* note 2.

like these have several advantages: efficiency, speed (and even fairness), and according equal treatment to all members of the class of victims. One can only speculate about the manner in which such governmental relief and traditional insurance recoveries will share such liabilities. The answer is certainly that the very concept of liability is at issue and depends on whether broad public risks are understood to require private or public remedy. For example, to the extent that traditional coverage of liabilities is invoked to relieve business interruption losses, traditional judicial and insurance mechanisms are appropriate; but if a loss evokes public remedies—collective or national—either because the risk of that loss implicates a national obligation (vaccines) or because it jeopardizes the country itself (September 11th), the politicization of risk will call for governmental relief, which is always a form of public assistance (*ex post*) rather than insurance (*ex ante*) and, therefore, implicates a different standard of fairness. Indemnified losses are not classified by the usual legal standards; there are no punitive damages and one scrambles to establish a new approach to fairness in treating victims. In effect, where public relief is provided, justice is not measured by the relationship of the victim to the author of his injury, but rather by the relationship of the victims to each other, in the light of a national solidarity that cannot differentiate among the victims.

This symposium issue is particularly important to me for several reasons. First, because I am honored that Tom Baker asked me to be associated with an issue that renders homage to the victims of September 11th. Also because it allows us to transcend the emotional content of September 11th in order to understand better some general features of insurance and its future. A new status quo is perhaps being born, parented by the emergence of mega-catastrophes (through their causes) of widespread public risks (through their effects) and a certain level of economic development. The meeting of these elements creates pressure for the politicization of risks and of mechanisms of private recovery and governmental relief, which will involve certain kinds of state intervention. This, which does not apply to all risks, should prompt us to think of the birth of a new insurance paradigm.

THE SEPTEMBER 11TH ATTACK ON AMERICA: GROUND ZERO IN TORT AND INSURANCE LAW*

*Richard P. Campbell***

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* This article is one of a series of writings and presentations made by the author following the terrorist attacks on the country. The writings and presentations arise out of his work as Chair of the American Bar Association Tort and Insurance Practice Section (TIPS), Chair of TIPS' Task Force on the 2001 Victims' Compensation Fund, and Presidential Appointee to the American Bar Association Task Force on Terrorism and the Law. The first of his published law review articles on the subject appears in *The Defense Counsel Journal.* Richard P. Campbell, *America Acts: Swift Legislative Responses to the September 11 Attacks*, 49 DEFENSE COUNSEL J. 139 (2002). *See also* Richard P. Campbell, *Real World Relationships, Tort Law, and Fundamental Fairness,* 31 THE BRIEF 4 (2000).

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INTRODUCTION

The nuclear war term "ground zero" is understandably used by Americans to describe the site of the attack on the World Trade Center in New York because the devastation wrought by the September 11th attacks is so comprehensive in its reach: nearly three thousand individuals killed; thousands of families torn apart; steel and concrete edifices perceived to be impregnable reduced to rubble; and economic losses of nearly one trillion dollars.[1] The ignorance, savagery, and irrational hatred that produced the horrific loss of life, personal suffering, and financial devastation also forced our society to look inward at its institutions and laws and to create unique resolutions to imminent problems that otherwise threatened to bring our economy to its knees.

The commercial airlines were the first industry brought to the brink of complete failure. Without passengers and cash flows, the resultant dislocations from the attack credibly threatened to bring the entire commercial airline industry down in an apocalyptic crash like the four aircraft that disintegrated in New York, Washington and Pennsylvania.[2] Confronted with the potential failure of the industry, and operating in a wartime mode, the U.S. Congress enacted the "Air Transportation Safety and System Stabilization Act" (ATSSSA)[3] to shore up the industry financially for the short term, to assure our cross-continental economy a viable air transportation system and to establish a Victim Compensation Fund (VCF) to compensate those who were injured or lost family members in the disaster. In order to help protect against such a travesty ever again occurring, Congress also speedily enacted the Aviation Transportation Security Act (the "Security Act")[4] on November 19, 2001, which provides for federal oversight of airport security screening, improved in-flight

1. Thomas S. Mulligan, *A Year After,* L.A. TIMES, Sept. 15, 2002, at C1. *See* WTC Insurance Loss Website, *at* http://www.wtcinsurance.org (last visited Nov. 9, 2002).

2. Frank Swoboda & Keith L. Alexander, *US Airways Cuts Jobs; Bush Pledges Aid for Ailing Industry*, WASH. POST, Sept. 18, 2001, at A1. The commercial airlines presented statements of cash flows to the government and Congress that demonstrated the inevitability of a complete shutdown in the absence of government intervention. *Id.*

3. Air Transportation Safety and System Stabilization Act, Pub. L. No. 107-42, 115 Stat. 230 (2001) (codified at 49 U.S.C. § 40101 note) (hereinafter ATSSSA).

4. Aviation and Transportation Security Act, Pub. L. No. 107-71, 115 Stat. 597 (2001) (hereinafter Security Act).

security measures and development of enhanced measures to increase aircraft security.[5]

The government and Congress, at the urging of business and insurance executives, are actively considering the creation of a federally underwritten reinsurance program that (if adopted) would make the United States government the ultimate provider of insurance proceeds to property owners and businesses victimized by future terrorist attacks on the country.[6] The drive toward government-subsidized reinsurance finds its wellspring in the same fundamental concern—the economic implications of surreptitiously planned mayhem by the nation's overt and covert enemies.[7] Interestingly, rather than academics and social planners, the captains of the major insurance companies are among the lead proponents of federal intervention in this most sacred of state based, state controlled industries.[8]

While the September 11, 2001 Victim Compensation Fund and the imminent federal reinsurance program will not replicate existing systems in compensating victims and underwriting insurance losses, they will serve to open the arcane tort and insurance reparations system in this country to public scrutiny. Bright sunshine illuminates fine features and warts. The tort system has worked well for hundreds of years. Tort laws provide compensation for injured people and those who suffer property damage through normative decision-making by jurors, roughly allocating responsibility along lines of fault and causation, and through voluntary decisions by risk adverse parties and insurers. Concerns over tort liability and adverse jury verdicts help mold individual conduct into acceptable patterns of civic behavior. But the system is imperfect. Equally innocent victims with similar injuries and damages can (and do) receive wildly

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5. ATSSSA § 101(a). *See* Sara Kehaulani Goo, *Cost Estimate on Bomb Detectors Rise,* WASH. POST, Dec. 8, 2001, at A10.

6. Both houses of Congress have passed similar bills on the subject matter and a conference committee will necessarily work out the differences. *See* Terrorism Risk Insurance Act of 2002, H.R. 3210, 107th Cong. (2001); S. 2600, 107th Cong. (2001). Riders promoting "tort reform" present a major stumbling block.

7. The terrorist attacks caused insurers to pay very large losses in property damage, business interruption, workers compensation and other claims. Cost and availability are said to be adversely impacting some markets. *See* Frank Kaplan, *Terrorism Alters Landscape of Insurance Fees for Workers' Comp, General Liability Increase While Coverage Shrinks,* BOSTON GLOBE, Aug. 18, 2002, at E1.

8. Warren Buffet of Berkshire Hathaway and Maurice R. Greenberg of AIG were the early proponents of such legislation. *See* Warren Buffet, *An FDIC for Insurers,* WASH. POST, Nov. 19, 2001, at A21; M.R. Greenberg, *Government Must be Insurer of Last Resort,* WALL ST. J., Nov. 26, 2001, at A18. *See also* McCarran-Ferguson Act, 59 Stat. 33 (1945) (codified as amended at 15 U.S.C. §§ 1011-15 (1994)).

different results, often depending on the skills of their lawyers or the amount and availability of insurance proceeds to satisfy a judgment. From a societal viewpoint, why is it acceptable for one innocent victim who is rendered quadriplegic to receive millions in compensation and a second equally innocent victim who is left just as paralyzed and devastated to receive little if anything? What is fair about this?

The Victim Compensation Fund will also raise questions about the role of fault, and the need for lengthy and costly litigation to adjudicate it, in compensating individuals for injuries and damages suffered in tragic events. In doing what is right and sensible for society as a whole, why leave a quadriplegic accident victim essentially hopeless because he was responsible in whole or in part for his injuries? Our academics, philosophers, and social planners will question the need for lawyers and litigation and will offer alternative schemes for resolving these problems outside of the legal system. This is not idle fantasy. In an opinion piece published by the *Washington Post*, Warren Buffet proposed federalization of property and casualty insurance for terrorist acts and war related injuries and damages by the creation of an insurance counterpart to the FDIC. He opined:

> Were a proposal such as I suggest to be enacted, the new law should sharply limit private lawsuits seeking to place blame on some party involved—an airline, say. We should want the Treasury to make payments to victims solely to compensate them for loss of property, life or direct earnings, without worrying about fault.[9]

Warren Buffet—captain of industry, guru of free markets, and staunch defender of subrogation rights—proposing government control of insurance (in part), elimination of fault as a critical determinant of compensation and exclusion of lawyers and the civil justice system from the process. But insurance industry advocates of government intervention ignore the adage of permitting the camel's head under the tent. Will the federal government, once entering the field, choose to occupy it? By default, it would immediately become the world's most powerful and dominant reinsurer. What will the federal government say and do about carrier investment income, loss ratios, allocated and unallocated loss adjustment expenses, and the like? As with the Victim Compensation Fund's potential impact on the tort system, federal entry into the world of casualty insurance marks a new beginning for a mature industry.

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9. Buffett, supra note 8, at A21.

This article identifies and explores federal legislation and correlative regulations adopted since the terrorist attacks on the country. Substantial case law interpreting the new laws has yet to be developed.

I. THE AIR TRANSPORTATION SAFETY AND SYSTEM STABILIZATION ACT

The President of the United States signed into law H.R. 2926, the Air Transportation Safety and System Stabilization Act (ATSSSA), Public Law 107-42, on September 22, 2001.[10] The ATSSSA provides substantial financial assistance to United States air carriers[11] and provides a mechanism by which all individuals who were injured and the personal representatives of those killed in the attacks may seek compensation for their personal injury or wrongful death claims.[12] The ATSSA may be fairly characterized as a bargain between business interests intending to bailout the large domestic commercial airlines and consumer interests looking to provide a ready source of funds to compensate injured individuals and families who lost loved ones. As one of the leading trial lawyers in the nation put it, "[a]fter all, 9/11 was a mass murder, not a mass tort."[13]

A. Title I: Airline Stabilization

In order to stabilize the financial condition of United States airlines following the September 11, 2001 attacks, the President is authorized to issue up to $10 billion in Federal loan guarantees and $5 billion in direct compensation.[14] The $5 billion compensation applies to direct losses resulting from any Federal ground stop order beginning September 11,

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10. Acts Approved by the President, 37 PUBLIC PAPERS OF THE PRESIDENT 39 (2001).

11. The Act adopts the definition of "air carrier" set forth in 49 U.S.C. § 40102: "a citizen of the United States undertaking by any means, directly or indirectly, to provide air transportation." 49 U.S.C. § 40102(a)(2) (2000); ATSSSA § 107(1).

12. ATSSSA § 405(c)(2).

13. Statement of Leo Boyle, President of the Association of Trial Lawyers of America (ATLA), to the American Bar Association Tort and Insurance Practice Section (TIPS) on his receipt of TIPS' "Pursuit of Justice Award" given at the African Meeting House in Boston, Massachusetts on October 12, 2001 (on file with the author). In response to the September 11, 2001 attack, and under Mr. Boyle's considerable leadership, ATLA created "Trial Lawyers Care," an organization comprised of volunteer lawyers who provide free legal services to victims of the attack. Trial Lawyers Care is believed to be the largest single *pro bono publico* program in the history of the country. Leo V. Boyle, *Victims Fund will Work, but Don't Toss Torts*, LEGAL TIMES, Jan. 28, 2002, at 53.

14. Michael Higgins, *Airlines' Cuts Anger Congress; Smaller Markets Feel Squeezed Out*, CHI. TRIB., Oct. 27, 2001, at N1.

2001 (and any subsequent ground stop orders) and to incremental losses sustained by air carriers as a direct result of the September 11, 2001 attacks, continuing through December 31, 2001.[15]

Title I creates the Air Transportation Stabilization Board which will serve as the decision-maker on applications for the Federal loan guarantees described above.[16] This Board will be made up of Cabinet members, members of the Federal Reserve and the Comptroller General of the United States.[17]

In order to receive a portion of the $5 billion compensation, an air carrier must demonstrate its losses through the use of sworn financial statements and supporting data.[18] An air carrier will receive the lesser amount of (1) the carrier's direct and incremental losses; or (2) a calculation based on the available seats or cargo revenue ton-miles just prior to the September 11th attacks.[19]

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15. ATSSSA § 101(a)(2). *See* Michael Higgins, *supra* note 14. Title III (Tax Provisions) provides further relief to the airlines in the form of deferred tax payments. The ATSSSA extends the deadline for eligible air carriers whose excise tax deposits were due after September 10, 2001 and before November 15, 2001. *Tax Deadline is Extended to Help Airlines Stay Aloft,* SEATTLE TIMES, Nov. 16, 2001, at C2. Under the ATSSSA, a carrier could make the deposits on or before November 15, 2001 and the Secretary of Transportation could have further extended the deadline up to and including January 15, 2002. *Id.* Compensation received by air carriers under ATSSSA will not be excluded from gross income under the Internal Revenue Code of 1986. ATSSSA § 301. Major air carriers have already received payments under ATSSSA. James F. Peltz, *Loans No Guarantee of Airlines' Survival,* L.A. TIMES, Sept. 29, 2001, at C1.

16. ATSSSA § 102.

17. *Id.* § 102(b)(2).

18. *Limitation on Employee Compensation.* In order to receive the benefits of the Federal credit instruments, an air carrier must enter into an agreement with the President of the United States that places restrictions on certain of the air carrier's employee salaries. The carrier must agree that during a two year period beginning on September 11, 2001 and running through September 11, 2003, no officer or employee whose total compensation exceeded $300,000 in calendar year 2000 will receive: (1) total compensation that exceeds that employee's compensation for calendar year 2000 during any twelve consecutive months of the two year term; and (2) severance pay or other termination benefits that exceed twice that employee's maximum compensation for the calendar year 2000. Lizette Alvarez & Stephen Labaton, *A Nation Challenged: The Bailout; An Airline Bailout,* N.Y. TIMES, Sept. 22, 2001, at A1. The limitation on employee compensation probably resulted from substantial "golden parachutes" given by US Airways to three of its principal executives during its negotiations with United Airlines. *See* Karen Hosler, *Congress OK's $15 Billion to Rescue Airline Industry,* BALTIMORE SUN, Sept. 22, 2001 at 1A; Randy Myers, *Minimize Parachute Penalties,* 192 J. OF ACCT. 33 (2001).

19. *Continuance of Certain Air Service.* The fundamental political nature of the airline bailout legislation is demonstrated by the decidedly non-economic provisions that require

B. Title II: Aviation Insurance

Title II of the Act allows the Secretary of Transportation to reimburse air carriers for insurance premium rate increases and amends provisions of the United States Code relating to the Secretary's ability to provide insurance and reinsurance for aircraft operations.[20]

The reimbursement applies to premiums for insurance coverage that ends before October 1, 2002.[21] The reimbursement amount will reflect the increase in premiums between coverage ending before October 1, 2002 and coverage for a "comparable operation" between September 4, 2001 and September 10, 2001.[22] The Secretary of Transportation's reimbursement authority expired on March 2002. [23]

Further, the Secretary of Transportation may impose conditions on insurance policies that are subject to the premium increase reimbursements.

1. Future Terrorist Attacks: Liability Cap on Third-Party Claims Against Carriers

The ATSSSA limits the liability of United States air carriers to third-parties for any action that arises out of an act of terrorism occurring between September 22, 2001 and March 21, 2002.[24] If the Secretary of Transportation had certified that an air carrier was the victim of an act of terrorism, the air carrier would not have been responsible for the losses of third-parties in excess of $100 million. The United States government would have been responsible for any liability above the $100 million cap. The ATSSSA also prohibited awards of punitive damages against an air carrier (or the United States government assuming responsibility for

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continuation of service on unprofitable routes. Under the Act, the Secretary of Transportation must work to ensure that all communities continue to receive adequate air transportation service. ATSSSA §105(a). The Act provides $120 million for the Secretary of Transportation to ensure that essential service to small communities continues without interruption. ATSSSA §105(b). Further, the Act authorizes the Secretary of Transportation to require an air carrier that receives direct financial assistance under the Act to continue scheduled air service to any point served by that carrier prior to September 11, 2001. ATSSSA § 105(c)(1).

20. 49 U.S.C. §§ 44302, 44306 (2000).

21. ATSSSA § 201(b)(1), codified at 49 U.S.C. § 44302.

22. *Id.*

23. *Id.* § 201(b)(4).

24. *Id.* § 201(b)(2). The requirements for third-party aircraft accident liability coverage are set forth in 14 C.F.R. § 205.5(b)(1) (2001).

liability over $100 million) in an action arising out of a certified terrorist act.[25]

2. Reinsurance and Premiums

The ATSSSA eliminates the United States Code provision that restricted the premium rates at which the Secretary could provide and purchase reinsurance.[26] The Secretary of Transportation retains the power to reinsure any part of the insurance provided by an insurance carrier and to reinsure with, transfer to, or transfer back to the carrier any insurance or reinsurance provided by the Secretary under this chapter.[27]

Anticipating increased carrier expenses, the ATSSSA also allows the Secretary to make allowances to the insurance carrier for expenses incurred in providing services and facilities that the Secretary considers good business practices.[28]

Further, the ATSSSA provides that the Secretary of Transportation could have extended the provisions of Title II to vendors, agents, and sub-contractors of air carriers from September 22, 2001 through March 20, 2002 (180 day period beginning on the date of enactment).[29]

C. Title IV: Victim Compensation

Title IV of the ATSSSA is the "September 11th Victim Compensation Fund of 2001." The statute is relatively simple and straightforward. Its stated purpose is "*to provide compensation* to any individual (or relatives[30] of a deceased individual) who was physically injured or killed as a result of the terrorist-related aircraft crashes of September 11, 2001."[31] Participation in the Fund is limited to physical injury and wrongful death claims only.[32] By statute, a "Special Master" appointed by the Attorney General has the job of "administering the compensation program" through "hearing officers and other administrative personnel" to be employed for that purpose.[33] The Special Master's statutory duty is straightforward: *he "shall . . . determine" (1) a claimant's eligibility, (2) the extent of harm (including economic and*

25. ATSSSA § 201(b)(2).
26. 49 U.S.C. § 44304(b) (2000).
27. ATSSA § 201(c), codified at 49 U.S.C. 44304.
28. 49 U.S.C. § 44306(b).
29. 49 U.S.C. § 40101.
30. The Act does not explain who may be considered a "relative." *See* ATSSSA § 403 (emphasis added).
31. *Id.*
32. *Id.* § 405(c)(2).
33. *Id.* § 404(a)(1)(2)(3).

non-economic losses), and (3) the amount of compensation "not later than 120 days after that date on which a claim is filed."[34] Congress set a broad scope of recovery; indeed, the scope of recovery is greater under this pure no-fault scheme than virtually any state tort law system. The statute requires the Special Master to award economic and non-economic damages. Economic damages are assessed "to the extent recovery for such loss is allowed under applicable State law."[35]

The statute defines economic losses as "*any pecuniary loss, including the loss of earnings or other benefits related to employment benefits, medical expense loss . . ., replacement services, burial costs, and loss of business or employment opportunities.*"[36] Non-economic damages are defined as "*physical and emotional pain, suffering, inconvenience, physical impairment, mental anguish, disfigurement, loss of enjoyment of life, loss of society and companionship, loss of consortium, hedonic damages, injury to reputation, and all other nonpecuniary losses of any kind or nature.*"[37]

Statutory recognition of hedonic damages is unique but generally welcome; identification of it as something different from the loss of enjoyment of life is puzzling.[38]

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34. *Id* §§ 405(b)(1), (b)(3) (emphasis added).

35. *Id.* § 402(5).

36. *Id.* (emphasis added).

37. *Id.* § 402(7) (emphasis added).

38. Several states recognize hedonic damages in their common law. For example, Michigan, Alaska, Maryland, Nebraska, Ohio and Wyoming all recognize loss of enjoyment as a separate element of damages. *See, e.g.,* Pierce v. N.Y. Cent. R.R. Co., 409 F.2d 1392 (6th Cir. 1969) (applying Michigan law) (holding loss of earning capacity and loss of capacity to carry on life's nonremunerative activities must be valued independently); Feldman v. Allegheny Airlines, Inc., 452 F. Supp. 151 (D. Conn. 1978); Culley v. Pa. R.R. Co., 244 F.Supp 710 (D.Del. 1965) (applying Maryland law); Buoy v. ERA Helicopters, Inc., 771 P.2d 439 (AK 1989); McAlister v. Carl, 197 A.2d 140 (Md. 1964); Swiler v. Baker's Super Mkt., 277 N.W.2d 697 (Neb. 1979); Fantozzi v. Sandusky Cement Prod. Co., 597 N.E.2d 474 (Ohio 1992); Mariner v. Marsden, 610 P.2d 6 (Wyo. 1980). On the other hand, California, Indiana, Iowa, Kansas, Minnesota, Missouri, New York, Texas and Washington all recognize loss of enjoyment as a factor in determining general damages. *See, e.g.,* Huff v. Tracy, 129 Cal. Rptr. 551 (Cal. Ct. App. 1976) (holding loss of enjoyment a factor in determining damages); Orkin Exterminating Co., Inc. v. Traina, 461 N.E.2d 693 (Ind. Ct. App. 1984), *rev'd on other grounds*, 486 N.E.2d 1019 (Ind. 1986); Poyzer v. McGraw, 360 N.W.2d 748 (Iowa 1985); Leiker v. Gafford, 778 P.2d 823 (Kan. 1989); Leonard v. Parrish, 420 N.W.2d 629 (Minn. Ct. App. 1988); Conchola v. Kraft, 575 S.W.2d 792 (Mo. Ct. App. 1978); Nussbaum v. Gibstein, 539 N.Y.S.2d 289 (1989); Mo. Pac. R.R. Co. v. Lane, 720 S.W.2d 830, 834 (Tex. App. 1986); Blodgett v. Olympic Sav. & Loan Ass'n., 646 P.2d 139 (Wash. Ct. App. 1982). *See also*, David R. Kamerschen & Robert W. Kamerschen, *Hedonic Damages in Personal Injury and Wrongful Death Cases*, DEF.

Congress explicitly appropriated "such sums as may be necessary to pay the administrative and support costs" and more importantly established victims' entitlement to compensation awards by deeming "the obligation [as one owed by] the Federal Government to provide for the payment of the amounts . . . ."[39] Final authority for all decision-making rests with the Special Master; his decisions are non-reviewable by any court.[40] The claimant must receive the award funds no later than twenty days after the Special Master's determination.[41] Claimants have two years in total from the effective date of the Special Master's regulations (promulgated in accordance with the grant of statutory authority) within which to file a claim.[42]

The Special Master must reduce the award by any "*collateral source 'compensation,*"[43] including life insurance, pension funds, death benefit programs, and payments by federal, state, and local governments, "related to the September 11th aircraft crashes."[44] No explicit mention is made in the statute of charitable gifts by the numerous special funds set up to assist victims and their families. Claim awards are not subject to state or federal taxes.[45]

The claimant (i.e., the victim or the victim's "personal representative") has a statutory right to present evidence through witnesses and documents and to such other "due process" as determined by the Special Master.[46] The right to an evidentiary hearing, therefore, is protected. The statute also assures the claimant the right to be represented by an attorney throughout the process.[47] There is no statutory provision for government representation by the Justice Department (or otherwise) or for an adversary process in any stage in the proceedings.

COUNSEL J., Jan. 1993, at 118-121; Ronald C. Wernette, Jr., *Hedonic Damages: Their Recoverability, Proof, and Valuation in Michigan*, DEF. COUNSEL J., June 1995, at 15-19 (on file with the author).

39. ATSSSA § 406(b).

40. *Id.* § 405(b)(3).

41. *Id.* § 406(a).

42. *Id.* § 405(a)(3). Potential claimants have until December 21, 2003 to file their claims. *Id.*

43. *Id.* § 405(b)(6) (emphasis added).

44. *Id.* § 405(b)(6).

45. *Id.* § 406(b).

46. *Id.* § 405(b)(4)(B)(C).

47. *Id.* § 405(b)(4)(A).

1. The Primary Issues Left by Congress for Resolution by the Special Master's Regulations

As it does with any statute, Congress worked to address the problem (here, compensation for innocent victims) and left for its chosen delegates (here, the Attorney General and the Special Master) the job of implementing Congress' plan through the promulgation of regulations. The devil, as the cliché goes, is in the details. Among other matters, the Attorney General and the Special Master were charged with deciding: (a) the policy, approach, and attitude toward claims, including the means for meeting the Congressional mandate for timely disposition of claims; (b) the extent, *vel non,* that proceedings will be conducted in an adversary manner; (c) the means and methods of gaining access to information that may be relevant to determining awards; (d) the degree to which proceedings will mirror the civil jury trial system in making awards; (e) the class of individuals entitled to recover awards for the deaths of their loved ones; (f) the reach of the statute to remote victims; (g) public access to proceedings and to award determinations; (h) accountability of hearing officers and other officials of the Office of the Special Master; (i) the role of private lawyers and expert witnesses in the proceedings; and (j) regulatory controls over lawyers' fees.[48]

a. The Special Master's Policy, Approach and Attitude Toward Claims

The administration of the Fund reflects the fundamental attitude that the Special Master and his subordinates bring to the task before them. If the Special Master directly, or indirectly in carrying out instructions of the Attorney General, looks at the Fund as precious government monies that should be controlled and dispersed with caution and circumspection, then the awards will reflect that attitude. At a continuing legal education program held in Washington in October, 2001, a highly respected member of Department of Justice expressed her personal view that society generally and the bar specifically should not look at the Fund as it would ordinary tort recoveries.[49] The Special Master could not, in her mind, administer the Fund as a jury would do because he will be dispersing *government* monies. The government, in her sense, should not be held to the same standard as a

48. *Id.* § 404(a)(1)(2)(3)(b).

49. American Bar Association, Tort & Insurance Practice Section Program on Aviation Litigation held at the Swisshotel in Washington, D.C. in October, 2001 (on file with the author).

property and casualty insurer or a commercial airline. It has to pay less for the same claim of damages than the amount that private parties would have to pay. The likelihood that the government will adopt this attitude and approach to the administration of the Fund is manifested by its response to other entitlement programs. The Veterans Administration, for example, rejected soft tissue lymphoma claims by Vietnam era veterans who were exposed to Agent Orange for a decade or more, relenting only when toxicological and epidemiological studies in peer reviewed medical journals proved the causal connection that the suffering veterans knew intuitively existed as they lost their lives or body parts to the cancers.[50] Government officials have a knee jerk reaction to deny claims—not to award them. Here, the victims' families will compare the awards to them with the fulsome largesse that Congress exhibited to the commercial airlines.

b. Adversary Proceedings

The statute spells out in broad terms a proceeding initiated by a claimant and considered by a hearing officer reporting to the Special Master. The statute does not provide for any role or participation by Department of Justice lawyers. Indeed, the statute forbids the Special Master from considering fault of any type by any person in making the award.[51] Since fault is not a consideration, and since eligible claimants are *entitled* to an award, one can fairly question the need for any participation by government lawyers or government witnesses (expert or otherwise). The only issues arguably open to challenge are ones dealing with the claimant's evidence on eligibility and damages. Hearing officers will consider testimony and reports from expert witnesses and others on such matters as work history, earning capacity and family relationships.[52] The hearing officers in the first instance[53] and the Special Master in final review are fully empowered to protect the government from fraudulent claims.[54] The Special Master could employ economists and make them available to hearing officers for review and analysis of claimants' expert reports on economic losses. Contested claims would delay the process and introduce risk for claimants where none should exist.

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50. *See* Pete Earley, *Agent Orange Compensation Gains Favor,* WASH. POST, Mar. 9, 1983, at A3.

51. ATSSSA § 405(b)(2).

52. *See id.* § 405(b)(4)(A)-(C).

53. *Id.* § 404(a)(3).

54. *Id.* § 405(b)(3).

c. Discovery and Access to Evidence

Claimants will need subpoena power to compel production of documents, other evidence, and witnesses (if a hearing is convened). Evidence gathered by and for the claimant for presentation at a hearing before the Special Master or his designee is a different kettle of fish from evidence gathered for the purpose of discrediting the claimant's documents and witnesses. "Discovery" as it exists in conventional civil practice will add up to significant time, unnecessary expense (including attorneys fees), delay in making awards, and risk to the claimant (in reduced net awards if nothing more).

d. Mirroring Jury Awards

The statute gives claimants a choice between presenting a claim for damages to the Special Master on the one hand and pursuing conventional civil litigation against potentially legally responsible parties in the United States District Court, Southern District of New York on the other.[55] At the same time, of course, Congress gave the commercial airlines tort immunity from awards in excess of the limits of their property and casualty insurance coverages.[56] (Other entities, like airport authorities, were later granted limited tort immunity).[57] Choosing conventional litigation (in the precise jurisdiction where the tragedy occurred) in the face of limited pools of insurance proceeds, tenuous liability, and massive direct and indirect property damage claims is extraordinarily risky to say the least. The *quid pro quo* offered up to the claimant who foregoes civil litigation and presents his claim to the Special Master is the unequivocal promise of an award made without regard to fault that mirrors in some fashion a jury award and that is backed by the Treasury of the United States of America. Indeed, the measure of damages established by the statute exceeds those typically given to juries for use in state law personal injury and wrongful death cases. Few state courts instruct juries on hedonic damages and the value of life. Damage matrices that predetermine awards for economic and non-economic losses regardless of evidence pertinent to individual

55. *Id.* § 405(c)(3)(B).

56. *See* Jackie Spinner, *Insurance Aid Plan Takes Shape; Parties Split on Repayment to U.S. for Terrorism Coverage,* WASH. POST, Nov. 8, 2001, at A4.

57. *See* Martha McNeil Hamilton & Jackie Spinner, *Airport Revenue Coming In Low; Facilities Need Funds To Pay Bondholders*, WASH. POST, Nov. 20, 2001, at E1.

claimants are not part of the American civil justice system.[58] Civil juries do not receive damage evidence in neatly predetermined lots. In jury trials every individual is different; every award is idiosyncratic. The common law recognizes the diversity of life's circumstances. Every claimant is in fact unique. In the statute, Congress assures each claimant a hearing in part to demonstrate the unique considerations applicable to his or her claim.

e. The Class of Beneficiaries in Death Cases

The statute calls for use of "applicable state law" when considering awards of *economic* losses.[59] This was an unfortunate lapse by Congress in an otherwise remarkable definition of assessable damages to victims and their families. Why impose a choice of law decision on the Special Master on economic damages but craft a national standard on non-economic damages? Why should a family, burdened by New York wrongful death law, be denied the same measure of damages afforded to a Connecticut family, particularly when the funds are derived from a common government source?[60] Why should an elderly parent who lived with a divorced son estranged from his minor children and who was physically and emotionally totally dependent on him be denied recovery because the decedent was domiciled in Massachusetts instead of another state with less antiquated and draconian intestacy laws? Why should a life partner from Vermont receive a recovery when another person domiciled in a less accommodating state with an equally tragic loss recovers nothing? State laws define familial relationships and the lines of intestate succession. The statutory incorporation of state law in this manner assured certain classes of loved ones further hardship in the form of exclusion from the Fund.

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58. Some social planners and legal commentators called on the Special Master to develop regulations that would assure so-called "horizontal fairness," a term meaning equivalent awards to claimants regardless of individual circumstances.

59. ATSSSA § 402(5).

60. New York law awards damages in wrongful death cases based largely on economic loss. *See, e.g.*, NY ESTATE POWERS & TRUST LAW § 5-4.3(McKinney 1999). *See also* Klos v. New York City Transit Auth., 659 N.Y.S.2d 97 (1997) (holding in a wrongful death action, an award of damages is limited to fair and just compensation for the pecuniary injuries resulting from the decedent's death to the persons for whose benefit the action is brought). Connecticut law awards damages in such cases based on the loss the decedent would have experienced had he lived, including the value of the enjoyment of life. *See, e.g.*, CONN. GEN. STAT. § 52-555 (2001). *See also* Lanier v. Hochman, No. CV 940533324S, 1998 Conn. Super. LEXIS 1755 (Conn. Super. Ct. June 18, 1998) (holding $5,000,000 verdict in noneconomic damages against a doctor was not excessive based on patient's permanent brain injury and loss of quality of life).

On the other hand, the statute left the Special Master free to make awards to "personal representatives" (i.e., the individual appointed by a probate court or similar authority) for the benefit of individuals who suffered actual, *non-economic* losses of the type outlined in the statute: loss of consortium, society, companionship, affection (loss of enjoyment of life and hedonic damages), mental anguish, inconvenience, and emotional suffering resulting from a loved one's death. [61] Nothing in the statute limits awards of non-economic damages to spouses and minor children.

f. Remote Victims

All of us vividly recall the panic and horror evident on the faces of thousands of people running from the collapsing World Trade Towers. We also easily bring to mind the swirling clouds of gray smoke, dirt and debris that enveloped most of lower Manhattan. People were covered from head to toe with the grit that was once mortar, insulation, and glass. We have no doubt that these individuals suffered some harm. Were they "present" at the World Trade Center? Did they suffer "physical harm"? Did they suffer physical harm of sufficient kind and quality to receive an award from the Fund?[62] Literally thousands of individuals will be included or excluded by the regulations addressing this thorny problem.

g. Public Access to Information and Awards

Before September 11th, the public was embroiled in fractious debates about individual privacy and the extraordinary reach of public and private organizations into private lives with modern technology. The Special Master will determine the extent to which information generated in presentations by claimants (and the Department of Justice lawyers if given a role) and the awards made in the process are public.[63] All proceedings, pleadings, and filings of other types in the criminal and civil courts are generally open and available to the public. The Special Master will be administering a public fund that is intended as an alternative to civil courts. There is no sound reason to limit public access to the information, evidence, and awards that arise from this program. In fact, the empirical data generated by the fund will be a treasure trove of information on claims

61. ATSSSA § 405(c)(2)(C).

62. The civil courts have been deluged with claims of injury based on exposure to asbestos. In the view of the EPA and certain toxicologists exposure to a single asbestos fiber causes physical harm. P.H. Abelson, *The Asbestos Removal Fiasco*, 247 SCIENCE 1017 (1990).

63. ATSSSA § 407; 28 C.F.R. § 104.34.

values for lawyers and claims executives alike. One possible side benefit from the administration of the Fund may be ready access to the largest, single event, publicly available database of wrongful death claims in history.

h. Official Accountability

All public officials should be held accountable for their actions. No less of a rule is acceptable in our democracy. In the context of the Fund, accountability can be afforded in two ways. First, hearing officers could set forth the factual basis of each category of damages awarded as well as precise dollar amounts for each element of damages. A written set of findings would facilitate the Special Master's oversight of his subordinates' work product and his assessment of any aberrational awards. Second, detailed findings and specific awards will enhance public oversight of the Special Master's administration of the Fund in part by permitting easy searches of the claims database.

i. The Role of Private Lawyers and Experts

The statute protects a claimant's right to counsel and mandates an evidentiary hearing if the claimant requests one.[64] Since competent evidence supporting substantial awards for economic and non-economic damages is anything but intuitive, the lawyer's role is fundamentally important. Likewise, the statute explicitly provides the claimant the opportunity to present "witnesses" at hearings.[65] In the field of economic loss, the testimony of economists may be quite valuable.

j. Lawyers Fees

Attorneys are always easy targets for vocal critics. Government control over lawyers fees paid from awards against the government is not a new or novel concept.[66] However, the marketplace best establishes lawyers' fees, like all other pricing decisions.

64. ATSSSA § 405(b)(4).

65. *Id.*

66. The Federal Tort Claims Act regulates fees for claimants' attorneys. *See* 28 U.S.C. § 2678 (2000).

2. An Overview of the Victim Compensation Procedure

The Attorney General of the United States administers the victim compensation program through the appointed Special Master and his designated hearing officers and staff.[67] The claimant must submit a claim form developed by the Special Master which requires: (1) information detailing the physical harm that claimant suffered or information confirming the decedent's death; (2) disclosure of any possible economic[68] and non-economic[69] losses; and (3) information about all collateral source compensation.[70]

a. Eligibility and Restrictions

Those individuals who are eligible to file claims before the Special Master are persons who were present at the crash sites "at the time, or in the immediate aftermath of the terrorist-related aircraft crashes of September 11, 2001."[71] The Victim Compensation Fund also covers "individuals who [were] member[s] of the flight crew or a passenger on American Airlines flight 11 or 77 or United Airlines flight 93 or 175."[72] The Fund expressly excludes any individual "identified by the Attorney General to have been a participant or conspirator in the terrorist-related aircraft crashes of September 11, 2001."[73]

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67. On November 26, 2001, the Attorney General appointed Kenneth R. Feinberg as Special Master. Diana B. Henriques and David Barstow, *A Nation Challenged: The Special Master, Mediator Named to Run Sept. 11 Fund*, N.Y. TIMES, Nov. 27, 2001, at B1.

68. The Act defines "Economic Loss" as: "any pecuniary loss resulting from harm (including the loss of earnings or other benefits related to employment, medical expense loss, replacement services loss, loss due to death, burial costs, and loss of business or employment opportunities) to the extent recovery for such loss is allowed under applicable State law." ATSSSA § 402(5).

69. The Act defines "Noneconomic Losses" as: "losses for physical and emotional pain, suffering, inconvenience, physical impairment, mental anguish, disfigurement, loss of enjoyment of life, loss of society and companionship, loss of consortium (other than loss of domestic service), hedonic damages, injury to reputation, and all other nonpecuniary losses of any kind or nature." *Id.* § 402(7).

70. Collateral Source means "all collateral sources, *including* life insurance, pension funds, death benefit programs, and payments by Federal, State, or local governments related to the terrorist-related aircraft crashes of September 11, 2001." *Id.* § 402(4) (emphasis added). Special Master Feinberg has determined that charitable contributions received by victims' families will not be deemed collateral sources. 28 C.F.R. § 104.47(b)(2).

71. ATSSSA § 405(c)(2)(A)(i).

72. *Id.* § 405(c)(2)(B).

73. *Id.*

b. Decision of the "Special Master"

The Special Master only decides whether claimants are eligible and (if so) the amount of compensation (damages) that they receive. The Special Master does not consider evidence bearing on liability against anyone. The Fund is a pure no-fault statute.[74] Congress mandated that the Special Master would decide whether the claimant is an eligible individual, the extent of harm suffered (including economic and non-economic losses), and the amount of compensation without regard to who might bear legal responsibility for such damages.[75] The Special Master may not award punitive damages and shall reduce the amount of the compensation award by the amount of an individual's collateral source compensation.[76] Congress specified certain types of collateral sources that must be considered in reducing an award.[77] Not later than 120 days after the date on which a claim is filed, the Special Master shall provide a written notice of his determination to the claimant.[78] The determination of the Special Master is "final and not subject to judicial review."[79]

c. Waiver and Withdrawal of Claim

A claimant exercising rights under Title IV "waives the right to file a civil action in any Federal or State court."[80] However, the ATSSSA does not otherwise limit the filing of a civil action against any party who is alleged to be responsible for the attacks. An individual filing a civil action may not submit a claim to the Special Master unless the individual withdrew from the pending civil action within ninety days after the date on which Regulations are promulgated (i.e., ninety days after December 22, 2001).[81]

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74. The Fund is the largest single no-fault statute ever adopted in the United States. Interestingly, rather than oppose its adoption, the trial bar vigorously lobbied Congress and the Executive branch to approve it.

75. ATSSSA §§ 405(b)(1)(B)(i), (ii).

76. *Id.* § 405(b)(5), (6).

77. "Collateral source compensation" was defined to include, without limitation, life insurance benefits, employer death benefits, pension benefits, and benefits under government programs (like Social Security). ATSSSA § 402(4); 28 C.F.R. § 104.47(b)(2).

78. ATSSSA § 405(b)(3).

79. *Id.*

80. *Id.* § 405(c)(3)(B)(i).

81. *Id.* § 405(c)(3)(B)(ii).

d. Limitation on Air Carrier Liability

The liability of an air carrier for "all claims," including claims for punitive as well as compensatory damages, arising from the terrorist actions of September 11, 2001, shall not be greater than the "limits of the liability insurance coverage maintained by the air carrier."[82] The power of Congress to grant to air carriers (and, later, others) retroactive immunity on extant state-based claims above the amounts of their available casualty insurance without full and adequate compensation to the putative victims of their tortuous conduct was not addressed in the statute.[83] Perhaps one or more of the dozen or so pending lawsuits will answer the question.[84]

e. Federal Cause of Action

For individuals who opt out of the Fund (and for other third parties who are not eligible for that program), ATSSSA creates a Federal cause of action for all claims arising out of the terrorist attacks of September 11, 2001[85] with the United States District Court for the Southern District of New York having exclusive jurisdiction over all actions, including any claim for loss of property, personal injury, or death resulting from or relating to the terrorist actions of September 11, 2001.[86] Congress did not

82. *Id.* § 408(a).

83. *See, e.g.*, U.S. CONST. amend. V; First English Evangelical Lutheran Church v. County of L.A., 482 U.S. 304 (1987) (holding government must pay property owner compensation for taking of private property); Chi. Burlington & Quincy R.R. v. Chi., 166 U.S. 226 (1897) (just compensation); Mo Pac. Ry. v. Neb., 164 U.S. 403 (1896) (property must be taken for public use).

84. At the time of the drafting of this article, there were at least eight cases pending in the United States District Court for the Southern District of New York. *See, e.g.*, Mariani v. United Airlines, Inc., 01-CV-11628; Arici v. Am. Airlines, et al., 02-CV-2978; Southwick v. Am. Airlines & Globe Aviation Serv. Corp., 02-CV-2669; Koutny v. United Airlines and Huntleigh USA Corp., 02-CV-2802; Doe v. American Airlines & Argenbright Sec., Inc., 02-CV-452; John Doe v. Am. Airlines & Argenbright Sec., Inc., 02-CV-454; Jane Doe 1 and 2 v. Am. Airlines & Argenbright Sec., Inc., 02-CV-456; Jane Doe v. United Airlines & Argenbright Sec., Inc., 02-CV-458.

85. ATSSSA § 408(b). Congress clearly has the power to occupy a field and thereby preempt state law. *See, e.g.*, Jones v. Rath Packing Co., 430 U.S. 519, 525 (1977); Rice v. Santa Fe Elevator Corp., 331 U.S. 218 (1947). Its ability to preempt extant state-based claims is likewise well established. *See, e.g.*, Fla. Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132 (1963); Hines v. Davidowitz, 312 U.S. 52 (1941). Congress' power to assign lawsuits to a particular venue within the federal court system is founded in Article III of the Constitution, which gives Congress plenary power to delineate the jurisdictional limits, both original and appellate, of these courts. See U.S. CONST. ART. III.

86. ATSSSA § 408(b)(3).

address either the fairness or the hardship to families of decedents from states other than New York to litigate their claims in the Southern District of New York. The substantive law applied to these suits will be derived from the substantive law of the State in which the crash occurred, including choice of law principles, unless the substantive state law is inconsistent with or preempted by Federal law.[87]

f. Subrogation

In regard to all payments made by the United States out of the Fund, the United States has the right of subrogation against any culpable party.[88] Further, ATSSSA expressly reserves claimants' rights to pursue the full limits of liability of those individuals who were knowing participants in the terrorist conspiracy and actions of September 11, 2001.[89] And indeed, lawsuits have been filed against terrorist organizations or their alleged financial backers.[90]

II. THE AVIATION TRANSPORTATION SECURITY ACT

President Bush signed into law the Aviation and Transportation Security Act (the "Security Act") on November 19, 2001.[91] The Security Act establishes the Transportation Security Administration (TSA), a new administration within the Department of Transportation directed by an Under Secretary, who will serve a five-year term.[92] The Under Secretary is responsible for security in all modes of transportation, including civil aviation.[93] The development of standards for airport security screening operations and for the hiring and training of security screening personnel is a responsibility of the TSA.[94] The Under Secretary shall share and manage with other Federal entities information on individuals who may pose a risk to transportation or national security and shall oversee domestic

87. *Id.* § 408(b)(2).
88. *Id.* § 409.
89. *Id.* § 408(c).
90. See, e.g., Susan Schmidt, *Sept. 11 Families Join to Sue Saudis; Banks, Charities and Royals Accused Of Funding al Qaeda Terrorist Network*, WASH. POST, Aug. 16, 2002, at A4.
91. Matthew L. Wald, *Official Says He'll Miss Screening Goal*, N.Y. TIMES, Nov. 27, 2001, at B9.
92. ATSA § 144(b)(3).
93. *Id.* § 101(d)(1).
94. *Id.* §§ 101(e)(2)-(4).

transportation during a national emergency.[95] The Security Act also establishes within the Department of Transportation the "Transportation Security Oversight Board," which will review and ratify or disapprove regulations issued by the Under Secretary.[96] The Oversight Board also will facilitate the coordination of intelligence and law enforcement activities affecting transportation.[97]

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95. *Id.* § 102(a) (to be codified 49 U.S.C. § 115). *Pre-Board Security Screening & Airport Access Security.* Measures to improve the control of access to secure areas of airports and the screening of passengers prior to boarding aircraft are important aspects of the Security Act. For flights and flight segments originating in the United States, screening of all passengers and property must take place before boarding and be carried out by Federal personnel, except as otherwise provided in the Security Act. *Id.* § 110(a). The Under Secretary shall establish qualification standards for the United States to hire and train individuals as security screening personnel. *Id.* § 111(e)(1). A prospective security screener shall undergo an employment investigation, including a criminal history check, and an annual evaluation once employed. *Id.* §§ 111(e)(2)(B), (f)(5). To ensure safety, the Under Secretary shall deploy at least one law enforcement official authorized to carry firearms at each airport screening location. *Id.* § 110(g)(2).

A system must be in operation to screen all checked baggage at all United States airports as soon as practicable. Explosive detection systems must be deployed so that all airports described in Section 44903(c) have systems to screen all checked baggage no later than December 31, 2002. *Id.* § 110(d)(1)(A). Until the explosive detection systems are fully deployed, the Under Secretary shall require alternative means for screening all checked baggage that is not screened by an explosive detection system. *Id.* § 110(e).

The Under Secretary may order the deployment of Federal law enforcement personnel in the secure areas of airports to counter security risks or due to national security concerns. *Id.* § 110(g)(1). Screening or inspection of all individuals and property before entry into a secure area of an airport will be mandatory. *Id.* § 110(a). Vendors with direct access to the airfield and aircraft shall develop security programs. *Id.* § 106(h)(4)(D). The FAA Administrator will establish pilot programs in no fewer than twenty airports to test new technologies that control access to secure areas of the airports. *Id.* § 106(d)(3). The Under Secretary shall recommend to airport operators available technology and procedures to prevent access by unauthorized persons to secure airport areas. *Id.* § 106(h)(4)(E).

96. *Id.* §§ 102(a), (c)(1).

97. *Id.* § 102(c)(2). *Improved In-Flight Security Measures.* In addition to federalizing aviation security, the Security Act provides measures to improve security on-board aircraft, including guidelines for the deployment of Federal air marshals on passenger flights. *See Id.* § 105(a)(1). The Under Secretary will provide for appropriate training of, supervision of and equipment for the air marshals. *Id.* § 105(a)(3). Air carriers shall provide seating for a Federal air marshal without regard to the availability of flights and at no cost to the United States Government or the marshal. *Id.* § 105(a)(5).

Additional on-board safety measures include prohibiting access to the flight deck of aircraft, strengthening the flight deck door and locks, and keeping the flight deck door locked during flight except to permit access by authorized persons. *Id.* §§ 104(a)(1)(A), (B), (C). The FAA Administrator may develop and implement methods to ensure continuous operation of an aircraft transponder in an emergency, to use video monitors or other devices

To pay for civil aviation security services, the Security Act requires the Under Secretary to impose a uniform fee on passengers of air carriers and foreign air carriers in air transportation originating at airports in the United States.[98] To the extent that the uniform fee is insufficient, the Under Secretary may impose a fee on air carriers and foreign air carriers.[99]

A. Title II: Liability Limitation—Air Transportation Safety and System Stabilization Act Amendments

The Security Act amended multiple sections of the ATSSSA. First, it adds a provision that a person filing a claim under ATSSSA does not waive the right to file a civil action against "any person who is a knowing participant in any conspiracy to hijack an aircraft or commit any terrorist act."[100] Section 408, previously entitled "Limitation On Air Carrier Liability," is now entitled "Limitation on Liability" to reflect an expanded group of entities and persons protected by the liability limitation.[101]

The amended Section 408(a) provides that liability for all claims, whether for compensatory or punitive damages or for contribution or

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to alert pilots to activity in the cabin, and to permit aircraft crews to discreetly notify flight deck crews of emergencies. *Id.* §§ 104(b)(1)-(3). The FAA Administrator and Under Secretary must develop detailed guidance to prepare crew members for potential threat conditions, and each air carrier shall develop and submit a flight and cabin crew training program subject to the Administrator's review. *Id.* §§ 104(b)(1)-(3).

Once the National Institute of Justice assesses the range of less-than-lethal weaponry available for use by a flight deck crew member to temporarily incapacitate an individual presenting a clear and present danger, the Department of Transportation will prescribe rules for crew members to use such weaponry. *Id.* §§ 126(a)-(h)(2)(B). If requirements are met, the pilot of a passenger aircraft operated by an air carrier is authorized to carry a firearm into the cockpit. *Id.* § 128. A program to permit qualified law enforcement officers, firefighters and emergency medical personnel to provide emergency services on commercial air flights during emergencies and to provide an exemption from liability if the individual meets the qualifications the Under Secretary prescribes also will be established. *Id.* §§ 131(a)(1)-(b).

98. *Id.* § 118(a)(1). The Security Act also authorizes the appropriation of money necessary for aviation security activities in fiscal years 2002-2005 and to make grants or other agreements in 2002 with air carriers to provide certain aircraft safety measures. *Id.* § 118 ch. 483(a), (b). For fiscal years 2002-2003, $1.5 billion is to be authorized for appropriation to the Secretary to reimburse airport operators, on-airport parking lots and vendors of on-airfield direct services to air carriers for direct costs incurred to comply with new or revised security requirements imposed on or after September 11, 2001. *Id.* § 121(a).

99. *Id.* § 118(a)(2)(A).

100. *Id.* § 201(a), codified at 49 U.S.C. 40101 note.

101. *Id.* § 201(b), codified at 49 U.S.C. 40101 note.

indemnity, against an air carrier, aircraft manufacturer, airport sponsor[102] or person with a property interest in the World Trade Center on September 11, 2001, or their directors, officers, employees, or agents, and arising from the September 11, 2001 events shall not be in an amount greater than the limits of liability insurance coverage maintained by the carrier, manufacturer, sponsor or person.[103] The liability of New York City for all claims arising out of the September 11, 2001 crashes shall not exceed the greater of the city's insurance coverage or $350 million.[104]

The Security Act also added to Section 408(c), which excludes the hijackers from any liability limitation, a provision specifically excluding from liability protection any person engaged in the business of providing air transportation security and who is not an airline or airport sponsor or a director, officer or employee of an airline or airport sponsor.[105] Language added to Section 402(1) states that the term "air carrier" does not include a person, other than an air carrier, engaged in the business of providing air transportation security.[106] Significantly, no private company providing airport security is entitled to a limitation of liability under Section 408(c) of the Security Act.[107]

The Security Act provides for other enhanced measures to increase aircraft security, such as requiring emergency call capability for telephones on board passenger aircraft,[108] consulting with the FDA Commissioner to develop alternative security procedures for transporting a medical product on a flight,[109] and providing for the use of technologies, including wireless and wire line data to enable private and secure communication of threats to aid in passenger screening.[110]

Additional security measures include establishing a uniform system of identification for all law enforcement personnel to obtain permission to

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102. An airport sponsor is defined as the owner or operator of an airport. *Id.* §201(d)(4), codified at 49 U.S.C. 40102.

103. The liability limitation does not apply to any person with a property interest in the World Trade Center if the Attorney General determines after notice and an opportunity for a hearing that the person willfully defaulted on a contractual obligation to rebuild or assist rebuilding the World Trade Center. *Id.* § 201(a)(2), codified at 49 U.S.C. 44302.

104. *Id.* § 201(b)(2), 115 Stat. 597, 645-46 (2001).

105. *Id.* § 201(b)(3), codified at 49 U.S.C. 40101 note.

106. *Id.* § 201(d)(1), codified at 49 U.S.C. 40101 note.

107. *Id.* § 201(b)(3), codified at 49 U.S.C. 40101 note.

108. *Id.* § 109(a)(1).

109. *Id.* § 109(a)(4).

110. *Id.* § 109(a)(5).

carry weapons in an aircraft cabin or a secure area of an airport,[111] considering requiring a photograph on all pilot licenses,[112] and establishing "trusted passenger" programs to expedite the screening of participating passengers, thereby allowing screeners to focus on passengers who should be subject to extensive screening.[113]

The focus of the Security Act is the federalization of aviation security functions through the creation of the Transportation Security Administration and the improvement of airport and in-flight security. The Under Secretary, once appointed by the President and confirmed, will have the task of meeting numerous short-term deadlines for development and implementation of new security guidelines and regulations.[114] Airport operators and air carriers also will be required to act swiftly to comply with new baggage check and search regulations.[115] Finally, by amending the ATSSSA, the Security Act extends the applicability of its liability limitations except for air transportation security companies, which are expressly excluded from the liability limitation.[116]

III. THE DEPARTMENT OF JUSTICE'S REGULATIONS IMPLEMENTING THE SEPTEMBER 11TH VICTIM COMPENSATION FUND CONVERTING INDIVIDUALIZED FACT FINDING INTO PRESUMPTIVE AWARDS AND "EQUAL JUSTICE"

A. Resolution of Issues Related to the Policy, Approach and Attitude Toward Claims

Congress' clear purpose in establishing the Fund (as stated in the ATSSSA) is the fair and just compensation of eligible individuals present at the sites of the terrorist-related aircraft crashes of September 11, 2001 and who were physically injured or killed as a direct result of the crashes or in the immediate aftermath of them.[117] In his statement accompanying the Regulations, the Special Master called the Compensation Fund an

> unprecedented expression of compassion on the part of the American people to the victims and their families . . . designed to bring *some measure of financial relief to those*

111. *Id.* § 109(a)(2).
112. *Id.* § 109(a)(6).
113. *Id.* § 109(a)(3).
114. *Id.* §§ 101–111.
115. *Id.* § 110(b)(2).
116. *Id.* § 201(b)(3).
117. ATSSSA § 403.

> *most devastated* by the events of September 11 . . . [and] an example of how Americans rally around the less fortunate.[118]

In his preamble and statement accompanying the Final Rule, the Special Master articulated a rationale for the regulatory decisions he made on the critical issues left open to him by Congress that is founded on victims' considerations of risk and reward:

> The September 11th Victim Compensation Fund is a unique federal program created by Congress in recognition of the special tragic circumstances these victims and their families confront. The Fund provides an alternative to the significant risk, expense, and delay inherent in civil litigation by offering victims and their families an opportunity to receive swift, inexpensive, and predictable resolution of claims. The Fund provides an *unprecedented* level of federal financial assistance for surviving victims and the families of deceased victims.[119]

In fact, the Special Master does not view the Fund as a vehicle to provide full and fair compensation to claimants for their provable economic losses (as defined by state law) and non-economic losses (as defined by Congress) that could be recoverable against a tortfeasor in wrongful death or personal injury litigation.[120] Instead, the Special Master has crafted a regulatory framework that rejects the uniqueness of each individual injured or killed in the attacks and opts instead for commonality of compensation and ease of administration. Comparing the Congressional mandate with the regulatory results proves the point. Congress intended to provide full compensation for loss of love, affection, guidance, companionship, pain, suffering, and other intangibles based on the individualized proofs offered to the Special

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118. September 11th Victim Compensation Fund of 2001, 66 Fed. Reg. 66,274 (Dec. 21, 2001) (codified at 28 C.F.R. § 104).

119. September 11th Victim Compensation Fund of 2001, 66 Fed. Reg. 11,233 (Mar. 13, 2002) (codified at 28 C.F.R. § 104).

120. Statement by author based on his interpretation of the following quote by Special Master Kenneth Feinberg:

> There is no way this program will be able to truly compensate people for their loss. . . . No way, no how. I will do the best that I can to bring some measure of financial relief to these people, but any assumption that somehow I am making them whole or am going to satisfy them—even I am not that optimistic or foolhardy.

Samantha Levine, *The Value of a Lost Life,* U.S. NEWS & WORLD REPORT, Dec. 31, 2001 at 46 (quoting Kenneth Feinberg, Special Master).

Master by the claimant.[121] As discussed below, the Special Master instead chose to award each decedent's estate $250,000 and each spouse or child $100,000 for non-economic damages.[122] Consequently, an infant child of a decedent will receive the same award for non-economic damages as an 18-year-old child living apart from the same parent. A 25-year-old widow who worked at home and cared for four minor children will receive the same $100,000 in non-economic damages as the 60-year-old widow who was estranged from her spouse.

A stated goal of the Regulations is to create a program that is fair, efficient and sufficiently detailed to enable potential claimants to make informed decisions about whether to file a claim with the Fund.[123] Special Master Feinberg offered his opinion that an award in excess of $3 million (tax-free) would rarely be appropriate in light of individual needs and resources.[124] However, sufficient compensation would be provided to ensure that victims' families receive at least a minimum level of resources to help meet their needs and rebuild their lives.[125]

Accordingly, Special Master Feinberg stated that families of deceased victims should receive a minimum of $500,000 from a combination of the Victim Compensation Fund, other state and federal programs, life insurance policies and other sources of compensation, with single decedents receiving a minimum of $300,000.[126] This has become a controversial issue since, if a decedent had a combination of life insurance and pension benefits in excess of the amount that his family would receive from the Fund, the family may receive nothing from the Fund. This possibility has provoked a strong reaction from those who argue that a decedent's foresight in purchasing life insurance punishes his family since they are unable to recover compensation from the Fund. The Special Master recognized that no "monetary compensation can possibly provide a full measure of relief to those who have suffered . . . [b]ut the Fund will provide appropriate compensation and some measure of comfort to those whose lives have been torn asunder by the events of September 11."[127]

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121. *See* ATSSSA § 405.

122. September 11th Victim Compensation Fund of 2001, 28 C.F.R. § 104.44 (2002).

123. *See generally*, Federal Register, The Final Rule, Vol. 67, No. 49, 11233-237.

124. September 11th Victim Compensation Fund of 2001, 66 Fed. Reg. 66,274 (Dec. 21, 2001) (codified at 28 C.F.R. 104).

125. *Id.*

126. *Id.* at 66,275.

127. *Id.*

All claims against the Fund must be filed on or before December 21, 2003.[128] A claimant choosing the Fund waives his or her right to file or be party to civil litigation in any court for damages resulting from the attacks of September 11, 2001.[129] The final determination on any claim is to be made within 120 days from when the claim is received as properly filed,[130] with payment to be authorized within twenty days thereafter.[131]

B. Resolution of Eligibility Issues

The ATSSSA provided that claimants eligible for compensation include: (1) the "personal representatives" of those aboard the flights that crashed on September 11, 2001 (excepting the terrorists); and (2) those who were "present at" the sites or in the "immediate aftermath" and suffered "physical harm" or death as a direct result of the crashes, or their personal representatives.[132] The Regulations provide the requisite definitions of the key terms used in determining eligibility: "immediate aftermath;"[133] "physical harm;"[134] and "present at the site."[135]

1. Persons Present at the Sites

A person who was killed while in one of the crashed aircraft or inside a collapsed building is clearly covered by the statute. Persons who were near the sites may be eligible for awards if they meet these criteria:

- they were physically present at the time of the crashes or in the immediate aftermath;
- in the buildings or portions of the buildings that were destroyed; or
- in any area contiguous to the crash sites "that the Special Master determines was sufficiently close to the site that there was a demonstrable risk of physical harm from the impact of the aircraft or any subsequent fire, explosions, or building collapse . . . ."[136]

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128. *Id.*
129. ATSSSA § 405(c)(3)(B).
130. *Id.* § 405(b)(3).
131. *Id.* § 406(a).
132. *Id.* § 405(c)(2).
133. September 11th Victim Compensation Fund of 2001, 28 C.F.R. § 104.2(b) (2002).
134. 28 C.F.R. § 104.2(c).
135. *Id.* § 104.2(e).
136. *Id.*

The import of the regulations is that persons who were injured in some fashion but who were physically remote from the crash sites are not eligible for an award from the Fund.[137] So, for example, the millions of people who were "present" in Manhattan (or Brooklyn or Jersey City) and who were exposed to and "injured" by airborne contaminants like asbestos fibers must resort to civil litigation against tortfeasors unprotected by federal grants of immunity.

2. The Immediate Aftermath of the Crashes

Physical presence at the site has also been conditioned by a temporal element as well. In order to recover an award, the person must show that he was at the site:

- within twelve hours of the crashes if he was not a rescue worker; or
- within ninety-six hours of the crashes if he was a rescue worker who assisted in the search for injured victims.[138]

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137. The English case of Victorian Ry. Comm'r v. Coultas, 13 App. Cas. 222 (1888) is generally recognized as establishing the impact rule, which holds that in order for plaintiff to recover for damages for negligent infliction of emotional distress, physical contact must have occurred. In 1901, however, this rule was abandoned in the English case of *Dulieu v. White & Sons*, 2 K.B. 669 (1901), and most American courts followed suit, adopting a "zone of danger" rule which allowed for recovery of damages for negligently inflicted emotional distress if the plaintiff was both located in the dangerous area created by the defendant's conduct, and frightened by the risk of harm. *See, e.g.*, Pierce v. Casas Adobes Baptist Church, 162 Ariz. 269, 782 P.2d 1162; Hale v. Morris, 725 P.2d 26 (Colo. 1986); Robb v. Pennsylvania R. Co., 58 Del. 454, 210 A.2d 709 (1965); Williams v. Baker, 572 A.2d 1062 (D.C. 1990); Seef v. Sutkus, 562 N.E.2d 606 (1990), aff'd, 583 N.E.2d 510 (1991); Resavage v. Davies, 199 Md. 479, 86 A.2d 879 (1952); Stadler v. Cross, 295 N.W.2d 552 (Minn. 1980); Asaro v. Cardinal Glennon Memorial Hosp., 799 S.W.2d 595 (Mo. 1990); Bovsun v. Sanperi, 61 N.Y.2d 219, 461 N.E.2d 843 (1984); Whetham v. Bismark Hosp., 197 N.W.2d 678 (N.D. 1972); Boucher v. Dixie Medical Center, 850 P.2d 1179 (Utah 1992); Vaillancourt v. Medical Center Hosp., 425 A.2d 92 (Vt. 1980). *See also* RESTATEMENT (SECOND) OF TORTS §§ 313, 436 (1965) (adopting "zone of danger" rule). In the case of *Hambrook v. Stokes Bros.*, 1 K.B. 141 (1925), English law went a step further, abandoning the "zone of danger" rule, and adopting instead a duty approach to liability for negligently inflicted emotional distress. A number of states have since abandoned the "zone of danger" approach, and embraced the foreseeability approach first adopted by the California Supreme Court in *Dillon v. Legg*, 441 P.2d 912 (Cal. 1968), *overruled by* Thing v. La Chusa , 771 P.2d 814 (Cal. 1989). *See also* Dziokonski v. Babineau, 380 N.E.2d 1295 (Mass. 1978) (rejecting a "zone of danger" rule); James v. Lieb, 375 N.W.2d 109 (Neb. 1985) (same); Sinn v. Burd, 404 A.2d 672 (Pa. 1979); Ramsey v. Beavers, 931 S.W.2d 527 (Tenn. 1996); Garrett v. City of New Berlin, 362 N.W.2d 137 (Wis. 1985).

138. 28 C.F.R. § 104.2(b).

The limitation to twelve hours for non-rescue personnel excludes from awards individuals who suffered physical injury at the sites in the early and late evening of September 11th.[139] The longer period of coverage for rescue workers (four days as opposed to one half day) makes sense given the significant danger presented by the unstable rubble. Rescue workers who suffered injury on the fifth day after the crashes (or any other day over the course of the many months of work at the sites) have no claim against the Fund.

3. Physical Harm

Persons who were present at the site within the time limits set by the regulations must also show substantial, medically treated, and properly documented bodily injuries. The requirements are as follows:

- physical injury to the body;
- that results in treatment by a medical professional;
- within twenty-four hours of the injury event; or within twenty-four hours of rescue; or within seventy-two hours of the injury event or rescue for victims who were unable to realize the extent of their injuries or get medical treatment (or under such circumstances as the Special Master may deem appropriate for rescue workers);
- and that results in hospitalization as an in-patient for at least twenty-four hours or that caused disability, incapacity, or disfigurement; and
- that is verified by contemporaneous medical records.[140]

The regulations exclude virtually all soft tissue injury cases that produce pain and discomfort but do not result in overnight stays at hospitals or work-related disability (like muscle strains from slip and falls or bouts of asthma from breathing airborne contaminants). Likewise, claims involving exclusively emotional injuries are excluded.[141] Indeed, the defining qualities of eligible claims are sufficiently exclusionary so that

139. *See id.*
140. *Id.* § 104.2(c).
141. See generally 28 C.F.R. § 104.2.

few personal injury claims (as opposed to ones for wrongful death) will make the grade.[142]

C. Resolution of Issues Related to the "Personal Representative"

With respect to eligibility, the Regulations define "personal representative" as an individual appointed by a court to be the decedent's personal representative as the executor or administrator of the decedent's estate.[143] However, before filing a claim as a personal representative, the purported personal representative must give written notice to the immediate family of the decedent, the executor of the decedent's will, and any other persons who may reasonably be expected to assert an interest in an award or to have a cause of action to recover damages relating to the wrongful death of the decedent.[144]

The Special Master has no duty to arbitrate, litigate, or resolve in any way disputes regarding the Personal Representative.[145] Once an award is determined, the Special Master shall review the Personal Representative's plan to distribute the award to the decedent's beneficiaries and may order a redistribution of the award to ensure that the members (beneficiaries) of the families are compensated quickly.[146] Simply put, the Special Master retains the authority to see to the distribution of federal funds so as to accomplish the purposes of the statute.

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142. *See* Spade v. Lynn & Boston RR, 168 Mass 285 (1897) (the regulation is reminiscent of the *Spade* impact rule, which required physical contact in order for plaintiff to recover for negligent infliction of emotional distress). *But see* Dillon v. Legg , 28 Cal. 2d 728 (1968) (the *Spade* impact rule law has been the subject of substantial criticism and led to the development of "modern" rules like the zone of danger rule, which permits recovery of damages for negligent infliction of emotional distress if the plaintiff was both located in the dangerous area created by the defendant's negligence and frightened by the risk of harm). *See also* RESTATEMENT (SECOND) OF TORTS § 313(2) (1965).

143. 28 C.F.R. § 104.4(a).

144. *Id.* § 104.4(b).

145. *Id.* § 104.4(d).

146. If no personal representative has been appointed and such appointment is not the subject of pending litigation, the Special Master may determine in his discretion the Personal Representative for purposes of the Compensation Fund. *Id.* Recognizing that the Special Master could not intercede in disputes over the identity of a decedent's Personal Representative and still perform his required duties, the disputing parties may agree in writing to a Personal Representative who may seek and accept payment from the Compensation Fund while the parties resolve their disputes. *Id.* Alternatively, the Special Master may suspend adjudication of the claim or place in escrow the award that is granted. *Id.*

Advance benefits are available for needy eligible claimants. Although not specifically provided for in the ATSSSA, the Regulations permit claimants to seek advance benefits in fixed amounts of $50,000 in the case of deceased individuals and $25,000 for severely injured individuals.[147] To qualify for advance benefits, applicants must complete a short form identifying their eligibility and need for such benefits.[148] Claimants must certify that they have not received $450,000 in collateral source compensation for a decedent with a spouse or dependent, $250,000 for a single decedent with no dependents, or an amount in excess of lost wages and out-of-pocket medical expenses for injured claimants.[149] Thereafter, claimants can file the lengthier Fund claim form at any time within the two-year period.[150] The filing of an advance benefits claim waives the right to file a civil action, and the advance payment will be deducted from the ultimate award.[151]

D. The Claims Process

1. Claims Evaluation

Except for an advance benefits request, no claim will be considered until the claimant has submitted an Eligibility Form and either a Personal Injury Compensation Form or a Death Compensation Form, along with required documentation establishing eligibility.[152] Claims will be deemed "filed" when a Claims Evaluator determines that the Eligibility Form and either a Personal Injury Compensation Form or a Death Compensation Form are substantially complete.[153] Claimants have the choice of two procedural options: Track A or Track B.[154] If a claimant selects Track A, a Claims Evaluator will determine the claimant's eligibility and set a presumed award according to the Special Master's economic and non-economic loss charts, which are discussed below.[155]

Any claimant deemed ineligible may appeal the decision to the Special Master or his designee.[156] Within forty-five days of filing, the Claims

147. *Id.* § 104.22(a).
148. *Id.* § 104.22(c).
149. *Id.*§ 104.21(b)(5) (2002).
150. *See e.g., id.*§ 104.21(b).
151. *Id.* § 104.21(d).
152. *Id.* § 104.21(a).
153. *Id.*
154. *Id.*§ 104.31(b) (2002).
155. *Id.* § 104.31(b)(1).
156. *Id.*

Evaluator must notify the Track A claimant of the eligibility determination, the amount of the presumed award, and the right to request a hearing before the Special Master.[157] The claimant may accept the award and request payment or request a review before the Special Master or his designee.[158] No further review or appeal is permitted.[159]

Under Track B, a Claims Evaluator also "shall determine eligibility within forty-five days of the date the claim was filed, but shall not determine a presumed award."[160] After notification of eligibility, the Track B claimant then will have a hearing before the Special Master or his designee, who will utilize the presumed award methodology but may modify the award if the claimant demonstrates "extraordinary circumstances not adequately addressed by the presumptive award methodology."[161] "There shall be no review or appeal from this determination."[162]

2. Resolution of Issues Related to Hearings

Hearings are to be non-adversarial; the regulations do not provide for appearances by Justice Department lawyers. "The objective is to permit the claimant to present evidence the claimant believes is necessary to a full understanding of the claim."[163] If a claimant opts for a hearing under either track, the claimant may make supplemental submissions and present witnesses, including experts.[164] The Special Master is "permitted to question witnesses and examine the credentials of experts."[165] Hearings are not limited to a proscribed amount of time. The Special Master or hearing officer will determine the conduct of the hearing (as in any tribunal).[166] An attorney in good standing may represent the claimant, but legal representation is not necessary.[167] The hearings will take place to the extent possible in venues convenient to the claimant or representative.[168]

157. *Id.*
158. *Id.*
159. *Id.* § 104.33(g).
160. *Id.* § 104.31(b)(2).
161. *Id.*
162. *Id.*
163. *Id.* § 104.33(b).
164. *See generally id.* § 104.33(d).
165. *Id.*
166. *Id.* § 104.33(c).
167. *Id.* § 104.33(d).
168. *Id.* § 104.33(c).

3. Resolution of Issues Related to Accountability and Public Access to Information

The Special Master has published a list of all individuals making claims against the Fund. His stated purpose is the delivery of notice to all potential beneficiaries of Fund proceeds of the identity of the persons making claims as personal representatives.[169] He also maintains a website[170] that provides substantial information about the operation of the Fund, including presumptive awards and mathematical tables to assist in calculating economic losses.[171] Regarding the unique potential utility of aggregate claims data from the Fund, the regulations provide the Special Master with discretion to publish data generally while keeping the identity of individual claimants confidential. Section 104.34 (Publication of Awards) provides:

> In order to assist potential claimants in evaluating their options of either filing a claim with the Special Master or filing a lawsuit in tort, the Special Master reserves the right to publicize the amounts of some or all of the awards, but shall not publish the name of the claimants or victims that received each award. If published, these decisions would be intended by the Special Master as general guides for potential claimants and should not be viewed as precedent binding on the Special Master or his staff.[172]

E. Resolution of Issues Related to Awards From the Compensation Fund

The regulations pertaining to the determination of awards for economic and non-economic losses are by far the most controversial and raise the potential for litigation over the Special Master's deviation, *vel non,* from the Congressional mandate and delegation of authority. Congress was clear in its intent—full and fair compensation based on the particular circumstances applicable to the individual claimant.

169. *See generally id.* § 104.4(b).

170. Department of Justice, September 11th Victim Compensation Fund of 2001 *at* http://www.usdoj.gov/victimcompensation/index.html (last modified Sept. 4, 2002).

171. *See id.*

172. 28 C.F.R. § 104.34.

1. Principal Objectives

Section 104.41 reiterates the Congressional intent:

> As provided in Section 405(b)(1)(B)(ii) of the Act, in determining the amount of compensation to which a claimant is entitled, the Special Master shall take into consideration the harm to the claimant, the facts of the claim, and the individual circumstances of the claimant. The individual circumstances of the claimant may include the financial needs or financial resources of the claimant or the victim's dependents and beneficiaries.[173]

The regulations and related statements and mathematical table demonstrate, however, intent to depart from the wishes of Congress and to distribute awards from the Fund with a general sense of equality and without significant regard to individualized facts and circumstances. The promise of a minimum amount of an award demonstrates the point. In Section 104.41, the claimants are promised that

> [i]n no event shall an award (before collateral source compensation has been deducted) be less than $500,000 in any case brought on behalf of a deceased victim with a spouse or dependent, or $300,000 in any case brought on behalf of a deceased victim who was single with no dependents."[174]

The point is made evident when considering the regulations on non-economic damages.

2. Non-economic Loss

Decedents, injured survivors, and their families in fact sustained non-economic losses. There is nothing feigned or hypothecated about the pain and suffering endured by the individuals burned to death in flaming buildings, or those who leaped to their deaths from 105 stories above the ground, or those who survived with disfiguring injuries. Children who grow up without fathers and mothers suffer greatly and surviving spouses who are left to raise children on their own have long and difficult roads ahead of them. Congress recognized the nature and types of loss these individuals would incur and called for compensation for each element of their damages: physical and emotional pain, suffering, inconvenience,

173. *Id.* § 104.41.
174 *Id.*

physical impairment, mental anguish, disfigurement, loss of enjoyment of life, loss of society and companionship, loss of consortium (other than loss of domestic service), hedonic damages, injury to reputation, and all other nonpecuniary losses of any kind or nature. The Special Master chose instead to establish fixed "presumed" non-economic loss awards.

Section 104.44 (determination of presumed losses for decedents) provides: "[t]he presumed non-economic losses for decedents shall be $250,000 plus an additional $100,000 for the spouse and each dependent of the deceased victim."[175] Section 104.46 (determination of presumed noneconomic losses for claimants who suffered physical harm) provides:

> The Special Master may determine the presumed noneconomic losses for claimants who suffered physical harm (but did not die) by relying upon the noneconomic losses described in Sec. 104.44 and adjusting the losses based upon the extent of the victim's physical harm. Such presumed losses include any noneconomic component of replacement services loss.

The reference back to Section 104.44 for a description of non-economic losses is meaningless as the regulation contains only the presumptive amounts of compensation. The obvious bottom line is that the Special Master will award the presumed amounts in death cases and some factored (and probably lesser) amount in cases brought by survivors. The regulations on non-economic loss flatly ignore the standard set by the Congress.

3. Economic Loss

Compensation for economic losses in death cases is determined by consideration of loss of earnings and employment benefits,[176] medical expense loss,[177] replacement services loss,[178] burial costs,[179] and loss of business or employment opportunities.[180] Comparable considerations, including the nature and type of any permanent or partial disability, are made in cases involving economic losses by injured survivors.[181] The

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175 *Id.* § 104.44.

176. *Id.* § 104.43(a) (utilizing salary or income data for the years 1998 through 2000 and "all forms of compensation" for government employees, like housing allowances).

177. *Id.* § 104.43(b).

178. *Id.* § 104.43(c).

179. *Id.* § 104.43(d).

180. *Id.* § 104.43(e).

181. *Id.* § 104.45.

regulatory standard meets the Congressional mandate in that the particular earnings history (medical and burial expenses and disability for survivors) serves as the factual basis for rendering an award.

However, the Special Master developed and published a statistical matrix for calculating "presumed" economic losses based on readily identifiable circumstances such as a claimant's age, prior income levels, marital status and the number and age of any dependents. The Special Master's published presumed loss charts were not incorporated into the regulations and do not facially constitute the law related to the grant of awards for economic loss. The economic loss awards identify presumed losses up to a salary level commensurate with the 98th percentile of individual income in the United States, or $231,000. In his statement and preamble to the final rule, the Special Master repeatedly avers that the use of the matrixes and the use of the 98th percentile salary do not constitute a cap on economic damage awards:

> To be absolutely clear: The fact that the "presumed awards" address incomes only up to the 98th percentile does *not* indicate that awards from the Fund are "capped" at that level. In extending the presumed awards only up to the 98th percentile, we merely recognized that calculation of awards for many victims with extraordinary incomes beyond the 98th percentile could be a highly speculative exercise and that, moreover, providing compensation above that level would rarely be necessary to ensure that the financial needs of a claimant are met.[182]

While not part of the regulations, the charts and methodology for using them provide useful information for claimants and their lawyers and assist them in making the choice between civil litigation and pursuing a claim against the Fund. The proper use of the methodology is detailed in a four-page set of instructions.[183]

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182. September 11th Victim Compensation Fund of 2001 (Final rule), 67 Fed. Reg. 11237.

183. September 11th Victim Compensation Fund of 2001, *at* http://www.usdoj.gov/victimcompensation/loss_calc.html (last visited Nov. 9, 2002).

Table 1 demonstrates the likely effective rates of taxation on pre-tax income.

Table 1
Presumed Future Effective Combined Federal, State and Local Income Tax Rates for New York

Income	
$10,000	5.27%
$20,000	8.50%
$25,000	10.46%
$30,000	12.25%
$35,000	14.03%
$40,000	14.72%
$45,000	15.41%
$50,000	16.10%
$60,000	17.27%
$70,000	18.44%
$80,000	19.50%
$90,000	20.55%
$100,000	21.60%
$125,000	25.00%
$150,000	26.35%
$175,000	27.70%
$200,000	29.05%
$225,000	30.39%

Note: Calculated from data reported in United States Selected Income and Tax Items for Individual Income Tax Returns: Forms 1040, 1040A & 1040EZ for Tax Years 1997, 1998 and 1999 (files 97IN33NY.XLS, 98IN33NY.XLS and 99IN33NY.XLS obtained from the IRS website www.irs.gov). Rates shown reflect a reduction of 5% from the reported data.

Table 2 shows the probable number of years that a decedent or injured survivor would likely continue to work.

Table 2
Expected Remaining Years of Workforce Participation

Age	All Active Males
25	33.63
30	29.36
35	25.04
40	20.78
45	16.65
50	12.64
55	8.97
60	5.97
65	4.20

Source: James Ciecka, Thomas Donley & Jerry Goldman, *A Markov Process Model of Work-Life Expectancies Based on Labor Market Activity 1997-1998*, J. LEGAL ECON. (Winter 1999-2000).

Table 3 exhibits the impact of inflation, productivity and wage growth on real earnings growth by age.

Table 3
Presumed Age-Specific Earnings Growth Rates
(Including Life-Cycle, Inflation, and Overall Productivity Increases)

Age	Earnings Growth Rate
18	9.744%
19	9.580%
20	9.419%
21	9.263%
22	9.055%
23	8.847%
24	8.640%
25	8.434%
26	8.227%
27	8.021%
28	7.816%
29	7.611%
30	7.406%
31	7.201%
32	6.997%
33	6.794%
34	6.591%
35	6.388%
36	6.185%
37	5.983%
38	5.781%
39	5.580%
40	5.379%
41	5.179%
42	4.979%
43	4.779%
44	4.579%
45	4.380%
46	4.182%
47	3.984%
48	3.786%
49	3.588%
50	3.391%
51	3.194%
52+	3.000%

Note – Nominal percentage changes assume annual inflation or cost of living increased of 2.0% plus overall productivity adjustments of 1.0% per year. The underlying real life-cycle percentage change is calculated using a regression analysis of log of total earnings on experience and experience squared using earnings for full-time year-round male workers form the 2001 Current Population Survey (CPS) table PINC-04.

Table 4 plots personal consumption rates by age and family status.

Table 4
Decedent's Personal Expenditures or Consumption as Percent of Income

	Single	Single, 1 Dependent child	Married, no children	Married, 1 Dependent child	Married, 2 Dependent children
$10,000	76.4%	21.6%	30.7%	19.0%	13.6%
$20,000	74.6%	21.6%	28.3%	17.6%	12.8%
$25,000	73.5%	21.6%	26.7%	16.9%	12.5%
$30,000	71.6%	21.6%	26.7%	16.9%	12.5%
$35,000	68.0%	20.6%	24.7%	15.9%	11.8%
$40,000	64.4%	19.7%	22.8%	14.9%	11.1%
$45,000	63.5%	19.0%	20.5%	13.6%	10.2%
$50,000	62.6%	18.3%	18.3%	12.4%	9.4%
$60,000	61.7%	17.8%	17.8%	12.1%	9.1%
$70,000	60.8%	17.4%	17.4%	11.8%	8.9%
$80,000	53.5%	15.1%	14.5%	9.9%	7.6%
$90,000	48.0%	13.7%	12.5%	8.7%	6.7%
$100,000	48.0%	13.7%	12.5%	8.7%	6.7%
$125,000	48.0%	13.7%	12.5%	8.7%	6.7%
$150,000	48.0%	13.7%	12.5%	8.7%	6.7%
$175,000	48.0%	13.7%	12.5%	8.7%	6.7%
$200,000	48.0%	13.7%	12.5%	8.7%	6.7%
$225,000	48.0%	13.7%	12.5%	8.7%	6.7%

Table 5 provides information on discount rates.

Table 5
Assumed Before-tax and After-tax Discount Rates

Age of Victim	Before-Tax Discount Rate	After-Tax Discount Rate
35 & Under	5.1%	4.2%
36-54	4.8%	3.9%
55 & Over	4.2%	3.4%

Note: The present value of presumed economic loss is calculated by applying the after-tax discount rate corresponding to the victim's age at death to all future periods. For example, projected earnings and benefits for a victim who was thirty years old at the time of death will be discounted to present value at 4.2% per year for all future years, and projected earnings and benefits for a forty-five year-old victim will be discounted to present value at 3.9% per year for all future years.

The tables and the underlying sources supporting the data will likely have a significant effect on economic loss calculations in civil litigation. One can easily imagine economists called to testify by plaintiffs or defendants utilizing the methodology outlined by the Special Master (and attributing it to him in testimony before the jury) as a means to lend credit to the damages calculations.

4. Resolution of Issues Related to Collateral Sources

Section 405(b)(6) of the ATSSSA requires the reduction of all awards by the amount of collateral source compensation a claimant received or is entitled to receive as a result of the terrorist-related aircraft crashes. The Regulations specify that collateral sources include life insurance, pension funds, death benefit programs, and payments by federal, state or local governments related to the aircraft crashes, all of which the ATSSSA expressly includes in the definition of collateral sources.[184]

According to the Special Master, the most troublesome ambiguity in the categories of collateral source compensation involved the treatment of charitable donations following the events of September 11, 2001, which according to New York Times reports exceeds $1.3 billion.[185] The Regulations establish that the value of services or in-kind charitable gifts such as emergency housing, food or clothing is not collateral source compensation.[186] Charitable donations distributed to victims or their beneficiaries by private charitable entities are not collateral sources except that funds provided to victims or their families through a private charitable entity (like a family foundation) might, in substance, constitute a collateral source.[187] Likewise, tax benefits under Victims of Terrorist Tax Relief Act of 2001[188] are deemed to be other than a collateral source.[189]

Collateral source income that is contingent (for example where the income terminates on remarriage) is reduced to its present value as a future benefit in light of the contingency.[190] The discretion imparted to the Special Master in the regulation to calculate the value of contingent collateral source income permitted him to make this statement:

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184. 28 C.F.R. § 104.47(a).

185. Diana B. Henriques, *A Nation Challenged: Compensation; Victims' Families Get Break on Earlier Charity*, N.Y. TIMES, Dec. 20, 2001, at B7.

186. 28 C.F.R. § 104.47(b)(1).

187. *Id.* § 104.47(b)(2).

188. *Id.* § 104.47(b)(1).

189. *Id.* § 104.47(b)(3).

190. *Id.* § 104.47(a).

> Where the benefits to be paid due to death of the victim are uncertain, unpredictable, or contingent on unknown future events, the amount of the compensation to which the survivor is entitled can be impossible to compute with reasonable certainty. In those instances, the Special Master has discretion not to require a *full* deduction where the amount of the collateral source compensation cannot be determined with reasonable certainty. Thus, for example, the Special Master has determined that workers' compensation benefits that are payable only if the spouse does not re-marry will only be offset to the extent they have already been paid.[191]

The message certainly was not lost on widows of New York City's firemen and police officers who are entitled to lifetime income because their loved ones were lost in the line of duty.

CONCLUSION

The Victim Compensation Fund is probably the most significant piece of tort based legislation passed anywhere in the United States in the last few decades. It is certainly the most unique. The Fund is a pure no-fault statute that is structured so as to compensate victims (or their families) with average incomes fully for their economic damages and to do so quickly and inexpensively. Compensation for non-economic losses, while supposedly full, fair, and individualized, will be in flat amounts regardless of the particular circumstances applicable to each victim. Nonetheless, the victims will receive substantial amounts of compensation for non-economic losses quickly, inexpensively, and without regard to fault. The Fund recognizes the reality of collateral source income and indeed has raised the discussion of the topic nationally to levels previously unimagined. It is unlikely that any reasonably well-read juror will be ignorant of the concept for the foreseeable future. The use of common economic analyses and published charts assisting claimants in predetermining their recoverable losses will guide decision-making on entry into the Fund. It will also likely have an impact on personal injury litigation generally. The greatest potential benefit of the Fund will come in its introduction of society to an alternative means for compensating seriously injured victims or the families of killed in accidents. In the end, society benefits by finding an

191. Sept. 11 Victim Compensation Fund of 2001 (Final Rule), 67 Fed. Reg. 11241 (2001).

efficient and inexpensive means for delivering funds of this type to needy victims.

INSURANCE, TERRORISM, AND 9/11: REFLECTIONS ON THREE THRESHOLD QUESTIONS

Robert H. Jerry, II[*]

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For most of us, the collapse of the World Trade Center towers exists at the outermost edge of human comprehension. Even after one visits Ground Zero, the events of 9/11 retain a surreal quality, invoking feelings beyond words as one tries to contemplate losses immeasurable with numbers. Indeed, the insurance losses are insignificant when compared to the human tragedies caused by the terrorist attacks—and in insurance terms, we witnessed the most costly, complex events to transpire in a single day in the history of the planet.[1] Many years will pass before all the insurance ramifications of 9/11 are sorted out.

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* Floyd R. Gibson Missouri Endowed Professor, University of Missouri-Columbia School of Law. Professor Jerry expresses his appreciation to Bruce Nguyen and Michele Mekel for their extremely helpful research assistance and to the trust of the Gibson Missouri Endowed Professorship for its support of this project,

1. A year after 9/11, estimates of insured losses continue to vary widely. Standard & Poor's figure is $30 billion, A.M. Best Co. projects losses of $30 to $40 billion, the Insurance Information Institute projects $40.2 billion, consulting firm A.T. Kearney projects losses of more than $50 billion, and Tillinghast-Towers Perrin predicts losses somewhere between $30 and $58 billion. Mark A. Hofmann & Meg Fletcher, *Loss Picture Still Unclear*, BUS. INS., Sept. 9, 2002, at 5–8, 18. The figure will probably not be known for years, and it may ultimately prove to be higher than all of these estimates. Economic loss in New York City is estimated at $83 billion and may eventually reach $95 billion, according

Unquestionably, the boundary between the unimaginable and the possible changed on 9/11. Thus, it is counterintuitive to suggest that the world on September 12th—and the insurance world in particular—was not hugely different than the world that existed on September 10th. Of course, it cannot be seriously asserted that little changed on September 11th; such a statement would be incredibly absurd and hugely insensitive to the thousands of people whose lives were altered or destroyed by the events in New York, Washington, and Pennsylvania. But close examination of the insurance ramifications of 9/11 suggests that not as much has changed as many observers claim. If this is so, we should expect minimal long-run dislocations in insurance markets, and we should therefore resist drastic governmental responses that are disproportionate to the specific capacity problems that 9/11 created. To explore this assertion more closely, this article examines three questions that illuminate at least a portion of 9/11's meaning for the business of insurance in America and around the globe:[2] (1) Is the post-9/11 world different from the pre-9/11 world? (2) Is the post-

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to a report released on September 4, 2002 by the New York City Controller. William Sherman, *Terror Cost City 83B Controller's Report Says Tab Could Rise*, N.Y. DAILY NEWS, Sept. 5, 2002, at 9. It is anticipated that liability and business interruption policies will account for most of the losses (59%), whereas property damage policies will pay about one-fifth of the total loss, and that "60 to 80 percent of the insurance payments for the 9/11 attacks will ultimately come from reinsurers." Report of Joint Economic Committee, *Economic Perspectives on Terrorism Insurance*, May 2, 2002, at 2, 4, *at* http://www.house.gov/jec/terrorism/insur.pdf, (last visited Nov. 9, 2002) [hereinafter JEC REPORT]. To put the total insured loss figure in perspective, prior to 9/11 the largest single-day loss was Hurricane Andrew, which struck southern Florida in August 1992 and caused approximately $16 billion in losses. The 9/11 total loss figure may prove to more than the total insured loss in the five most recent catastrophic losses for the insurance industry prior to 9/11—Hurricanes Andrew and Hugo; the Northridge, California and Kobe, Japan earthquakes and the Lothar and Martin windstorm in Europe—which totaled $53 billion in losses. *See* ROBERT H. JERRY, II UNDERSTANDING INSURANCE LAW 1065. n.1 (Matthew Bender & Co., Inc., 3d ed. 2002). *See also* Robert P. Hartwig, *The Long Shadow of September 11: Terrorism and Its Impacts on Insurance and Reinsurance Markets*, July 25, 2002, PowerPoint presentation *available at* http://www.iii.org/media/hottopics/insurance/sept11 (last visited Nov. 9, 2002) [hereinafter Hartwig]. The presentation uses data supplied by Insurance Information Institute and Swiss Re. *Id.* The figure may also be more than the total insured loss in the ten next most costly catastrophes in the United States, which include seven hurricanes, the Northridge earthquake, the 1993 multi-state winter storm, and the 1991 fire in Oakland, California. In inflation adjusted dollars (as of 1999), these ten events totaled $53.1 billion. INSURANCE INFORMATION INSTITUTE, FACT BOOK 2001 93 (2001) [hereinafter Insurance Information Institute].

2. Portions of the following discussion are based upon JERRY, *supra* note 1, at 1065-74.

9/11 "insurance world" different from the pre-9/11 "insurance world?" (3) If government is to have a role in facilitating terrorism coverage, what should it be? The discussion begins by looking at two opposing, yet simultaneously correct, answers to the first question.

I. IS THE POST-9/11 WORLD DIFFERENT FROM THE PRE-9/11 WORLD?

One answer is, "of course it is, and it is silly to suggest otherwise." This answer makes so much sense that it is difficult to imagine another answer even being possible. Before 9/11, we had no idea something like this could happen; now we know it can. That the World Trade Center towers could *vanish*—let alone disappear in this manner—was unfathomable. The structural engineer for the World Trade Center has stated that engineering analysis at the time the towers were built contemplated the impact of one of them being hit by a Boeing 707,[3] the largest civil aircraft of that era, presumably flying at low speed lost in a fog at the end of a journey. Even if that statement is correct,[4] the engineers did not contemplate a tower being struck by a Boeing 767, a much larger and heavier aircraft, flying at very high speed (which greatly increases the forces) loaded with aviation fuel at the beginning of a journey.[5] Before 9/11, we understood that America's enemies abroad would continue their

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3. *See* Andrea Oppenheimer Dean, *Panelists: Despite Terrorist Attack, the Skyscraper Is Here to Stay*, 189 ARCHITECTURAL RECORD 21 (2001) (quoting Leslie Robertson, the structural engineer for the World Trade Center, "We designed the towers [to withstand the impact of] a Boeing 707 flying slowly," and not a much larger Boeing 767 flying at top speed and full of fuel).

4. There is disagreement as to whether the Towers were designed with this scenario in mind (as opposed to the designers realizing or calculating, after the design was prepared, that the Towers could withstand this impact). Theo Stein, *Professor: Build New, Taller WTC*, DENVER POST, Sept. 20, 2001, at A19 (citing Hyman Brown, professor of civil engineering, that "[r]eports that the building was designed to withstand a crash of a Boeing 707 . . . are false. . . [t]he calculations suggesting the skyscrapers could survive a plane crash weren't performed until after the design phase"); Gregory Richards, *U. Pennsylvania: In Eyes of Experts, No Way to Anticipate Collapse of Towers*, U-WIRE, Sept. 17, 2001 (quoting Ronald Klemencic, president of engineering firm that designed the Towers' skeleton, as stating that reports that the Towers were designed to withstand the force of the Boeing 707 are "folklore") (on file with the author).

5. Even if such a scenario had been contemplated, the consensus of experts is that no engineering design presently exists that would enable a building of this size (or, for that matter, of *any* size) to withstand such an impact under similar conditions. Deborah Snoonian & John E. Czarnecki, *World Trade Center's Robust Towers Succumb to Terrorism*, 189 ARCHITECTURAL RECORD 22, 26 (2001) (stating that, "Designers agree that few structures, no matter what their height, can endure such aggressive attacks.").

efforts to damage United States interests in other nations, but we apparently did not understand that those enemies would seek to cause massive civilian casualties on United States soil. Now that America has experienced massive devastation at a civilian site on the mainland, we know that such an event could happen again and we will take much more aggressive steps to prevent it. We must also prepare ourselves emotionally and economically for the next attack because we know that our prevention efforts, no matter how stringent, cannot be one hundred percent effective. This means that another domestic terrorist attack with civilian casualties will occur at some time in the future, although whether this will happen next week, next month, next year, or within the next fifty years cannot be known. This is the new reality, and it is a massive change from the world as we knew it on September 10th.

There is, however, another perspective. This alternative view concedes, as it must, that we did not foresee the destruction of the World Trade Center. But this view points out that before 9/11 we did understand that something of this nature and on this scale could happen—even if we tried to put (and some would say succeeded too easily in putting) these probabilities outside our consciousness. Several years earlier, many Americans had read a Tom Clancy novel that bore an eerie similarity to the events of 9/11.[6] Beyond the realm of fiction, the potential for a massive domestic terrorism incident was demonstrated by the Sarin nerve gas attack in the Tokyo subway in March 1995, where twelve died and more than 5500 suffered injuries.[7] Had the attack been carried out more skillfully, 5500 or more easily could have perished.[8] The potential for domestic terrorism was demonstrated by Timothy McVeigh's assault on the Murrah Office Building in Oklahoma City in April 1995.[9] McVeigh was an amateur using a crude device; as horrific as the Oklahoma City bombing was, it could have been much worse.[10] The benefits of hindsight always

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6. TOM CLANCY, DEBT OF HONOR (1994) (fictional account of terrorists hijacking a jetliner and crashing it into the U.S. Capitol with devastating consequences).

7. *See Tokyo Police say Injured Includes Possible Suspect*, BALT. SUN, Mar. 21, 1995, at A4.

8. *See* Robert S. Greenberger & Jerry E. Bishop, *Suspected Toxic Agent in Attack is Made of Chemicals Easily Available in U.S.*, WALL ST. J., Mar. 21, 1995, at A12 (citing retired member of U.S. Army chemical corps, who explains that the terrorists may have diluted the chemical's mix for their own safety, which greatly reduced the loss of life).

9. *See* Laura E. Keeton, Mark Pawlosky & Robert Tomsho, *In Broad Daylight—Terrorism Hits Home: U.S. Building Bombed*, WALL ST. J., Apr. 20, 1995, at A1.

10. *See* Elizabeth Gleick, *This Guy is a National Tragedy*, TIME, May 15, 1995, at 43 ("Some bomb experts have concluded that McVeigh and his associates were eager amateurs.

sharpen one's vision, but other events provided good reason for imagining the potential for terrorism aimed at civilian targets.[11] These include the Olympic Park bombing in Atlanta during the 1996 Olympic Games,[12] the February 1993 bombing of the World Trade Center,[13] the August 1998 bombings of the United States embassies in Kenya and Tanzania,[14] and the IRA bombings in London and other locations dating back to the 1970s.[15]

Ironically, one motive for future attacks results directly from America's overwhelming military might. Underscored by the rather limited projection of United States military force in Kosovo and more recently in Afghanistan, America's foreign enemies undoubtedly learned one important lesson from the 1991 Gulf War: the overwhelming technological superiority of United States military forces means that any

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According to one investigator, 'If they were truly mad bombers, they could have brought the building down, and they didn't do it.'").

11. Terrorist attacks on military targets arguably belong to a different genre, but the methods of such attacks are extremely important for understanding potential attacks on domestic civilian targets. The most notorious examples of terrorism directed at U.S. military targets include the October 1983 bombing of the Beirut, Lebanon barracks occupied by U.S. Marines participating in the Mideast peacekeeping mission, which resulted in 242 deaths, William E. Smith, *Carnage in Lebanon; Twin Terrorist Bombings Decimate the U.S. and French Peacekeeping Forces*, TIME, Oct. 31, 1983, at 14; the attempted bombing of approximately one-hundred U.S. Marines staying at hotels in Yemen in December 1992, *Bombs Explode Near Marines; One Person Killed*, ASSOCIATED PRESS, Dec. 29, 1992; the June 1996 bombing of the Khobar Towers, the Saudi Arabia housing facility used by U.S. Air Force personnel involved the overflight operation in Iraq, which killed nineteen Americans, Robert S. Greenberger, *Saudi Bomb at U.S. Base Leaves 19 Dead*, WALL ST. J., June 26, 1996, at A3; and the October 2000 suicide boat attack on the destroyer U.S.S. Cole in Aden, Yemen, which killed seventeen members of the U.S. Navy, Greg Jaffe, *Gunships Hover Over a Deeper Mideast Morass—U.S. Investigates Blast That Struck its Ship; Terrorism Suspected*, WALL ST. J., Oct. 13, 2000, at A15. For a chronology of terrorist activity since 1992 that includes casualty totals, see Amanda Bower, *Terrorist Hits and Misses; A Chronology of Mayhem*, TIME, Nov. 12, 2001, at 68.

12. *See* Douglas Blackmon, Nikhil Deogun & Robert Frank, *FBI is Investigating 'Significant Leads' in its Probe of Bombing at Olympic Site*, WALL ST. J., July 29, 1996, at A3.

13. *See* William M. Carley, *Explosive Theory: Bombing in New York Bears Some Hallmarks of Mideast Terrorists*, WALL ST. J., Mar. 1, 1993, at A1. This attack killed six and injured more than 1,000 people.

14. *See* Carla Anne Robbins & Hugh Pope, *Bombings Put Focus on Saudi Patron of Terror—Egyptian Islamic Militants Draw Initial Suspicion in African Explosions*, WALL ST. J., Aug. 10, 1998, at A10. In this attack, 224 were killed and over 5,000 were injured. *Id.*

15. *See The IRA & Sinn Fein: Chronology*, *at* http://www.pbs.org/wgbh/pages/frontline/shows/ira/etc/cron.html (last visited Nov. 9, 2002) (providing, *inter alia*, a list of IRA bombings and other attacks through 1999).

foreign nation, military force, or organization wishing to inflict injury on America can hope only for extremely limited success if it attempts to confront the United States military on the traditional battlefield in conventional terms. Thus, for the foreseeable future, anyone wishing to inflict harm on the United States—indeed, anyone wishing to "wage war" against America—will do so surreptitiously, covertly, and unconventionally, through use of the techniques of the terrorist.[16] That this was not well understood before 9/11 now appears, with the benefit of hindsight, to have been naive.

Appreciation of the potentially massive destruction that terrorists could cause also appears in insurance trade literature before 9/11. In January 1999, Gene Rappe, an underwriter with St. Paul Fire and Marine, published an essay in which he expressed concern for the "one catastrophe loom[ing] over the horizon that most insurers don't expect: Terrorism."[17] Rappe compared terrorism to catastrophes like "[e]arthquakes, tornadoes, floods, hail and hurricanes" which "[i]nsurers dread, but expect . . . ."[18] After referring to the 1993 World Trade Center and 1995 Oklahoma City bombings, he observed that

> [o]ne bomb planted in a key spot creates an instant catastrophe resembling a war zone. . . . When one reflects upon the fact that one bomb caused each event, the possibility that terrorists could inflict damages of a war-like nature, using more lethal bombs or weapons of mass destruction, is not far fetched.[19]

Like almost everyone else, Rappe did not anticipate the manner of the loss on 9/11,[20] but he, like many others who no doubt had reached the same

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16. This observation is, in a sense, unremarkable, because history is replete with examples of combatants faced with long odds or an overwhelming opposition finding success in the use of new techniques previously beyond the imagination of the opponents.

17. Gene Rappe, *Should Insurers Cover Terrorism?*, NAT'L UNDERWRITER (PROP.& CAS./RISK & BEN. MGMT. ED.), Jan. 11, 1999, at 7. Rappe also published before 9/11 a law review article on terrorism. Gene Rappe, *The Role of Insurance in the Battle Against Terrorism*, 12 DEPAUL BUS. L. J. 351 (1999/2000).

18. Rappe, NAT'L UNDERWRITER, *supra* note 17, at 7.

19. *Id.*

20. A notable exception to the foregoing is Rex Hudson, a Library of Congress analyst, who prepared a report in 1999 on behalf of the Library of Congress' Federal Research Division in which he predicted "suicide bomber(s) belonging to Al Qaeda's Martyrdom Battalion could crash-land an aircraft packed with high explosives (C-4 and Semtex) into the Pentagon, the headquarters of the Central Intelligence Agency (CIA), or the White

conclusion independently but had not published their thoughts in a national trade journal, understood the risks before 9/11. On September 10th, the possibility that terrorism could wreak extraordinary damage in an urban center was not beyond our imagination.[21] On September 12th, the main difference was that what we had earlier known *could* happen, had in fact occurred.

Thus, it is correct to say that the world changed on 9/11. An event that was previously unthinkable occurred, with consequences so vast that it is inconceivable that we will ever return to the state of things that existed before. It is, however, also correct to say that this type and size of loss, while unexpected as a discrete event, was anticipated and imagined before it occurred. Any time losses happen in any context, things are changed; one need only talk to those victimized by a loss to grasp this simple point. But when anticipated losses become real losses, the fundamental order of relationships in the world is not necessarily altered. Thus, from this perspective, the world on September 12th was not much different than the world on September 10th, except with the important qualification that a major loss with wrenching consequences had occurred in the meantime.

II. IS THE POST-9/11 "INSURANCE WORLD" DIFFERENT FROM THE PRE-9/11 "INSURANCE WORLD?"

Embedded in the general question of whether the world changed on 9/11 is the more specific question of whether the *insurance world* changed on that day. Because the magnitude of the loss that occurred on 9/11 was unprecedented, it was tempting to describe the scale of the event as "off the charts" and to suggest that the losses suffered exceeded that which the insurance industry could have ever reasonably expected it would be asked to absorb.[22] By this assessment, 9/11's redefinition of the upper boundary

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House." Frank James, *Report Cited Potential for Suicide Jets; Senior Officials Likely Didn't See It*, CHI. TRIB., May 18, 2002, at 1.

21. If one parses Rappe's essay, it is clear that one of his points was that the insurance industry did not expect a major terrorism event and that this was a major oversight. Thus, on the one hand, Rappe supports the perspective that the world changed on 9/11 when the insurance industry was stunned by the event that it did not expect. On the other hand, Rappe, a member of the industry himself, is representative of some within the industry who before 9/11 understood that such an event was "not far-fetched," suggesting that we should not have been surprised when the major attack finally occurred. Rappe, NAT'L UNDERWRITER, *supra* note 17, at 7.

22. For discussion of what kinds of insurance are potentially applicable to the events of 9/11 and the most common coverage questions presented under these policies, see Jeffrey

of possible loss amounted to an unalterable, permanent change in the insurance world.[23] Moreover, concern has been widespread that terrorists might have the capability to carry out an attack that would produce devastation on a scale so massive as to be uninsurable.[24] Although such destruction has rarely been witnessed, many cities in Japan, Germany, and England suffered these kinds of losses in World War II. The infliction of similar degrees of destruction would be difficult for a terrorist organization to accomplish, but 9/11 requires that this possibility be recalculated. The detonation of a portable nuclear device, a well-placed conventional weapon laced with radioactive material, or a chemical or biological weapon in an urban metropolis could cause massive economic loss and many deaths and personal injuries.[25]

W. Stempel, *The Insurance Aftermath of September 11: Myriad Claims, Multiple Lines, Arguments Over Occurrence Counting, War Risk Exclusions, The Future of Terrorism Coverage, and New Issues of Government Role*, 37 TORT & INS. L. J. 817, 821-32 (2002).

23. Insurance industry representatives routinely expressed this view in their first reactions to the events of 9/11. *See, e.g., Trade Center Disaster Expected to Mark an Insurance Turning Point, at* http://www3.ambest.com/frames/FrameServer.asp?Site=news&Tab=1&RefNum=44436&AltSrc=13 (last visited Nov. 9, 2002) (quoting Bernie Heinze, executive director of the American Association of Managing General Agents: "It [9/11] will forever change the way underwriters approach their business" and quoting Joe Annotti, spokesperson for the National Association of Independent Insurers: "Someone commented, as they watched the towers collapse and dust cloud billowing out from it, that that is what is going to happen to the insurance industry.").

24. The possibility of losses on this scale is what gives rise to the "war risk exclusion," which puts the consequences of war outside the coverage of property and many other kinds of policies.

25. It seems obvious that the detonation of a nuclear bomb in an urban center would dwarf what happened on 9/11. Depending on the location, hundreds of thousands could die and the destruction of property would be unprecedented. *Dirty Bombs and Basement Nukes: The Terrorist Nuclear Threats: Hearing Before the Comm. on Foreign Relations*, 107th Cong., 2nd Sess. (2002) (statement of Dr. Harry C. Vantine, Division Leader, Counterterrorism and Incident Response) (noting that terrorist's detonation of an improvised nuclear device would have "catastrophic effects" and "could dwarf the devastation of the September 11 attack"). A so-called "dirty bomb"—a conventional bomb laced with radioactive material—would cause much less destruction and loss of life, but the clean-up costs and economic loss could be enormous. *Dirty Bombs and Basement Nukes: The Terrorist Nuclear Threats: Hearing Before the Comm. on Foreign Relations*, 107th Cong., 2nd Sess. (2002) (statement of Dr. Donald D. Cobb, Associate Laboratory Director for Threat Reduction) (discussing effect of radiological dispersal devices, or so-called "dirty bombs"). *Huge Financial Fallout from Dirty Bomb (Reuters), available at* http://www.news24.com/News24/USAttack/0,1113,2-1195_1197646,00.html (last visited Nov. 9, 2002) (explaining that while loss of life would not be in the hundreds of thousands

There is, however, another perspective. Catastrophic loss is not new to the insurance industry, and terrorism arguably stands as simply another kind of catastrophe, a peril neither quantitatively nor qualitatively different from the various kinds of natural disasters. If acts of terrorism are uniquely different, one might have expected insurance markets to seriously flounder in the face of 9/11, but this did not occur. The markets coped remarkably well, demonstrating the insurance industry's preparation and ability to handle such an event. Under this alternative view, the insurance world's order did not change on 9/11, even as the industry confronted an event unprecedented in magnitude. Just as the general question discussed above—whether the world changed on 9/11—has two opposing but plausible answers, both perspectives on what 9/11 means to the insurance world have some merit. Although it is fair to claim that the upper boundary of possible loss *from terrorism* changed on 9/11,[26] it is also correct to assert that before 9/11 insurers contemplated and anticipated single-day or single-event losses on the scale of those suffered on 9/11. Hurricanes, earthquakes, volcanic eruptions, and other natural events[27] all carry with

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as is likely with a crude nuclear device, the financial cost of cleanup would be in the billions, with it possible that affected land would have to be abandoned). Chemical and biological weapons would not destroy property, but decontamination costs of uncertain—perhaps massive—size would result. Depending on the circumstances, loss of life could be enormous. *See* Office of Technology Assessment, *Proliferation of Weapons of Mass Destruction: Assessing the Risks*, OTA-ISC-559 (Aug. 1993), at 52-59.

26. As discussed above, the projections that might have been made pre-9/11 based on past terrorism events makes even this proposition debatable. But the data comparing the insured loss on 9/11 to the next nine largest terrorism events in the world, even when all losses are adjusted to 2001 dollars, show that the losses in New York City dwarf all of the other events. The second largest event, after 9/11, is the 1993 IRA bombing in London, where losses were $907 million. Five of the nine terrorist incidents involve insured losses less than $400 million. In inflation-adjusted dollars, the insured loss on 9/11 will be in the vicinity of ten times (or more) that of the combined losses in the nine largest previous terrorist events. *See* JEC REPORT, *supra* note 1, at 3–4 (citing data from Swiss Re).

27. Windstorms (including tornados or straight-line winds) can produce catastrophic losses. A tsunami (a large wave caused by an earthquake on the ocean floor or an asteroid impact in the ocean) could cause devastating coastal losses. A meteorite or asteroid striking Earth is, unfortunately, not science-fiction fantasy. In 1908, a "near earth object" (NEO) exploded over Tunguska, Siberia with the explosive force of more than fifteen megatons of TNT. This was a relatively small event, given the size of other NEOs that could strike our planet. Incredibly, although the risk is slight, the risk of perishing in a catastrophic NEO impact is, by one scientist's calculation, about the same as perishing in an airliner crash and is greater than the risk of dying in a flood or tornado. Dr. Clark R. Chapman, Statement on The Threat of Impact by Near-Earth Asteroids, Southwest Research Institute, May 21, 1998,

them the possibility of financial losses in the tens—and even hundreds—of billions of dollars. During the last twenty years, the extremely rapid pace of coastal development has greatly increased the loss exposure in prime hurricane territory,[28] and similar magnitudes of exposure exist in areas of

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available at http://impact.arc.nasa.gov/congress/1998_may/chapman.html (last visited Nov. 9, 2002).

> Based on estimates of the number of objects out there, astronomers expect an asteroid 1 kilometer (1,100 yards) in diameter to collide with the Earth about once every 100,000 years, on average. Such an impact is thought to be at the threshold of global catastrophe[—]100 million people could die, mainly from starvation due to global crop failures . . . An asteroid 50 yards in diameter could easily devastate a city.

Michael Paine, *Chicken Little Was Right: The Sky is Falling, at* http://www.explorezone.com/columns/space/1999/july_neo_overview.htm (last visited Nov. 9, 2002). According to "the astronomers who operate the Near Earth Asteroid Tracking (NEAT) project" the number of one-kilometer asteroids is about 700—down from the previous estimate of 2,000. Michael Paine, *Asteroid Hunters Downgrade Overall Threat to Earth, at* http://www.explorezone.com/archives/00_01/12_asteroid_odds.htm (last visited Nov. 9, 2002). *Contra* Antonio Regalado, *Beware of Falling Rocks: Scientists Lay Plans to Keep NEOs (Near-Earth Objects) from Smashing the Planet*, WALL ST. J., Sept. 20, 2002, at B1 (putting the number of one-kilometer-wide NEOs at 1,200). "If [the estimate of 700 is] accurate, the new number would reduce the odds of a civilization-destroying impact in any one year from about 1 in 100,000 to about 1 in 300,000, something still more likely than being dealt a royal flush in five-card poker." Michael Paine, *Asteroid Hunters Downgrade Overall Threat to Earth, at* http://explorezone.com/archives/00_01/12_asteroid_odds.htm (last visited Nov. 9, 2002). *Cf. Asteroidscience, at* http://www.explorezone.com/space/asteroids.htm (last visited Nov. 9, 2002) (noting that asteroids large enough to create a "'nuclear winter' . . . strike Earth only once every 1,000 *centuries* on average, NASA officials say," whereas "[s]maller asteroids that are believed to strike Earth every 1,000 to 10,000 years could destroy a city or cause devastating tsunamis."). For additional information on NEOs, see NeoDys Risk Page, *at* http://newton.dm.unipi.it/cgi-bin/neodys/neoibo?riskpage:0;main (last visited Nov. 9, 2002).

28. *Prediction: Coastal Development Will Lead to Hurricane Disaster*, DAYTONA BEACH NEWS, June 14, 2002, *available at* http://www.news-journalonline.com/2002/Jun/14/CANE2.htm (visited Nov. 9, 2002) [hereinafter Prediction] (citing Max Mayfield, director of the National Hurricane Center, who observes that the United States could be hit with a hurricane disaster causing more than $80 billion in damage because of increased coastal development). "In 1960, an average of 187 people were living on each square mile of U.S. coast, excluding Alaska. That population density increased to 273 per square mile by 1994 and is expected to reach 327 by 2015." John McQuaid & Mark Schleifstein, *Developing Disasters, Huge Bills Will Surely Come Due for Population Growth in High-Risk Areas*, SEATTLE TIMES, July 8, 2002 at A3. "If a Category 5 hurricane with winds of 155 mph (258 km/h) hit the U.S. coast, the damage could be enormous as the value of U.S. coastal property in the hurricane belt is at least $6.4 trillion." CNN, *Warmer Ocean Equals More Hurricanes, available at* http://www.cnn.com/CNN/Programs/presents (last visited Nov. 9, 2002).

the United States vulnerable to earthquake or volcanic eruption.[29] In some respects, we have been fortunate that severe natural disasters have avoided dense population centers. For example, until 9/11, the largest disaster was Hurricane Andrew, which caused approximately $16 billion in losses[30]—a number that would have increased three to four times if the hurricane had made a direct hit on the Miami metropolitan area.[31] Where hurricanes make landfall is completely random; it seems obvious enough that eventually a large hurricane will strike Miami, New Orleans, or another large city and cause property damage greatly exceeding that which occurred in New York City on 9/11.[32]

Catastrophic earthquakes constitute a risk that many are surprised to learn is not confined to the west coast of the United States. Memphis, Tennessee is near the New Madrid fault, which is the source of earthquakes that struck the Midsouth in 1811-1812 and are thought by some scientists to be the largest earthquakes ever to strike North America (at least in recorded history).[33] A similar earthquake today could devastate Memphis and cities as far north as St. Louis,[34] perhaps causing damages as high as $115 billion.[35] According to the U.S. Geological Survey, the San Francisco Bay area has a seventy-percent chance of a 6.7 earthquake before 2030.[36]

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29. *See infra* notes 37 and 43 and accompanying text.

30. INSURANCE INFORMATION INSTITUTE, *supra* note 1, at 93.

31. *See* Steve Tuckey, *Analysis Takes Stock of Alternative Risk*, 12 INS. ACCT (Apr. 2, 2001). According to the director of the National Hurricane Center, if a hurricane like the one that struck Miami in 1926, which killed 243 people and caused $112 million in damages, were to strike Miami today, the storm would cause about $87 billion in damage. Prediction, *supra* note 28.

32. For example, "there's roughly a one in six chance that a killer hurricane will strike New Orleans over the next 50 years." American Radio Works, *Hurricane Risk for New Orleans*, *available at* http://americanradioworks.org/features/wetlands/hurricane1.html (last visited Nov. 9, 2002). In addition to massive property destruction, somewhere between 20,000 and 100,000 fatalities would result. *See* American Radio Works, *Hurricane Risk for New Orleans: Terrible Devastation*, *available at* http://www.americanradioworks.org/features/wetlands/hurricane5.html (last visited Nov. 9, 2002).

33. Center for Earthquake Research and Information, The University of Memphis, *The New Madrid Fault System*, *at* http://www.ceri.Memphis.edu/public/facts_long.shtml (last visited Nov. 9, 2002).

34. McQuaid & Schleifstein, *supra* note 28.

35. *See* Tuckey, *supra* note 31.

36. WORKING GROUP ON CALIFORNIA EARTHQUAKE PROBABILITIES, EARTHQUAKE PROBABILITIES IN THE SAN FRANCISCO BAY REGION: 2000 TO 2030—A SUMMARY OF FINDINGS (1999); *Major Quake Likely to Strike Between 2000 and 2030*, *available at* http://geopubs.wr.usgs.gov/factsheet/fs152-99/ (last visited Nov. 9, 2002).

A 1995 study estimated that if an earthquake similar to the 1906 San Francisco quake struck the same area today, fatalities could reach 8000 and total damages could reach $225 billion,[37] a sum nearly three times all economic loss suffered in New York City on 9/11.

The risk of volcanic eruption did not worry us during most of the twentieth century, but we should probably have paid more attention to this risk. After all, the destruction of Pompeii and Herculaneum in the unexpected eruption of Mt. Vesuvius in August A.D. 79 is a well-known example of the complete destruction of cities by natural disaster, and there are others.[38] Probably the reason Americans were so casual about this risk before the eruption of Mt. St. Helens in 1980 was that the last prior volcanic activity in the United States had been a series of small eruptions at Mt. Lassen in California, from 1914 to 1917.[39] The case law even tells of one insurer revising its easy-read homeowners policy to delete any mention of volcanoes in the list of exclusions shortly before the eruption of Mt. St. Helens.[40] When Mt. St. Helens lost approximately 1100 feet of its height and destroyed a few hundred homes in a rather remote area of Oregon in the process, we began to pay more attention to the active volcanic range that runs along most of the west coast of the United States. Scientists now know that past eruptions in the Cascade range were far more violent than the Mt. St. Helens eruption. For example, the eruption (and destruction) of Mt. Mazama about 7700 years ago was fifty times more powerful than Mt. St. Helens; what is left of this mountain is now the world's seventh deepest lake, Crater Lake in Oregon, located in a crater six miles across.[41] There

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37. Haresh C. Shah, *Earthquake Risk Management: A Crucial Ingredient in Reducing Death, Injury, and Economic Disruption, at* http://www.anglia.ac.uk/geography/radix/gujarat2.htm (last visited Nov. 9, 2002).

38. The sudden eruption of Mt. Vesuvius on August 24, A.D. 79 buried these two cities so thoroughly in only a few hours that their ruins were not uncovered for nearly 1,700 years. *See Italy Volcanoes and Volcanics, at* http://vulcan.wr.usgs.gov/Volcanoes/Italy/description_italy_volcanics.html (last visited Nov. 9, 2002). *See also The Eruption of A.D. 79, at* http://www.geo.mtu.edu/~boris/VESUVIO_79.html (last visited Nov. 9, 2002). In 1902, on the Caribbean island of Martinique, Mt. Pelee erupted and sent a pyroclastic flow into the town of St. Pierre, killing 29,000 people. The 1991 eruption of Mt. Pinatubo in the Philippines released enough volcanic material to bury a space the size of Manhattan 1,000 feet deep. Jack McClintock, *Under the Volcano*, DISCOVER, Nov. 1999, at 82, 85.

39. U.S. Geological Survey, Fact Sheet 173-98, *Eruptions of Lassen Peak, California, 1914 to 1917, at* http://geopubs.wr.usgs.gov/fact-sheet/fs173-98 (last visited Nov. 9, 2002).

40. Graham v. Pub. Employees Mut. Ins. Co., 656 P.2d 1077, 1079 (Wash. 1983).

41. The former Mt. Mazama was one of the larger mountains in the Cascade range, between 10,800 and 12,000 feet in height. The eruption was witnessed by native American

are sixty-five active volcanoes in the United States—more than any other country except Japan and Indonesia—and many of these mountains are overdue for an eruption.[42] Washington's Mt. Rainier, the tallest mountain in the Cascade range, is a particularly dangerous peak. According to scientists with the U.S. Geologic Survey, "[d]uring the past 10,000 years, about 60 giant debris flows from Mount Rainier have filled river valleys to a depth of hundreds of feet near the volcano, and have buried the land surface under many feet of mud and rock sixty miles downstream. Seven debris flows large enough to reach Puget Sound have occurred in the past 6,000 years."[43] Some entire communities are built on the remains of the mudflows of past eruptions.[44] Scientists calculate that "residents of the [Puget Sound L]owlands have a one in seven chance of being affected by massive mudlows from Rainier within their lifetimes."[45] Should Mt. Rainier awaken from its long slumber, the consequences to the northwestern United States will be extraordinarily devastating.[46]

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peoples who passed to later generations stories about the event. The force of the eruption was about fifty times that of Mt. St. Helens; the amount of ash and ejected material from Mt. Mazama could have evenly covered the entire state of Oregon nine inches deep. The crater where Mt. Mazama once stood averages more than five miles in diameter, and is 1,958 feet deep. United States Geographic Service, *Description: Mount Mazama Volcano and Crater Lake Caldera, Oregon, available at* http://Vulcan.wr.usgs.gov/Volcanoes/CraterLake?description_crater_lake.html (last visited Nov. 9, 2002).

42. U.S. Dept. of the Interior, *U.S. Geological Survey, U.S. Has 65 Active Volcanoes . . . Reducing the Risk from Active Volcanoes*, Aug. 27, 1997, *available at* http://www.usgs.gov/public/press/public_affairs/press_releases/pr315m.html (last visited Nov. 9, 2002). *See also* McClintock, *supra* note 38, at 85.

43. Discovery Channel/TLC, *Mount Rainier: Preparing for the Worst*, 2000, *at* http://tlc.discovery.com/tlcpages/volcano/america1.html (last visited Nov. 9, 2002) [hereinafter Discovery Channel].

44. "About 100,000 people now live in areas that have been buried by debris flows during the past few thousand years." McClintock, *supra* note 38, at 89.

45. Discovery Channel, *supra* note 43.

46. Geologists estimate that a lahar [a volcanic mudflow, originating from Mount Rainier] could slip down the mountain and arrive at the town of Orting in less than an hour. . . .

> A large lahar, traveling at 30 miles an hour, would quickly sweep over Orting and continue down the Puyallup Valley towards more densely populated areas [including] [t]he towns of Sumner, Ashford, Elbe, Packwood, Randle, Greenwater, [as well as] [p]arts of Tacoma, Buckley, Enumclaw, South Prairie, Carbonado, and Wilkeson.

Micah Fink, *Savage Planet: Volcanic Killers: America's Most Dangerous Volcano*, http://www.pbs.org/wnet/savageplanet/01volcano/03/indexmid.html (last visited Nov. 9, 2002). The lahar would then "continue onwards toward the lowlands of Puget Sound. In

Thus, one cannot claim that the terrorism risk merits special treatment under the logic that terrorism losses are large and uninsurable in contrast to the kinds of losses caused by natural disasters.[47] Some terrorism events are accompanied by losses well within the capacity of the insurance industry (consider, for example, the small bomb that damages a business),[48] and the same is true with respect to natural disasters. By the same token, one can imagine terrorist acts or natural disasters that would easily outstrip the industry's capacity. These events might usefully be labeled as "mega-catastrophes" or "cataclysms"[49] to distinguish them from the "smaller catastrophes" that the industry can manage. Private risk-spreading mechanisms are irrelevant to losses in the mega-catastrophic category; when losses of this magnitude occur, government institutions must become the means of repairing loss and spreading the risk of future similar losses.

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all, 30,000 Puyallup River Valley residents could be in direct danger, along with 100,000 people living in the mountain's six other valleys." *Id.* A similar event occurred less than two decades ago in Columbia. In 1985, a small eruption of snowcapped Nevado del Ruiz created a volcanic mudflow one-fifth the size of the Amazon, which buried 23,000 people in the town of Amero. This town had been built on a solidified mudflow from a previous eruption, much like a number of the towns near Mt. Rainier. McClintock, *supra* note 38, at 86.

47. Indeed, in one respect it may be *easier* to insure terrorism than the risk of natural disaster. Conceptually, terrorism attacks the symbols of America, which is tantamount to an attack on all of America. Thus, it is both logical and politically palatable to spread the risk across the entire nation. Natural disasters are different, as becomes evident when one asks a worker in a Wisconsin cheese factory to subsidize insurance on a Florida beachfront home, a California condominium perched on a known fault line, a farm in the Missouri River flood plain, or a mountain resort at the foot of an active volcano. This phenomenon, however, may only work *ex poste* and not *ex ante.* By way of illustration, consider the answer we should expect to receive from an Indiana farmer who is asked to help fund a terrorism insurance backstop that would facilitate the future establishment of a business in the shadow of the Sears Tower or the future construction of a 100-story skyscraper.

48. Sometimes the boundary between terrorism and vandalism is hazy, particularly when the magnitude of the incident is small. For example, in May, 2002, a series of pipe bombs accompanied by anti-government letters were placed in rural mailboxes in Nebraska, Iowa, and Illinois, injuring six people. Clemente Lisi, *Pipe-Bomb Peril Spreads: Post Office Warns of More Mayhem*, N.Y. POST, May 5, 2002, at 7. These acts fit most definitions of terrorism. In the absence of personal injury, however, it may be more appropriate to view such incidents as vandalism.

49. The term "cataclysm" was used by Cutler and Zeckhauser to make a distinction between insurable and uninsurable catastrophes. *See* David M. Cutler & Richard J. Zeckhauser, *Reinsurance for Catastrophes and Cataclysms*, in THE FINANCING OF CATASTROPHIC RISK (1999), at 239 ("We term events that would exhaust the reserves of worldwide insurers in a particular risk market *cataclysms*.").

Although the 9/11 losses constitute the largest single-event loss in history, they do not reach that level.

That terrorism does not present a unique challenge to the insurance industry is, it might be argued, demonstrated by the success with which the industry absorbed the effects of 9/11. Although the final accounting is not complete and will not be so for some time, the 9/11 losses were within the industry's capacity; the industry continues to demonstrate that it was well prepared before 9/11 to digest an event of this size without default or insolvency. In the wake of the disaster, much of the expended capital was replenished, and new capacity continues to flow into the industry in 2002.[50] Terrorism coverage, although more expensive, has generally been available since 9/11; businesses were not always pleased with its price, but these increases were for many firms no greater than what had occurred in other insurance cycles. Although coverage disappeared for some businesses (this is similar to what happened during the pollution coverage "crisis" in the 1980s; in that situation, coverage was eventually found in appropriate amounts for most businesses that needed it), the market did not collapse.[51] In this respect, the markets' response to 9/11 is similar to what happened after what was previously the largest catastrophe in history. After Hurricane Andrew struck southern Florida in 1992, commercial reinsurers restricted coverage and raised prices. In turn, primary insurers, desiring to pass along the reinsurance premium increases and not wanting exposure on risks where reinsurance was lacking, raised prices, canceled some policies

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50. According to data supplied by Morgan Stanley, total capital flowing into the property-casualty industry since 9/11 is approximately $44.5 billion. Hartwig, *supra* note 1. *See also* Barbara Bowers, *Reinsurance Rebound*, BEST'S REV., Aug. 1, 2002, at 26 (stating that "[s]ince Sept. 11, fresh capital has been flowing into the insurance industry in response to tight capacity and rising premiums"); Martin J. Nilsen, *Perspective: Market Gets Capital Infusion: Hardening Market, Sept. 11 Spur Growth*, BUS. INS., July 15, 2002, at 12H (noting that "unprecedented losses arising from Sept. 11, coming on the heels of a resurgent hard market that was gaining momentum in the months before the terrorist attacks, have acted as a catalyst for an infusion of new capital."). Not surprisingly, the capital situation receives different interpretations from different constituencies. *See* Brendan Noonan, *Insurers Cast Wary Eye on Flow of New Capital*, BEST'S INS. NEWS, Feb. 22, 2002 , at 1 (stating that "[t]he flow of new capital into the insurance industry after Sept. 11 impressed veteran observers, but views vary on how necessary or permanent the fresh reservoir of funding might prove to be.").

51. *See, e.g.*, Bowers, *supra* note 50, at 27 (quoting Mike Koziol, counsel for the National Association of Independent Insurers, "[t]he reinsurance marketplace is working—under some strained conditions—but it is working as a free market" and that "[w]hile many reinsurers now have excluded [terrorism], others have not and are covering terrorism to a limited degree based on the nature of the underlying risk.").

on properties in coastal areas, and increased deductibles for insureds with significant hurricane exposure. Within a couple of years, the reinsurance market stabilized, which in turn was followed by a new period of stability in the primary market. In short, transitory capacity problems in insurance are not uncommon, and, in the absence of multiple "shocks" in a short period of time, these problems are generally self-correcting.[52]

There is, however, an alternative interpretation of conditions in insurance markets. In May 2002, the Joint Economic Committee summarized the situation with respect to cost and availability of terrorism insurance as follows: "[t]errorism insurance policies are available on a limited basis today. Policies are more available and affordable today than in the weeks after 9/11. However, terrorism insurance is still very expensive, terms are restrictive and coverage limits are frequently too low, when it is available at all."[53] To take a few of many possible examples,[54] property insurance for the firm managing an office building one block from the White House has doubled, rising from $2 million to $4 million, according to one report.[55] Insurers have cut the coverage limits for property and casualty insurance for George Washington University's downtown campus in half (from $1 billion to $500 million), have raised the premium 160 percent, and have advised that renewing terrorism coverage will be fifteen times more expensive.[56] Post 9/11, premiums at "trophy" properties in central Washington and New York City have increased fifty to one hundred percent, and in suburban areas premiums have increased about twenty-five percent; moreover, the coverage for terrorism is now excluded or greatly reduced in these areas.[57] The Metropolitan Transportation Authority, which oversees New York City's subway, bus system, railways,

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52. *See* Anne Gron & Alan O. Sykes, *Terrorism and Insurance Markets: A Role for the Government as Insurer?*, JOHN M. OLIN, LAW & ECONOMICS WORKING PAPER NO. 155 (2d Series), July 2002, *available at* http://www.law.uchicago.edu/Lawecon/index.html (last visited Nov. 9, 2002).

53. JEC REPORT, *supra* note 1, at 5.

54. A compendium of examples of the high cost or lack of availability of terrorism coverage can be viewed on the Website of the Coalition to Insure Against Terrorism, *at* http://www.insureagainstterrorism.org/facts_examples.html (last visited Nov. 9, 2002). For another collection of examples, *see* JEC REPORT, *supra* note 1, at 5.

55. Spencer S. Hsu, *Insurance Rates Rise in D.C., Soar Downtown*, WASH. POST, June 13, 2002, at A1.

56. *Id.*

57. *Id.* Yet, the District of Columbia Insurance Commissioner was quoted as saying that "the market is under pressure, but buyers and sellers seem to be bearing the price increases." *Id.*

tunnels, and bridges, saw its terrorism coverage limits shrink from $1.5 billion pre-9/11 to $100 million currently.[58] Professional sports venues and teams throughout the nation have seen insurance costs rise. For example, coverage for Milwaukee's Miller Park, the site of baseball's All-Star game in July 2002, saw its annual insurance premium rise from $225,000 to $2.25 million.[59] Results of a June 2002 survey of its commercial members by the Mortgage Bankers Association of America found that the lack of affordable terrorism coverage for commercial properties had stopped $3.7 billion in deals in 2002 and delayed or changed the pricing on another $4.5 billion.[60]

What should be made of these different descriptions of 9/11's impact on insurance markets? If one agrees that 9/11 defines the upper boundary of potential terrorism losses in the United States, it might be possible to embrace with confidence the conclusion that the insurance world did not change appreciably on 9/11. The problem, however, is that we are not, and cannot be, certain that the upper boundary has been reached, and we are uncertain about where the mean now rests in the distribution of terrorism losses. When risk is measured, one assumes a normal distribution of expected losses, and one expects both the frequency of losses in discrete time periods and the severity of losses to regress to the mean. History teaches, however, that we cannot be certain where the mean is located at any particular point in time. Also, our uncertainty increases with respect to risks that produce loss on a less frequent basis, such as, for example, earthquakes as compared to auto accidents. One of the lessons of 9/11 is that the mean with respect to terrorism losses is not where we previously thought it rested.[61] Further, because this lesson was taught in such an unforgettable way, we are not confident about our current understanding of

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58. *See* Russ Banham, *Terrorism Insurance: Pray as You Go*, CFO MAGAZINE, Feb. 2002, at 27.

59. Darren Rovell, *Terrorism Insurance Bill Could Aid Sports World*, June 18, 2002, *at* http://espn.go.com/sportsbusiness/s/2002/0618/1396438.html (last visited Nov. 9, 2002).

60. Mortgage Bankers Association of America, *More than $8 Billion in Commercial Property Deals Killed, Delayed or Changed Due to Terrorism Insurance Issues,* July 15, 2002, *at* http://www.mbaa.org/news/2002/pr0715a.html (last visited Nov. 9, 2002).

61. When our leaders tell us we have a "'new normalcy' in America or when pundits observe that "things will never be the same again," the same point is being made about an altered understanding of the location of the mean. *See Vice President Cheney Delivers Remarks to the Republican Governors Association*, Oct. 25, 2001, *at* http://www.whitehouse.gov/vicepresident/news-speeches/speeches/vp20011025.html) (last visited Nov. 9, 2002).

where the events of 9/11 will fit in the normal distribution of catastrophic losses.

Whatever is said about the current status of insurance markets, whether markets need help in the future in dealing with the risk of terrorism presents a different question. Again, the comparison to natural disasters is helpful. Based on past experience as reflected in accumulated statistical information and sophisticated predictive models, scientists can estimate the frequency of earthquakes and hurricanes. In contrast, terrorism involves losses produced by humans, the timing and severity of which are not subject to reliable prediction. In particular, the *frequency* of terrorism losses is an extremely difficult variable to measure. Massive terrorism losses could occur, for example, in close succession temporally; indeed, many Americans feared precisely this scenario in the immediate aftermath of 9/11.[62] A series of catastrophes, no one of which in isolation outstrips the insurance industry's capacity, could cumulatively constitute a "mega-catastrophe." Past experience strongly suggests that this is highly unlikely to occur with respect to natural disasters, but intuitively such a conclusion seems less reliable with respect to the peril of terrorism. In addition, historical data show that hurricanes and earthquakes have random paths, and one can reliably expect a measurable proportion of hurricanes and earthquakes to strike relatively unpopulated and less developed areas. In contrast, terrorists typically select targets in order to maximize the impact of their efforts, which usually means maximizing loss of life, damage to property, or both.[63] In the case of volcanoes and hurricanes, the science of seismology and atmospherics makes it possible to warn those who are in harm's way, which in turn makes it possible to mitigate loss to some extent. In contrast, terrorist acts usually come with little or no warning, occurring whenever a human actor is sufficiently motivated to act. In short, natural

62. The nonoccurrence of a second 9/11-type attack in the months after 9/11 suggests that orchestrating a large number of 9/11-type events in close succession is difficult, both in terms of planning and execution. After one event, heightened awareness leads to preventive measures that are likely to avert or mitigate future losses. This was most dramatically illustrated on 9/11 by the manner in which the fourth hijacked airliner was prevented from reaching its target. This implies that terrorism events may adhere to the same distributional patterns as natural disasters. The problem, however, is that we do not know this; even if we did, we may be unable to assimilate or accept it. In other words, we are in a relative sense more uncertain about the frequency of terrorism losses than we are about the frequency of natural disasters.

63. This does not dispute that many terrorist attacks cause small losses, such as the car bomb that damages a business, etc. The point here is that terrorists seek to maximize the damage (output) from their efforts (input).

catastrophes do not self-select their targets or self-calibrate their destructive force.[64]

Even granting these obvious differences, it might be argued that there is no obvious reason why pricing models for terrorism coverage cannot be developed. For example, the FBI keeps statistical records on terrorist events, both at home and abroad,[65] and this data set might be an appropriate starting point for the development of a pricing model. Further study of terrorism losses may reveal that just as there is a "normal distribution" of loss from natural catastrophes, there is a distribution of terrorism losses with an identifiable mean that can be used to price future coverage.[66] Indeed, as Professor David Cummins has observed, the industry offers political risk insurance and insurance for satellite launches, even though the

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64. The differences between natural catastrophes and terrorist acts also explain why terrorism catastrophes have more severe psychological impacts on those victimized. One psychologist explains it this way:

> In contrast to a natural disaster, which is random and unpreventable, terrorist acts are purposeful and can be directed at everyone, including the innocent children. In contrast to a natural disaster in which few, if any, died, the terrorist acts on September 11 may have killed as many as 6,000, including children and other innocent people. However, one of the most important differences between a natural disaster and a terrorist act is the connectedness factor. It can greatly affect the degree to which one feels traumatized. It can be determined by estimating how much the respondent identifies with the helpless and victimized. High identity, including those with relatives and friends who died would be the most difficult to overcome. Fundamentally, man-made trauma causes more harm than natural disasters and accidents.

Charles R. Figley, *Terrorism and the Nature of Traumatic Events,* FAMILY THERAPY MAGAZINE, Jan./Feb. 2002, *available at* http://www.aamft.org/resources/Product_Events/magazine_article.htm (last visited Nov. 9, 2002).

65. FBI, *Counterterrorism Threat Assessment and Warning Unit, Terrorism in the United States* (1999) *available at* http://www.fbi.gov/publication/terror/terror99.pdf (last visited Nov. 9, 2002). According to this report, over "14,000 international terrorist attacks have taken place worldwide since 1968." *Id.* at 15. Acts of domestic terrorism have accounted for the majority of terrorist attacks in the United States over the past twenty years, and no serious act of international terrorism in the U.S. had occurred before the 1993 bombing of the World Trade Center. *Id.* at 16.

66. Within a year after 9/11, some risk modelers had developed and were soon to offer insurers predictive models for terrorism insurance pricing. Erika Morphy, *Three Firms Offer Insurers Models for Terrorism,* INS. FINANCE & INVESTMENT, Sept. 15, 2002, at 9. *See also* Chad Bray, *Terrorism Insurance Hard to Come By For Many Companies,* AP NEWSWIRE, Sept. 27, 2002 (discussing terrorism catastrophe modeling). Whether and to what extent insurers would accept these models was not yet known in late 2002.

data set for pricing these risks would appear to be much smaller than existing data sets for terrorism.[67] But there is another perspective. The foreseeable losses from these perils are not potentially catastrophic (i.e., a satellite loss might measure in the millions, but not in the billions), and this surely makes margins of error in the data set tolerable, which is not the situation when potential losses are $50 billion, $100 billion, or more. In addition, even if one concurs that terrorism is not so unusual as to be uninsurable, pricing models do not now exist that will support a robust market in terrorism insurance. The future may see the emergence of such models, but the industry will need time to develop them.

Thus, the question of whether 9/11 has changed the insurance world cannot be answered simply. In some respects, nothing is different; terrorism is simply another form of catastrophe with which insurance markets will deal in the usual ways. But it is difficult to be sanguine about this assessment. Terrorism, at least intuitively, seems less predictable in terms of magnitude and frequency of loss, and this raises doubts about the capacity of the industry with respect to future events. Capacity is a problem for natural disasters, too, but there is less uncertainty, in a relative sense, about the normal distribution of catastrophic natural disaster losses. Until the uncertainty with respect to the terrorism risk abates and markets stabilize, problems of cost and availability of insurance coverage for terrorism will persist. This, of course, has been true in other insurance sectors in the past, and temporary dislocations do not necessarily justify government intervention. The question, then, is what use, if any, should be made of government risk spreading mechanisms with respect to terrorism.

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67. *See Protecting Policyholders from Terrorism: Private Sector Solutions, Hearing Before the House Subcomm. on Capital Mkt., Ins. and Gov't Sponsored Enter.*, 107th Cong. 2 (2001) (statement of J. David Cummins, Harry J. Loman Professor of Ins. and Risk Mgmt., The Wharton School, Univ. of Penn.), *available at* http://financialservices.house.gov/media/pdf/102401dc.pdf (last visited Nov. 9, 2002) [hereinafter statement of Cummins & Loman]. It may be, however, that satellite insurance is a poor illustration to support this point. According to one report, the "global satellite industry faces a worsening insurance crunch" as "$1.5 billion in anticipated new claims . . . threaten the availability of future liability coverage." Andy Pasztor, *Insurance Issues Threaten Satellite Industry*, WALL ST. J., Sept. 10, 2002, at B3.

III. IF GOVERNMENT IS TO HAVE A ROLE IN FACILITATING TERRORISM COVERAGE, WHAT SHOULD IT BE?

As with the preceding two questions, the question of the appropriate role of government in facilitating terrorism coverage receives different answers from different constituencies. Whatever one's perspective, it cannot be claimed that the tasks of reallocating risk and serving as the insurer of last resort are foreign to the federal government.[68] Where private insurance markets are inadequate to distribute risk or to provide the resources necessary to regenerate property that is vital to the well being of our nation, the vast risk-spreading potential of government has often been tapped. Thus, in the immediate aftermath of 9/11, those who questioned the ability of insurance markets to absorb the losses suggested the need for some kind of government-funded insurance mechanism to "backstop" the private sector.[69] Supporters of government intervention can cite not only the federal government's experience as an insurer, but also programs in other nations where the central government plays a major role in underwriting terrorism coverage.[70] To the surprise of many, the success of the insurance industry in absorbing the losses that occurred on 9/11 and the fact that market failures did not occur after 9/11 to the extent many predicted took much of the steam out of the pro-government backstop position in late 2001 and early 2002. The House of Representatives passed a bill in December 2001 that would create a federal backstop for property and casualty insurance,[71] but similar legislation stalled in the Senate. A GAO study released in late February 2002 listed many examples of firms

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68. *See* DAVID A. MOSS, WHEN ALL ELSE FAILS: GOVERNMENT AS THE ULTIMATE RISK MANAGER (2002) (discussing risk management as a public policy of government). *See also* JERRY, *supra* note 1, at 57-60 (overview of various government programs where government serves as provider of insurance).

69. *See, e.g.*, Lynna Goch, *Support Grows For Federal Terrorism Backstop*, BESTWIRE, Nov. 28, 2001, at 1, *available at* 2001 WL 24725898.

70. *See* JEC REPORT, *supra* note 1, at 17.

71. *See Terrorism Insurance Proposals[;] Comparison of Key Features: 6/25/02, at* http://www.insureagainstterrorism.org/pdf/bill_comparison.pdf (last visited Nov. 9, 2002). Under H.R. 3210, the federal government would provide coverage for 90% of losses exceeding $1 billion, subject to a requirement that the industry repay the government over time. *Id.* The first $20 billion would be repaid via industry-wide assessments, and aid exceeding $20 billion would be repaid via policy surcharges. *Id.* In return, all commercial insurers must provide terrorism coverage in accordance with to-be-created "consistent state guidelines." The program would expire on January 1, 2003, but could be authorized for an additional two years by the Secretary of the Treasury. *Id.*

and businesses having trouble getting needed terrorism coverage,[72] but the study disappointed those who were expecting quantification of significant costs to the economy from insurance unavailability in the aftermath of 9/11. During the spring of 2002, however, Congress continued to hear stories of economic dislocation caused by the unavailability of reasonably affordable terrorism coverage.[73] A report of the Joint Economic Committee in May 2002 also sharpened the analysis of the economic dislocations that would occur if another 9/11 event occurred while terrorism coverage continues to erode. The report found "a growing amount of evidence that the difficulty and cost of obtaining terrorism insurance pose a very real threat to sustained economic growth."[74] In the face of this analysis, the persistent recession, and the realities of election year politics, senators found it difficult not to support legislation designed to make insurance available to businesses and firms needing it. In June 2002, the Senate passed its own version of a government backstop,[75] and as of September 2002, differences in the Senate and House legislation were scheduled to be resolved in conference committee. Although in early 2002 it seemed unlikely that insurance backstop legislation would pass the

72. *Terrorism Insurance: Rising Uninsured Exposure to Attacks Heightens Potential Economic Vulnerabilities, Hearing Before the Subcomm. on Oversight and Investigations, of the House Comm. on Fin. Serv.*, 107th Cong. (2002) (statement of Richard J. Hillman, Director, Financial Mkts. and Cmty. Inv.).

73. *See* JEC REPORT, *supra* note 1, at 6, 7.

74. *Id.* at 8. The Report concluded that the lack of insurance is stopping some business deals, the high cost of insurance when it is available is diverting resources from other more productive uses, thereby negatively affecting investment and jobs, and low coverage limits are shifting risk to businesses, which means insurance payments needed to rebuild will not be available in the event of another attack similar to 9/11. *See id.* at 8–15.

75. Under Senate Bill 2600, the federal government would provide coverage for ninety-percent of losses (over a per company retention) exceeding $10 billion and eighty-percent of losses (over a per company retention) between $1 billion and $10 billion. In return, all property and casualty policies issued by "participating insurance companies" (as defined in the bill) must provide terrorism coverage. The per company retention is defined as a participating company's market share, multiplied by $10 billion, with respect to insured losses resulting from a terrorist act. The calculation changes in the event the program is authorized for a second year; under the Senate bill, the program would last for one year from the date of enactment. There is no requirement that the industry repay the federal government under Senate Bill 2600. For a brief summary of the House bill (and a citation to a chart comparing the two bills), see Statement of Cummins & Loman, *supra* note 67.

Congress,[76] by October 2002 the situation had changed[77] and the enactment of some kind of federal backstop seemed likely.[78]

There are various ways the federal government could become involved in providing terrorism coverage. One is by directly providing insurance and totally displacing private markets. This would be similar to the government program that protected property owners from loss from enemy attack during World War II and to what Israel currently provides to property owners with respect to terrorism. This approach has not received serious consideration in the United States for the current terrorism situation, and this is not likely to change. Once the government takes over a particular market, private insurance mechanisms cease to exist, and it is extremely difficult, and perhaps impossible, to restore such mechanisms once they are dismantled. There is also the problem of the government identifying the appropriate price for the coverage: setting the price too low, the likely tendency in the face of political pressure, will encourage risky behavior and increase losses to the ultimate cost of the American taxpayer. In other words, the unavailability of coverage is not necessarily a problem if the absence of insurance in the market correctly signals that a building should not be constructed adjacent to a nuclear or hydroelectric power facility or as tall as an engineering design allows. Yet this approach may make sense where insurance markets have already ceased to function in their entirety; where private markets are still operational, however, federal preemption is too drastic. The resilience of private markets in responding in recent months to terrorism cautions against displacement of private

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76. *See* JERRY *supra* note 1, at 1074 (predicting that legislation would likely not be enacted by Congress).

77. As of mid-2002, the issue was receiving the attention of editorial writers. *See, e.g., Insuring Against Terrorism*, N.Y. TIMES, June 8, 2002, at A14:

> Last fall, Congress responded energetically to the Sept. 11 terrorist attacks. But the response was incomplete. When the fog of normalcy, with its paralyzing partisanship, again descended on Capitol Hill late last year, Congress had not yet enacted urgently needed legislation to provide federal help in insuring against similarly catastrophic terrorist attacks in the future. It must do so now . . . .

Id.

78. *See* John D. McKinnon, *House Leader Says Congress Will Pass Terror Insurance*, WALL ST. J., Sept. 11, 2002, at A4 (quoting Representative Michael Oxley (R-Ohio), chairman of the House Financial Services Committee, and a White House spokeswoman, regarding their confidence in the passage of terrorism insurance bill). Shortly before the Congress adjourned for its 2002 election recess, an agreement was reached among Senate Democrat conferees, some House Republican conferees, and White House and Treasury staff on a compromise terrorism insurance.

mechanisms, particularly when there is no reason to think that the markets will not continue to evolve in ways that respond positively to the need for coverage.

An approach to be taken more seriously would have the federal government create a reinsurance company that would provide coverage for terrorism risk. Private insurers would be compelled to participate in the funding of this company, which would have the effect of pooling the industry's risk while capping industry losses through a government backstop. This approach would be similar to that now followed in the United Kingdom, where in 1993 Parliament established in response to a series of destructive IRA bombings the Pool Reinsurance Program (commonly called "Pool Re") to provide insurance against damage caused by terrorist attacks on industrial, commercial, and residential properties within the British mainland.[79] Insurers are responsible for the first £100,000 of terrorism coverage, and claims exceeding £100,000 are paid from premiums accumulated within a pool made up of insurance companies and Lloyd's syndicates.[80] If the pool is exhausted, all participating insurers may be required to contribute an additional ten percent of the premiums they collected during the year; beyond this amount, pool investment income is spent, and beyond this sum, the British government—meaning the British taxpayer—is responsible for paying claims, although the government has not yet been called upon to make payments as the insurer of last resort.[81]

The reinsurance approach enjoys some support, but it also faces substantial opposition in the United States. This approach requires the creation of a new government regulatory entity which, once established, will be difficult to dismantle. This entity would, among other things, set the premium for the government reinsurance by assessing private insurers, but critics argue that government regulators cannot do a better job of setting these rates than private markets. To the extent the private market has the potential to manage terrorism risk in the future, the creation of a permanent, government-run reinsurance institution seems premature.

Another option would have the federal government share the risk along with private entities. For example, a large deductible could be set for insurer contributions to terrorism losses beyond which the federal

79. This description of Pool Re is based on JERRY, *supra* note 1, at 1072.
80. *Id.*
81. *Id.*

government assumes all risk.[82] A potential problem with this approach is that because the government is responsible for one hundred percent of all losses above a certain level, insurers and risk managers have little incentive to constrain losses once they rise above the deductible. Thus, the challenge of crafting this approach involves designing a system that requires insurer participation in compensating loss—i.e., that makes insurers bear an appropriate share of the risk—without placing disincentives on the creation of terrorism coverage.[83] The advantage of this approach is that it can be adjusted or dismantled as private markets improve their ability to underwrite terrorism coverage and manage terrorism risk. This, in general terms, is the approach that is likely to emerge from the ongoing efforts in Congress to create a federal backstop.

In a sense, the emerging consensus on the approach to a government backstop acknowledges the opposing, yet simultaneously correct answers to the questions posed above about how the world generally and the insurance world specifically have changed as a result of 9/11. On the one hand, private markets have demonstrated considerable resiliency in the aftermath of 9/11. All signs suggest that capacity continues to improve, which means that the industry could be positioned to deal adequately with the next event when it occurs (assuming it does not set a new upper boundary for the size of terrorism losses—which is possible). Yet it is also true that if the industry had been required to digest a second 9/11-type event in the immediate aftermath of 9/11 (or a major natural disaster of some kind), the industry's weakened condition would have produced a much different scenario. On top of all of this looms the possibility of a mega-catastrophe—or a series of smaller events in close succession that

82. One question that must be answered in developing any such scheme is whether the industry should be assessed for the purpose of reimbursing the government for payments it makes. Of course, if the industry is subject to assessment, the industry still bears the risk, but payments are made relative to a terrorism incident *ex post*, much like what happens in the mutual form of insurance where premiums are kept low relative to risk and members are assessed for losses exceeding reserves. This contrasts with the reinsurance approach, where the government charges a premium for the reinsurance it provides, which means the industry pays for losses *ex ante* by creating a pool of capital that may never be needed for terrorism compensation. If the government provides compensation for disasters after the fact anyway, the reinsurance approach might be advocated on the ground that the government should collect revenue for providing this service. Assessing the industry for payments made under the "deductible approach" also serves a revenue collection function, but this occurs *ex poste*.

83. Gron and Sykes argue that S.B. 2600 misses in the mark in this regard because the government would assume all losses incurred above low aggregates without charge, thereby subsidizing insurers that have already sold policies. Gron & Sykes, *supra* note 52, at 5.

have the cumulative impact of a mega-catastrophe—which would overwhelm the insurance industry.

All of this suggests the desirability of a limited role for the federal government: helping underwrite the portion of the terrorism risk that is beyond the industry's capacity while leaving plenty of room for private markets to function and to develop capacity for smaller losses. This kind of limited backstop would cap the industry's losses, thereby making explicit what is already the commonly assumed, unstated premise: if a mega-catastrophe were to occur, the government would provide disaster assistance *ex poste*.[84] But by making the informal understanding explicit *ex ante*, the federal government would play a useful role in facilitating a market for affordable coverage.[85]

AUTHOR'S NOTE: As this article was going to press, Congress enacted and President Bush signed into law The Terrorism Insurance Risk Act of 2002.[86] The general framework of the Act sets a large deductible for insurer contributions to terrorism losses beyond which the federal government assumes most of the risk. In 2003, the federal government would pay for ninety percent of losses exceeding $10 billion (rising to $15 billion in 2005). In addition, no insurer would receive assistance until it has paid what is essentially a deductible based on a percentage of its total premiums (seven percent in 2003, rising to fifteen percent in 2005). The federal government's liability is capped at $100 billion a year.

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84. *See id.* at 4-5 (noting the federal aid to New York City following 9/11 is currently authorized at $25 billion; that a compensation fund has been established for victims; and that federal emergency assistance is routinely provided for all major natural disasters). As Gron and Sykes point out, the question can be framed as whether the government should shift from *ex poste* disaster relief efforts to *ex ante* insurance coverage. *See id.* at 22-23.

85. This view is consistent with the one urged by Professor Jeffrey Stempel, who counsels restraint with respect to establishing permanent programs until the situation is better understood but does not oppose a short-term program to preserve coverage. *See* Stempel, *supra* note 22, at 880-82. This view is inconsistent with that urged by Professors Gron and Sykes, who argue that "practical considerations may undermine any gains from temporary government participation as an insurer or reinsurer," capacity problems typically self-correct with time, governmental programs often live past their usefulness, government is incapable of improving on the markets' pricing, political pressures to retain government-subsidized insurance make such programs impossible to terminate, and the development of private insurance is deterred. *See* Gron & Sykes, *supra* note 52, at 19-20. Ultimately, how one assesses the opposing view turns on whether one believes that government is capable of creating short-run gains without establishing permanent institutions that disrupt markets and cause harms in the long-run; Gron and Sykes do not think this is possible.

86. Pub. L. 107-297, 116 Stat. 2322 (Nov. 26, 2002).

THE SEPTEMBER 11TH VICTIM COMPENSATION FUND: FUND APPROACHES TO RESOLVING MASS TORT LITIGATION

Linda S. Mullenix[*] *& Kristen B. Stewart*[**]

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INTRODUCTION

In an effort to respond to the terrorist attacks of September 11, 2001, the United States Congress enacted and President George W. Bush signed the Air Transportation Safety and System Stabilization Act (ATSSSA).[1] The primary goal of the Act is to "preserve the continued viability of the United States air transportation system."[2] The "September 11th Victim Compensation Fund of 2001"[3] (the "Victim Compensation Fund") is one of the key components of ATSSSA. This portion of ATSSSA provides victims of the September 11th terrorist attacks with compensation from the United States Government *provided* that they do not seek restitution for their claims through the court system. On December 20, 2001, the Department of Justice, in accordance with ATSSSA, issued procedural rules for administrating the Victim Compensation Fund. The regulations issued by the Department of Justice "delineate eligibility requirements and procedures for the determination of pecuniary claims under the Victim Compensation Fund."[4] These regulations, requirements and procedures have been modified several times by the Fund's administrator, Kenneth Feinberg.

The tragic events of September 11th were unique in American History. In the immediate aftermath of this disaster, most Americans were surprised by what was perceived as the unprecedented and immediate governmental action resulting in the establishment of the Victim Compensation Fund.

Since the enactment of the legislation, World Trade Center victims have been encouraged to join the Victim Compensation Fund, "the country's largest experiment in paying mass victims and their families without placing blame."[5] In the ensuing months, however, the implementation of the Victim Compensation Fund has received much well-

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1. Air Transportation Safety and System Stabilization Act of 2001, Pub. L. No. 107-42, 115 Stat. 230 (codified at 49 U.S.C. § 40101 note) (2001) [hereinafter ATSSSA]. The full text of the Air Transportation Safety and System Stabilization Act is available at http://www.usdoj.gov/victimcompensation (last visited Nov.9, 2002).

2. *Id.*

3. *Id.*

4. Kent C. Krause & John A. Swiger, *Analysis of the Department of Justice Regulations for the September 11th Victim Compensation Fund*, 67 J. AIR L. & COM. 117, 117-18 (2002).

5. Amanda Ripley, *What is a Life Worth?, To Compensate Families of Sept. 11, the Government Has Invented a Way to Measure Blood and Loss in Cash: A Look at the Wrenching Calculus*, TIME, Feb. 11, 2002, at 22.

publicized criticism. Although the Fund is widely perceived as unprecedented, this article places the Victim Compensation Fund in a historical context. Many Americans are simply unaware that the government has enacted and sponsored other "fund" solutions to mass tort events.

This article comments on the September 11th Victim Compensation Fund as one among several past legislative fund-type solutions for no-fault liability. Further, this article suggests that the Victim Compensation Fund most probably will not be utilized as a model for future alternatives to tort litigation, largely because each prior fund-approach to mass tort harms has been idiosyncratic in design and implementation.

I. THE EVENTS OF SEPTEMBER 11TH ARE UNIQUE IN AMERICAN HISTORY: MODELS OF MASS TORT LITIGATION

The terrorist attacks on September 11, 2001 constitute the largest and most catastrophic mass tort in history. With the exception of the Japanese attack on Pearl Harbor, the World Trade Center events are unique in the American experience and fit uncomfortably within models of mass tort litigation. However, despite arguments to the contrary, the terrorist attacks do embody certain characteristics of mass torts.

Leo Boyle, President of the Association of Trial Lawyers of America, has been quoted as saying, "[w]hat happened on September 11th was a mass murder, not a mass tort."[6] Despite this rhetorical hyperbole, the events of September 11, 2001 embody characteristics typical of both mass accidents as well as true dispersed mass tort litigation.

Commentators distinguish between "mass-accident" cases and "mass tort" litigation. "Most so-called mass-accident or mass-disaster cases involve situations in which a number of persons are simultaneously harmed by a single act of the defendant."[7] Typical examples of mass-accident cases are airplane crashes, explosions, catastrophic fires, and oils spills.[8]

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6. Leo V. Boyle, *Victims Fund Will Work, but Don't Toss Torts*, LEGAL TIMES, Jan. 28, 2002, at 53.

7. Linda S. Mullenix, *Class Resolution of the Mass-Tort Case: A Proposed Federal Procedure Act*, 64 TEX. L. REV. 1039, 1044 n.19 (1986). Typically, mass-accident or mass-disaster cases "do not involve complex questions concerning the time between the defendant's wrongful conduct and the plaintiff's injury, remoteness of damage, contributory negligence, or assumption of risk." *Id.*

8. *Id. See, e.g.*, In re Beverly Hills Fire Litig., 639 F.Supp. 915 (E.D. Ky. 1986) (dealing with a nightclub fire which killed and injured over 300 people); In re Fed. Skywalk Cases, 93 F.R.D. 415 (W.D. Mo. 1982). Rau v. Stover, 459 U.S. 988 (1982) (Hyatt-

Dispersed mass tort litigation, in contrast, is "characterized by multiple occurrences of various related harms over time."[9]

The events that occurred on September 11, 2001 encompass certain characteristics typical of mass accident cases, such as a single site, single event disaster; a large number of claimants; little geographical dispersion of claimants; and combined claims for personal injury, wrongful death, and property damage. However, the events of September 11, 2001 also reflect classic mass tort litigation. Thus, the events at the World Trade Center are also characterized by "numerous victims seeking damages from the same defendants; claims arising from similar events or series of events; high costs attending individual litigation; and injuries being widely dispersed over space, time, and jurisdictions."[10] Other characteristics of mass tort litigation include an indeterminate class of claimants, the possibility of future claimants, and indeterminate defendants. Mass torts "vary from single disasters with many victims, to prolonged exposure to or use of hazardous products or materials."[11]

There can be little doubt that the events of September 11, 2001 constituted a mass disaster. Whether those events are viewed as a mass accident or true dispersed mass tort has implications only if claims arising from these events are pursued through litigation. The different analytical models would have consequences in the litigation arena.

The legal landscape surrounding the World Trade Center events merits attention because through the Victim Compensation Fund the United States government quickly offered victims an alternative means for remediation. This approach, rather than through the tort litigation system, is known as a fund approach.

Although there has been increasing public dissatisfaction with the Victim Compensation Fund with each passing month, the Fund approach is not itself novel. Indeed, as will be explained, the Fund incorporates many characteristics of other fund approaches enacted by Congress in the past.

Regency Hotel skywalk collapse killing more than 100 people and injuring over 220 people); In re Air Crash Disaster at Fla. Everglades, 549 F.2d 1006 (5th Cir. 1977).

9. Mullenix, *supra* note 7, at 1044 n.19. *See generally* Deborah R. Hensler & Mark A. Peterson, *Reinventing Civil Litigation: Evaluating Proposals for Change: Understanding Mass Personal Injury Litigation: A Socio-Legal Analysis*, 59 BROOK. L. REV. 961 (1993) (discussing profiles of mass torts and mass accident cases).

10. Peter Charles Choharis, *A Comprehensive Market Strategy for Tort Reform*, 12 YALE J. ON REG. 435, 491 n.188 (1995).

11. *Id.*

Two points are signally important. First, fund solutions are not new. There are many examples of fund approaches to mass tort litigation. Second, although the fund approaches share common characteristics, each is unique based on its facts, features, and implementation.

II. FUND SOLUTIONS

A. September 11th Victim Compensation Fund of 2001

The Victim Compensation Fund may be described as *sui generis*. The "September 11 tort reforms are viewed now, even by avid reformers, as a unique response to a terrible emergency, not a model for the future."[12] However, while the Victim Compensation Fund most likely does not foreshadow a future of tort reform, it may be considered a reflection of past legislative fund-type solutions for no-fault liability. The Victim Compensation Fund was based on some of these antecedent models, but has expanded or modified these precedents in novel and untested ways.

1. Goals and Intent

The Victim Compensation Fund was an "add-on to the emergency bill intended to bail out the airlines in the aftermath of the attacks."[13] It is an

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12. Patti Waldmeir, *Lost Cause of Law Reform: President Bush's Plans to Tame Lawsuit Abuse May Have Become a Casualty of Events*, FIN. TIMES (London), Feb. 7, 2002, at 11.

13. Steven Brill, *A Tragic Calculus; The Plan for Compensating Terror's Victims is About as Fair as it Could Possibly Be*, NEWSWEEK, Dec. 31, 2001, at 28. Brill further explains:

> Airlines typically have insurance of $1.5 billion per air crash, which would cover most situations, even with planes carrying 200 or 300 passengers. But in the September 11 crashes, the victims were not only the passengers but also the thousands of people on the ground or in the Trade Center or the Pentagon, plus the owners of the Twin Towers, the businesses in and around the towers and anyone else damaged that day—a stadium's worth of plaintiffs whose claims could easily exceed $100 billion. On top of that, the airlines were crippled by the decline in business following the attacks. So late on the night of Sept. 21, Congress not only appropriated $15 billion in direct aid and loans to the airlines to keep them in business, but also legislated a cap on each airline's liability that was limited to its insurance coverage. This meant that although thousands of people and businesses might sue the airlines, the pot from which they could collect would be limited to the insurers' $1.5 billion per crash, or $6 billion in all.

Id.

uncapped fund financed by the U.S. Treasury. Title IV of ATSSSA established the Victim Compensation Fund and states "[i]t is the purpose of this title to provide compensation to any individual (or relatives of a deceased individual) who was physically injured or killed as a result of the terrorist-related aircraft crashes of September 11, 2001."[14] The Victim Compensation Fund was "born of very mixed parentage. On one side was the impulse of generosity and sympathy for the victims families. On the other was the attempt to protect the airlines from lawsuits."[15]

2. Eligibility

The fund provides a no-fault liability alternative to tort litigation, and, according to ATSSSA, a claimant shall be determined eligible to participate in the Victim Compensation Fund if they were injured or died at the World Trade Center, the Pentagon, or the site of the aircraft crash at Shanksville, Pennsylvania at the time of, or immediately following the attacks.[16] Eligibility also extends to passengers and flight crew of the aircraft involved in the attacks, but excludes the terrorists.[17] Relatives and

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14. ATSSSA § 403.
15. Ellen Goodman, *A Life's Worth*, WASH. POST, Jan. 5, 2002, at A21.
16. ATSSSA § 405(c)(2)(A)(i).
17. *Id.* § 405(c). This section of ATSSSA states:

> (c) Eligibility
>
> (1) IN GENERAL- A claimant shall be determined to be an eligible individual for purposes of this subsection if the Special Master determines that such claimant—
>
> (A) is an individual described in paragraph (2); and
>
> (B) meets the requirements of paragraph (3).
>
> (2)INDIVIDUALS- A claimant is an individual described in this paragraph if the claimant is—
>
> (A) an individual who—
>
> (i) was present at the World Trade Center, (New York, New York), the Pentagon (Arlington, Virginia), or the site of the aircraft crash at Shanksville, Pennsylvania at the time, or in the immediate aftermath, of the terrorist-related aircraft crashes of September 11, 2001; and
>
> (ii) suffered physical harm or death as a result of such an air crash;
>
> (B) an individual who was a member of the flight crew or a passenger on American Airlines flight 11 or 77 or United Airlines flight 93 or 175, except that an individual identified by the Attorney General to have been a participant or conspirator in the terrorist-related aircraft crashes of September 11, 2001, or a representative of such individual shall not be eligible to receive compensation under this title; or
>
> (C) in the case of a decedent who is an individual described in subparagraph (A) or (B), the personal representative of the decedent who files a claim on behalf of the decedent.

representatives of individuals who died as a result of the events of September 11, 2001 also qualify to receive compensation.[18]

At the time that ATSSSA was passed, the legislation was only concerned with the victims of the September 11th attacks. However, in the ensuing months after promulgation of the implementing regulations, American victims of other terrorist attacks asserted that their losses were as compensable as those which occurred on September 11th.[19] The utilization of tax dollars to finance the Victim Compensation Fund raised serious concerns about the fairness of such a fund to the exclusion of other victims of terrorist attacks.

Consequently, Congress has enacted additional legislation to broaden the September 11th Victim Compensation Fund to include victims of the 1993 World Trade Center bombing, the 1995 Oklahoma City bombing, the 1998 embassy bombings in West Africa and the anthrax attacks which occurred in the fall of 2001.[20] Congress has determined that the harms

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Id.

18. There has been much controversy regarding just who is eligible to be considered a relative or dependent of a deceased victim. *See* David W. Chen, *Money Fight Revives Pain of Sept.11; Victims' Kin Clash on Compensation*, CHI. TRIB., June 17, 2002, at 8. Chen discusses the conflicts ensuing between family members of victims of the attacks of September 11, 2001. The article states:

> One mother is challenging the legitimacy of her daughter's marriage to an estranged husband. The adult children of one victim's first marriage are challenging the status of the victim's second marriage, as well as the children from that union. An unwed partner who shared a mortgage and two young children with another victim finds herself quarreling with his teenage son from an earlier relationship.

Id.

19. *See* Patricia Hurtado, *A Forgotten Fight; Compensation Eludes Many Victims of 1993 WTC Attack*, NEWSDAY (New York), Feb. 24, 2002, at A7 (discussing the insufficient amount of compensation given to the victims of the 1993 World Trade Center bombing as compared to those victims compensated with the September 11th Victim Compensation Fund).

20. *See* David W. Chen, *Traces of Terror: Compensation; House Gives Embassy Victims Same Status as Those of Sept. 11*, N.Y. TIMES, May 22, 2002, at A23 (discussing the legislation passed on May 21, 2002 to make the American victims of two American Embassy bombings in Africa in 1998 eligible for the September 11th Victim Compensation Fund); Shaila K. Dewan, *Traces of Terror: Compensation; Accord to let Other Victims of Terrorism Receive Aid*, N.Y. TIMES, May 25, 2002, at A11. According to Dewan's article, "Senate Democrats and Republicans have agreed to allow the Sept. 11 Victim Compensation Fund to provide hundreds of millions of dollars to the families of victims of other terrorist attacks, including those involving anthrax[.]" *Id.* Dewan quotes Senator Charles E. Schumar as stating, "[t]hey will get the same benefits that the 9/11 families did

resulting from these events are an appropriate extension of the Victim Compensation Fund.

3. Claims Processing

Victims electing to proceed under the Victim Compensation Fund have two procedural options under Section 104.31 of the regulations. Under Section 104.31, Track A Documents are presented to a claims evaluator to determine eligibility and the preliminary award amount.[21] The claimant is then notified within forty-five days of eligibility for the award of the award amount and of the right to request a hearing before the Special Master.[22]

Under Section 104.33 of the regulations, Track B claimants file the appropriate documents and there will be a determination of eligibility within forty-five days.[23] However, a Track B case will proceed directly to a hearing where testimony and evidence are permitted to be presented. No appeal or review is permitted following a Track B determination by hearing.[24]

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and I am happy to say I talked to the 9/11 families and they are fine with it." *Id.* According to Senator Schumar:

> Families who lost members in bombings at the World Trade Center and the Pentagon in 1993, in Oklahoma City in 1995 or at the embassies in West Africa in 1998, or who contracted anthrax after Sept. 11 would be entitled to benefits under the same rules as families who lost members on Sept. 11.

Id. However, Dewan does take note of the fact that the "Bush administration is on the record as opposing the measure adopted by the House, partly on the ground that the Sept. 11 Fund was created specifically for the attacks on that day." *Id.* The fact that the September 11th Victim Compensation Fund was broadened in this way to include the victims of other terrorist attacks has been viewed as a precedent setting event. Senator Schumar has been quoted as saying that "'[t]his does set a precedent . . . [a]nd I hope that we could extend that precedent' into the future." *Id.* However, such a precedent may be deemed dangerous as it may be seen as creating an obligation for the United States government to extend the Victim Compensation Fund way beyond where it was ever intended. *See also* Raymond Hernandez, *Traces of Terror: Compensation; Changes to Sept. 11 Fund Would Extend Aid to Victims of Past Terror Bombings,* N.Y. TIMES, May 24, 2002, at A22 (discussing changes to the September 11th Victim Compensation Fund that would allow the families of the six people killed in the 1993 World Trade Center bombing and the 1995 Oklahoma City bombing to receive compensation through the fund).

21. 28 C.F. R. § 104.31(b)(2) (2002).

22. *Id. See also* David W. Chen, *Legal Heavyweights to Help Decide Sept. 11 Fund Appeals,* N.Y. TIMES, Sept. 24, 2002, at 1 (discussing appointment of forty-one retired judges, lawyers and professors to hear appeals and mediate objections from family members attempting to collect from the fund).

23. September 11th Victim Compensation Fund of 2001, 28 C.F.R. § 104.33 (2002).

24. *Id.*

4. Exclusivity of Remedies

The Victim Compensation Fund "provides a less complicated, non-adversarial way to compensate victims and their families."[25] Claimants electing to participate in the Victim Compensation Fund waive their right to seek compensation for their claims through the court system.[26]

The centerpiece concept of the Fund is that claimants give up their rights and ability to resolve their claims through the tort litigation system. This waiver of tort remediation has received much criticism, and much of the public debate surrounding the Fund has centered on the relinquishment of this right, and the consequences for the recovery of damages. "In the name of the economy, the government severely restricted the victims' right to sue—whether they join the fund or not. It is this lack of a viable option, even if they would not take it, that galls many families."[27]

Claimants have two years from the date of publication of the Victim Compensation Fund Regulations within which to make their choice between joining the fund or litigating.[28] "If a claimant opts in, he waives all litigation rights regarding the Sept. 11 attacks. If he opts out, then his cause of action is limited to a federal one created by ATSSSA that must be brought in the U.S. District Court for the Southern District of New York."[29] Ultimately, it is believed that most people will choose the fund over

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25. *CRA Vice President Receives Award for Providing Analytic Assistance to 'Trial Lawyers Care' Regarding September 11th Victims' Fund*, BUSINESS WIRE, July 12, 2002.

26. ATSSSA § 405(c)(3)(B)(i). This portion of the Act states:

> Upon the submission of a claim under this title, the claimant waives the right to file a civil action (or to be a party to an action) in any Federal or State court for damages sustained as a result of the terrorist-related aircraft crashes of September 11, 2001. The preceding sentence does not apply to a civil action to recover collateral source obligations.

Id. The Act:

> is an alternative to the tort system that is constructed out of a mixture of carrot and stick. The carrot is the promise of presumably generous no-fault payments. The stick is the threat that if one were to sue, recovery could be barred if others had reached the defendant first and used up its insurance coverage.

Anthony Sebok, *Disaster Plan Can the Sept. 11 Fund's Alternative to Court Resolve Future Mass Torts?*, LEGAL TIMES, Mar. 25, 2002, at 26.

27. Ripley, *supra* note 5.

28. ATSSSA § 405(a)(3).

29. William Angelley, *A Legal Perspective: Aviation: The September 11th Victim Compensation Fund*, 65 TEX. B. J. 34, 34 (2002).

litigation; Special Master Kenneth Feinberg has deemed the Victim Compensation Fund "the only game in town."[30]

5. Compensation

The Department of Justice regulations govern compensation for those who choose to join the Victim Compensation Fund. Economic loss is defined as "any pecuniary loss resulting from harm (including the loss of earnings or other benefits related to employment, medical expense loss, replacement services loss, loss due to death, burial costs, and loss of business or employment opportunities) to the extent recovery for such loss is allowed under applicable state law."[31] The money in the Victim Compensation Fund is to be distributed exclusively to the injured and to families of the deceased.[32]

ATSSSA has a three-part formula to determine the amount to be awarded to those who choose remediation through the Victim Compensation Fund. First, ATSSSA provides for a determination of the amount a victim would have earned over his or her lifetime, subject to certain limitations.[33] Secondly, compensation for pain and suffering is added to the projected earnings. Pain and suffering is awarded in the amount of $250,000 for the deceased victim and $100,000 for the pain and suffering of each child.[34] Finally, each award is adjusted for amounts received from collateral sources except for money received from charities.[35]

"Collateral source" is defined in the Victim Compensation Fund to mean "all collateral sources, including life insurance, pension funds, death benefit programs, and payments by federal, state, or local governments

30. Tim O'Brien, *Cracks in the Plaintiff Bar's Solidarity: Sept. 11 Survivors Caught Between Competing Brands of Legal Advice*, LEGAL INTELLIGENCER, Feb. 1, 2002, at 4.

31. ATSSSA § 402(5).

32. *Id.* § 405(c)(2)(C).

33. September 11th Victim Compensation Fund of 2001, 28 C.F.R. § 104.44 (2002).

34. *Id.* Originally, each spouse and dependent child of a deceased victim was to receive $50,000 in non-economic loss compensation. However, with the publication of the Final Rule for the Victim Compensation Fund, non-economic loss compensation was increased to $100,000. This is in addition to the $250,000 presumed non-economic loss that is awarded on behalf of all decedents. *See* Press Release, U.S. Dept. of Justice, Final Regulations of September 11th Compensation Announced (Mar. 7, 2002), *available at* http://www.usdoj.gov/victimcompensation/pressmar7.html (last visited Nov. 9, 2002). *See also* September 11th Victim Compensation Fund of 2001, 67 Fed. Reg. 11,233 (Mar. 13, 2002) (to be codified at 28 C.F.R. § 104) (discussing and publishing the Final Rule governing the September 11th Victim Compensation Fund).

35. ATSSSA § 405(b)(6).

related to the terrorist-related aircraft crashes of September 11, 2001."[36] Critics of the Fund strenuously objected that the policy of deducting collateral-source payments "could result in a significant reduction in award amounts for claimants seeking restitution under the Victim Compensation Fund as compared with the amounts awarded under traditional litigation methods."[37] During the months after promulgation of the regulations, Special Master Feinberg modified the rules relating to collateral source deductions. Feinberg has promised that he will make sure that no one receives zero compensation.[38]

The September 11th Victim Compensation Fund is a reflection of past legislative fund solutions, and Congress established the Fund to facilitate a policy of no-fault liability for an unprecedented tragedy. Congress has created similar funds to compensate victims of mass torts in the past, but nonetheless the Victim Compensation Fund has been the object of criticism.

The deduction of collateral sources from awards has been a major source of controversy, with some claimants objecting to the deduction of collateral sources, arguing that they should not be penalized because they are receiving benefits from other sources.[39]

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36. *Id.* § 402(4). In a statement by Special Master Kenneth Feinberg regarding the Final Rule, he states:

> The final rule clarifies the definition of 'collateral source' compensation by expressly stating that certain government benefits, such as tax relief, contingent Social Security benefits, and contingent workers' compensation benefits . . . need *not* be treated as collateral source compensation. Also, because we do not believe that Congress intended to treat a victim's savings accounts or similar investments as collateral source compensation, the collateral-source offsets will not include moneys or other investments in victims' 401(k) accounts.

September 11th Victim Compensation Fund of 2001, 67 Fed. Reg. at 11,233. It is interesting to note that with the publication of the Final Rule governing the September 11th Victim Compensation Fund on March 7, 2002, it was decided by fund administrators that "personal pensions and retirement accounts, such as 401(k) plans" will not be deducted from fund payments. *See* William Sherman, *Final Regulations for Victims' Fund Issued; Average Payout to be $1.85 Million*, N.Y. DAILY NEWS, Mar. 8, 2002, at 21.

37. Krause & Swiger, *supra* note 4, at 128.

38. *Id.*

39. *See* O'Brien, *supra* note 30. In a discussion of the controversial deduction of collateral sources, O'Brien states:

> Widows of high earners in the prime of their careers loathe this, saying they could lose a large chunk of any award. Widows of the uniformed service victims also object to this provision because police and fire unions have lucrative widows' and orphans' benefit plans and because

Additional objections include the differential treatment of male and female victims. Compensation figures are determined through Bureau of Labor statistical tables, which are thought to "underestimate the time that women are currently in the work force by as much as five years."[40] Also, "another controversial interim provision calculates future earning power based on a total compensation package of $231,000 a year," which arguably under-compensates claimants with actual income in excess of that amount.[41]

The following sections analyze other funds which have been utilized as a means of creating non-tort, no-fault liability alternatives to litigation.

B. National Childhood Vaccine Injury Act (NCVIA)

1. Goals and Intent

Congress enacted the National Childhood Vaccine Injury Act[42] (NCVIA) in 1986 as a response to a vaccine liability crisis that threatened the nation's supply of childhood vaccines. NCVIA established a National Vaccine Injury Compensation Program and is a "mandatory no-fault, non-tort compensation scheme for individuals injured by routinely administered childhood vaccines."[43]

Congress quickly responded to the threat of litigation and loss of industry products in an effort to guarantee the supply of vaccines to the American public.[44]

Just as the September 11th Victim Compensation Fund was enacted as a fund solution for no-fault liability backed by the United States Treasury Department, NCVIA "created a no-fault compensation program for childhood vaccine-injury victims to be funded by an excise tax on each

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> the federal government has awarded those families a separate $250,000 grant.

Id. *See also* Joseph Kelner & Robert S. Kelner, *Victim's Compensation Fund Update; Kenneth Feinberg Interview*, 227 N.Y.L.J. 3, 3 (2002) (discussing the controversial aspects of the collateral source deductions and stating that it is felt by many that simply because a "victim chose to invest in a life insurance policy, as opposed to stocks, bonds or real estate, [this] should not eviscerate a family's proposed award to the point that the fund may not be a viable alternative to litigation.").

40. Kelner & Kelner, *supra* note 39, at 3.

41. O'Brien, *supra* note 30.

42. 42 U.S.C. § 300aa (2000).

43. Mary Beth Neraas, Comment, *The National Childhood Vaccine Injury Act of 1986: A Solution to the Vaccine Liability Crisis?*, 63 WASH. L. REV. 149, 156 (1988).

44. *See id.*

dose of vaccine."[45] The creation of NCVIA resulted in an "expeditious, flexible, and quick alternative to the tort system."[46]

2. Eligibility

In order to create a standardized method of determining who is eligible for compensation under NCVIA, a Vaccine Injury Table was devised to define "exactly which injuries appearing within a given period of time would be compensable."[47] Claimants will be awarded compensation under NCVIA if they are able to demonstrate "by a preponderance of the evidence, that the injured or deceased person received a vaccine set forth in the Vaccine Injury Table."[48]

3. Claims Processing

In order to proceed with a claim under NCVIA, there are no inquiries into the adequacy of the manufacturer warnings.[49] Furthermore, a claimant does not have to establish causation.[50] NCVIA sets forth specific procedures by which compensation for a vaccine-related injury or death may be obtained.[51] First, a claimant must file a petition with the United States District Court either in the jurisdiction where the claimant resides or

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45. Victor E. Schwartz, Mark A. Behrens & Leavy Matthews III, *Federalism and Federal Liability Reform: The United States Constitution Supports Reform*, 36 HARV. J. ON LEGIS. 269, 297 (1999). *See also* Janet Benshoof, *Protecting Consumers, Prodding Companies, and Preventing Conception: Toward a Model Act for No Fault Liability for Contraceptives*, 23 N.Y.U. REV. L. & SOC. CHANGE 403, 415 (1997). In a discussion of funding of the National Childhood Vaccine Injury Act, Benshoof reports that "[f]unding is provided by an excise tax on each dose of vaccine sold by a manufacturer, producer or importer. Only those vaccines listed on the Injury Table are taxed." *Id.* The excise tax levied on each dose of vaccine administered is authorized by 26 U.S.C. §§ 4131-4132 (2000).

46. Benshoof, *supra* note 45, at 413.

47. *Id. See also* 42 U.S.C. § 300aa-14 (2000). The Vaccine Injury Table is a "table of vaccines, the injuries, illnesses, conditions, and deaths resulting from the administration of such vaccines, and the time period in which the first symptom or manifestation of onset or of the significant aggravation of such injuries, disabilities, illnesses, conditions, and deaths is to occur after vaccine administration for purposes of receiving compensation under the Program[.]" *Id.* The full text of the Table of Vaccines is available at 42 U.S.C. § 300aa-14 (2000). *See also* Benshoof, *supra* note 45, at 414 (discussing the Vaccine Injury Table and how it "relieves claimants of the burden of establishing causation.").

48. Neraas, *supra* note 43, at 157.

49. *See* Benshoof, *supra* note 45, at 414.

50. *Id.*

51. *See* 42 U.S.C. § 300aa-11 (2000).

where the injury occurred.[52] The petition for compensation must contain an affidavit and supporting documentation showing that the claimant received one of the vaccines set forth in the Vaccine Injury Table.[53] The court subsequently will award compensation if it is determined that the "injured or deceased person received a vaccine set forth in the Vaccine Injury Table or contracted polio from a person who received an oral polio vaccine."[54] Following the district court's judgment, the claimant must accept or reject the judgment by filing an election with the court. If the petitioner accepts the court's determination and receives compensation under NCVIA, then he or she is prohibited from bringing a subsequent civil action against a vaccine manufacturer.[55]

4. Exclusivity of Remedies

Compensation through NCVIA is not an exclusive remedy. If a claimant chooses to waive an award from the National Childhood Vaccine Compensation Program, the claimant may pursue a civil action on a negligence theory. However, "individuals must fully adjudicate their claims through the compensation program prior to filing any civil claims against manufacturing companies."[56]

5. Compensation

Because the seven most-commonly administered vaccines have been utilized for decades, it was possible to fairly predict the number of injuries that would result. Thus, Congress was able to legislate fair compensation awards for claimants. Moreover, "[d]amages for actual and projected pain and suffering and emotional distress [were] limited to $250,000."[57] Thus, the legislature did not recognize non-economic losses. As a result, the unpredictability of award size was minimized by a cap on damages.[58]

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52. *See id.* § 300aa-11(a)(1).

53. *See id.* § 300aa-11(b)(2)(c).

54. Neraas, *supra* note 43, at 157. *See also* 42 U.S.C. §§ 300aa-11(c)(1)(A)—13(a)(1)(A).

55. *See* 42 U.S.C. § 300aa-21(a).

56. Benshoof, *supra* note 45, at 414. As civil liability remains a threat to vaccine manufacturers they still have an incentive to be cautious and take the necessary steps to prevent injury. "However, to avoid problems of over-deterrence, NCVIA provides that a showing of compliance with the Federal Food, Drug, and Cosmetic Act protects manufacturers from punitive damages." *Id.*

57. *Id.* at 415.

58. *Id.*

At least one commentator has suggested that NCVIA is a superior alternative to the traditional tort recovery system for three reasons:

> First, the Act provides a necessary alternative to the tort recovery system which proved unworkable because of courts' inconsistent and unpredictable application of the duty to warn standard to vaccine manufacturers. Second, the Act provides a fair compensation scheme to injured vaccinees because it requires society as a whole to bear the cost of inevitable vaccine injuries. Third, the Act creates a more stable litigation climate for vaccine manufacturers and thus decreases significantly the threat of severe vaccine shortages.[59]

C. The National Swine Flu Act

1. Goals and Intent

In an effort to encourage manufacturers to produce a vaccine for swine flu, a virus that caused twenty million deaths worldwide, Congress passed the National Swine Flu Immunization Program of 1976 (the "Swine Flu Act").[60] The Swine Flu Act "barred common law tort actions against swine flu vaccine manufacturers and providers and created a Federal Tort Claims Act remedy against the United States as the exclusive means of recovery for swine-flu related injuries."[61]

The Swine Flu Act transferred to the federal government "all liability for injury resulting from swine flu inoculations."[62] The purpose of the Swine Flu Act was to protect vaccine manufacturers from civil liability and to assuage insurance companies that a nationwide immunization program would result in increased liability for manufacturers.

2. Eligibility

A person would be eligible for compensation under the Swine Flu Act if the person experienced "personal injury or death arising out of the administration of swine flu vaccine under the swine flu program and based upon the act or omission of a program participant in the same manner."[63]

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59. Neraas, *supra* note 43, at 158.

60. The National Swine Flu Immunization Program of 1976 was passed as an amendment to the Federal Tort Claims Act. *See* 28 U.S.C. §§ 2671-2680 (2000).

61. Schwartz, *supra* note 45, at 292.

62. Benshoof, *supra* note 45, at 415.

63. *Id.* at 416 (internal citations omitted).

Eligible claims also included suits for injuries related to the development of Guillain-Barre syndrome, other neurological diseases, or allergies.[64]

3. Claims Processing

Under the Swine Flu Act, lawsuits were permitted to be brought on any theory of liability available in the state where the alleged tortuous act occurred. In many federal courts, "liability was conceded if a plaintiff could prove that he or she suffered from Guillain-Barre syndrome as a result of the vaccination."[65] Plaintiffs bringing suit were not required to allege the manufacturer's negligence or breach of duty to warn. However, because there was no provision for a presumption of specific causation "protracted litigation took place in federal courts."[66]

4. Exclusivity of Remedies

The Swine Flu Act provided an exclusive remedy for injured consumers and, as a result, manufacturers were completely shielded from liability for negligence.[67] This absolute protection resulted in extensive criticism of the Swine Flu Act and led many to argue that the primary motivation behind its enactment was to shield manufacturers rather than compensate victims.[68]

5. Compensation

When Congress enacted the Swine Flu Immunization Program in 1976, manufacturers were unsure of the scope of adverse reactions to the vaccine. There appeared to be no cap on available compensation funds. Therefore, Congress appropriated $135 million for the program.[69] The United States Treasury directly distributed the Congressionally appropriated funds.[70]

The National Swine Flu Immunization Program of 1976 was discontinued three months after it was initiated when the swine flu vaccine became linked to Guillain-Barre syndrome.[71] The Swine Flu Act was deemed a failure because in order to be considered compensable, a

64. *Id.*
65. *Id.*
66. *Id.*
67. *Id.*
68. *Id.* at 416-17.
69. *Id.* at 417. By 1985, costs associated with the program had reached almost $100 million. *Id.*
70. *Id.*
71. *Id.* at 415-16.

claimant was required to prove that he or she suffered from Guillain-Barre syndrome. This requirement "led to different standards of liability across the states, which was highly inconsistent with the goal of a national immunization policy."[72]

The proof requirement, coupled with protracted litigation in federal courts, ultimately led to the discontinuation of the Swine Flu Immunization Program.[73]

D. The Price-Anderson Act

1. Goals and Intent

Congress passed the Price-Anderson Act in 1957[74] in an effort to encourage the entry of private industry into the field of nuclear energy while ensuring that "funds would be available to compensate for injuries and damages sustained by the public in the event of a nuclear accident."[75] The Price-Anderson Act "imposes a set of statutory constraints on possible catastrophic tort liability in the event of a nuclear accident, and has essentially established a hybrid system that combines components of both

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72. *Id.* at 416 (internal citations omitted).

73. *See id.* at 416-17. It is indicated that "[c]ritics of the Swine Flu Act argue that its primary goal was to shield the manufacturers of the vaccine from liability, rather than to compensate victims. In the urgency in which the legislation was conceived, the government eliminated many economic safety incentives for manufacturers." *Id. See also* Sebok, *supra* note 26, at 26. In a discussion of the September 11th Victim Compensation Fund and the National Swine Flu Act, Sebok states:

> It is unclear how much in its collective memory Congress recalled of the debacle of the swine flu vaccination program. In 1976, in order to encourage rapid production, Congress took over the potential liability of the manufacturers of the vaccine by requiring anyone injured by a vaccine to sue under the Federal Tort Claims Act, with the right to a jury, using the applicable jurisdiction's tort law. Congress quickly discovered how expensive the tort system can be-associated legal costs ate up almost the entire budget of the program. The memorable lesson is that if one establishes a no-fault scheme, one cannot permit the typical rules of adversarial adjudication to determine damages.

Id.

74. The Price-Anderson Act was enacted on September 2, 1957 as Pub. L. No. 85-256, 71 Stat. 576 (codified at 42 U.S.C. § 2210 (2000) (The Price-Anderson Indemnity Amendments to the Atomic Energy Act of 1954)). The Price-Anderson Act was amended three times in 1965, 1975, and 1988.

75. Benshoof, *supra* note 45, at 417.

tort and no-fault compensation models."[76] The Price-Anderson Act was originally legislated for ten years, but Congress extended and amended this Act several times in 1965, 1975, and 1988. The 1988 Amendments extended the Price-Anderson Act until the year 2002.[77]

The Price-Anderson Act was designed as a protective measure to ensure participation in the field of nuclear energy in a time when the insurance industry was either not able or "willing to provide the necessary coverage to protect new entrants into the atomic energy field."[78]

2. Eligibility

A determination of eligibility under the Price Anderson Act focuses on "whether the nuclear accident giving rise to the claim is an 'extraordinary nuclear occurrence.'"[79] The provisions of the Price Anderson Act will only be applied when the Nuclear Regulatory Commission (NRC) has declared an extraordinary nuclear event.[80]

3. Claims Processing

The Price-Anderson Act provides for a waiver of defenses, which acts as a strict liability system following an "extraordinary nuclear occurrence." Ordinarily, it would be difficult, if not impossible, for a plaintiff to prove negligence following a nuclear accident.[81] The Price-Anderson Act does not permit the assertion of several defenses commonly asserted in tort law: contributory and comparative negligence; charitable and governmental immunities; and any defense based on a statute of limitations shorter than three years.[82]

Plaintiffs have the burden of proving that their "radiation-induced injuries resulted from a nuclear power plant accident."[83] Also, the Price-

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76. Robert L. Rabin, *Some Thoughts on the Efficacy of a Mass Toxics Administrative Compensation Scheme*, 52 MD. L. REV. 951, 955 (1993).

77. Dan L. Burk & Barbara A. Boczar, *Biotechnology and Tort Liability: A Strategic Industry at Risk*, 55 U. PITT. L. REV. 791, 858 (1994).

78. Benshoof, *supra* note 45, at 418.

79. *Id.*

80. *Id.*

81. *Id.*

82. *Id.*

83. *Id.* at 419. *See also* Rabin, *supra* note 76, at 956 (discussing the claims process to be followed under the Price-Anderson Act and the burden imposed upon the claimant to bear the burden of establishing causation as inefficient).

Anderson Act shields individual manufacturers from liability for negligence.[84]

4. Exclusivity of Remedies

Claimants indemnified by the fund established under the Price-Anderson Act are required to waive all of their legal defenses in the event of a substantial nuclear accident.

5. Compensation

The compensation plan established under the Price-Anderson Act is funded through a pooling mechanism in which "each nuclear licensee is required to purchase $160 million in private liability insurance and to contribute a maximum of $10 million yearly (up to a maximum of $63 million) to the compensation fund when there is a nuclear incident at any plant."[85]

The Price-Anderson Act "guarantees a pool of funds of approximately $7 billion."[86] Each civilian nuclear power plant was initially granted sixty million dollars in coverage. Additionally, a $560 million cap was imposed on all liability for nuclear accidents.[87] The Price-Anderson Act did not address claims exceeding the $560 million cap as it was determined that if such an extensive event occurred, Congress would then decide "whether it should act to provide greater public compensation."[88]

The Price-Anderson Act was one of the first legislative responses to perceived deficiencies in the traditional tort system dealing with mass tort liability. In 1978, the Price-Anderson Act withstood a constitutional challenge in *Duke Power Co. v. Carolina Environmental Study Group, Inc.*[89] In order to prevent construction of nuclear power plants, individuals in North and South Carolina, and two organizations, sought a declaration

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84. Benshoof, *supra* note 45, at 419 (discussing the impact of the Price-Anderson Act which "removes the nuclear industry from market risks").

85. *Id.*

86. *Id.* at 420. The Price-Anderson Act "has been criticized for setting a limit on liability, in light of the possibility that $7 billion may not be enough to compensate claimants adequately in the event of an extraordinary nuclear occurrence." *Id. See also* Marcie Rosenthal, Note, *How the Price-Anderson Act Failed the Nuclear Industry*, 15 COLUM. J. ENVTL. L. 121, 123 n.9 (1990).

87. Benshoof, *supra* note 45, at 420. *See also* Burk & Boczar, *supra* note 77, at 858 (discussing issues of compensation addressed under the Price-Anderson Act and its subsequent amendments).

88. Benshoof, *supra* note 45, at 420.

89. 438 U.S. 59 (1978).

that the Price-Anderson Act was unconstitutional.[90] The United States Supreme Court addressed the argument that the Act violated the Due Process Clause because of the $560 million statutory ceiling on liability.[91] The Court held that the provisions of the Price-Anderson Act were constitutional:

> t]he record before us fully supports the need for the imposition of a statutory limit on liability to encourage private industry participation and hence bears a rational relationship to Congress' concern for stimulating the involvement of private enterprise in the production of electric energy through the use of atomic power . . . .[92]

E. The Longshore and Harbor Workers' Compensation Act

1. Goals and Intent

Congress initially enacted the Longshore and Harbor Workers' Compensation Act[93] (LHWCA) in 1927 to provide compensation for the death and disability of any person engaged in maritime employment if the disability or death resulted from an injury incurred upon the navigable waters of the United States. LHWCA is a "federal no-fault compensation scheme for occupational injury and disease claims."[94]

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90. *Id.* at 67.

91. Schwartz, *supra* note 45, at 291. *See also Duke Power*, 438 U.S. at 84.

92. *Duke Power*, 438 U.S. at 84. Plaintiffs also argued that the limitation on liability "failed to provide a satisfactory quid pro quo for the common law rights of recovery that the Act abrogated." Schwartz, *supra* note 45, at 291. The Court, however, cited to earlier decisions that "clearly established" that "a person has no property, no vested interest, in any rule of the common law." *Duke Power,* 438 U.S. at 88 n.32 (quoting Munn v. Illinois, 94 U.S. 113, 134 (1877)). Also, the United States Supreme Court found that "[t]he 'Constitution does not forbid the creation of new rights, or the abolition of old ones recognized by the common law, to attain a permissible legislative object . . . .'" *Id.* (quoting Silver v. Silver, 280 U.S. 117, 122 (1929)).

93. 33 U.S.C. §§ 901-950 (2000). One of the stated purposes of the Longshore and Harbor Workers' Compensation Act was to provide a quid pro quo system in which the employer of longshoremen was protected from suit by his employees in exchange for providing benefits, pursuant to the Longshore Act, to those injured in the course of their work. *See* Taylor v. Bunge Corp., 845 F.2d 1323, 1326 (5th Cir. 1988).

94. Benshoof, *supra* note 45 at 422.

2. Eligibility

LHWCA, as originally enacted, created jurisdictional problems. Congress amended the statute in 1972 to increase benefits and broaden compensation coverage to all persons "engaged in maritime employment," except for the master and crew of any vessel.[95] LHWCA extends eligibility to cover traumatic injuries and occupational diseases, "which often have long latency periods and slowly progressive symptoms."[96]

3. Claims Processing

The 1972 amendments to LHWCA, "eliminated covered workers' use of the un-seaworthiness remedy against vessels while retaining tort remedies for a vessel owner's negligence."[97] Under LHWCA, Congress allowed an injured worker to be compensated without requiring the worker to establish negligence by the employer.[98] Courts have interpreted the LHCWA "as allowing a presumption of causation if the worker proves that she was exposed to an injurious substance, that she has a disease, and that the toxic substance exposure could have caused her disease."[99] If the presumption is established, the "burden shifts to the employer to provide

95. 33 U.S.C. § 902(3) (2000) (amended 1972). In order to be covered under LHWCA, a worker must prove both "status" and "situs" that he or she is a longshore or harbor worker as defined under the act, and that the injury occurred upon the navigable waters of the United States. Robert Force, *Federalism and Uniformity in Maritime Law: Post-Calhoun Remedies for Death and Injury in Maritime Cases: Uniformity, Whither Goest Thou?*, 21 TUL. MAR. L.J. 7, 14 (1996). *See also* Jeffrey W. Peters, Note, *Attempting to Make Sense of LHWCA:* Bienvenu v. Texaco, 24 TUL. MAR. L.J. 929, 930-31 (2000) (discussing the 1972 amendments to LHWCA and the additions of the "situs" and "status" tests).

96. Benshoof, *supra* note 45, at 423. *See also* Lawrence P. Postol, *The Federal Solution to Occupational Disease Claims—The Longshore Act and Proposed Federal Programs*, 21 TORT & INS. L. J. 199, 201-02 (1986).

97. Benshoof, *supra* note 45, at 422. Section 905 of LHWCA was amended by Congress in an effort to simplify the previous liability scheme. 33 U.S.C. § 905(b) (2000) states, "In the event of injury to a person covered under this chapter caused by the negligence of a vessel, then such person, or anyone otherwise entitled to recover damages by reason thereof, may bring an action against such vessel as a third party in accordance with the provisions of section 933 of this title . . . ." This amendment to Section 905 altered the previous LHWCA scheme whereby longshore workers sued the vessel under the strict liability action of un-seaworthiness. *See* Seas Shipping Co. v. Sieracki, 328 U.S. 85 (1946).

98. *See* Frazor T. Edmondson, Note, *Toward a Vessel Owner's Interpretation of Dual Capacity: Why* Fanetti *Should Be Deemed Implicitly Overruled*, 18 DEL. J. CORP. L. 477, 486-88 (1993) (discussing the Longshore and Harbor's Workers Compensation Act).

99. Benshoof, *supra* note 45, at 423.

substantial evidence of lack of causation. If that burden is carried, the court drops the initial presumption and makes a factual determination."[100]

4. Exclusivity of Remedies

The fund established under LHWCA provides an exclusive remedy for occupational injury and disease.[101] The compensation fund is partially financed though annual contributions by operators. The size of these contributions is determined annually and is "fixed in proportion to the number of claims made against each operator during the previous year."[102] Although the fund is an exclusive remedy for claimants, "operators retain a financial incentive to ensure worker safety" as LHWCA "preserves a private tort action if the vessel owner's actions constitute negligence."[103]

5. Compensation

According to LHWCA, the costs of compensation shall be estimated at the beginning of each calendar year along with "the amount of payments required . . . to maintain adequate reserves in the fund."[104] Under LHWCA, an employer must "pay death benefits according to the statutory scheme which include: reasonable funeral expenses (not exceeding $3,000), and spouse and dependent benefits."[105]

LHWCA's fund is the statutory source for monetary compensation for injured longshoremen who sustain injuries during the course of their employment. LHWCA was one of the first workers' compensation funds enacted in the United States. The United States Supreme Court has consistently upheld the constitutionality of this legislation.[106]

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100. *Id.*

101. *Id.*

102. *Id.* at 424. *See also* 33 U.S.C. § 944(c)(2) (2000). Furthermore, an employer is expected to make a contribution of five-thousand dollars to the fund when a worker dies and there is no person entitled to compensation under the statute. *Id.* § 944(c)(1). Additionally, all amounts collected as fines and penalties under LHWCA are paid to the fund. *Id.* § 944(c)(3).

103. Benshoof, *supra* note 45, at 423. A higher incidence of injury leads to greater operating expenses so there is an incentive for operators to take safety precautions to potentially lower the cost of their operations. *Id.*

104. 33 U.S.C. § 944(c)(2) (2000) states: "At the beginning of each calendar year the Secretary shall estimate the probable expenses of the fund during the calendar year and the amount of payments required (and the schedule therefore) to maintain adequate reserves in the fund."

105. Nicolas R. Foster, Yamaha v. Calhoun: *The Supreme Court Allows State Remedies in Certain Wrongful Death Cases in Admiralty*, 26 GA. J. INT'L & COMP. L. 233, 241 (1996).

106. Edmondson, *supra* note 98, at 484 n.26.

F. The Black Lung Benefits Act (Black Lung Disability Trust Fund)

1. Goals and Intent

In 1968, congressional attention focused on the working conditions of underground coal miners, especially as related to pneumoconiosis ("black lung disease").[107] Congress enacted Title IV of the Federal Coal Mine Health and Safety Act of 1969, which is commonly referred to as the Black Lung Benefits Act (BLBA).[108] The stated purpose of the BLBA is to "provide benefits, in cooperation with the states, to coal miners who are totally disabled due to pneumoconiosis and to the surviving dependents of miners whose death was due to such disease[.]"[109]

2. Eligibility

The BLBA allows for present and former coal miners and their surviving dependents, including surviving spouses, orphaned children, totally dependent parents, brothers, and sisters, to file a claim for black lung benefits.[110] Following the Black Lung Benefits Reform Act of 1977, coverage was extended to additional mining industry workers. In addition, Congress expanded the definition of pneumoconiosis.[111] To be eligible for compensation, a claimant is required to prove that the claimant is totally disabled, the disability was caused by pneumoconiosis, and the disability arose out of coal mine employment.[112] The United States Supreme Court has held that "[a]ll three of these conditions of eligibility are presumed if the claimant was engaged in coal mine employment for at least 10 years and if the claimant meets one of four medical requirements[.]"[113]

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107. *See* Burk & Boczar, *supra* note 77, at 855. *See also* Donald T. DeCarlo, *The Federal Black Lung Experience*, 26 HOW. L.J. 1335, 1335 (1983) (discussing congressional recognition of the urgent need to provide more effective means and measures for improving the working conditions in the nation's coal mines following the coal mine explosion in Farmington, West Virginia in 1968 which killed seventy-eight coal miners).

108. Black Lung Benefits Act, 30 U.S.C. §§ 901-962 (2000).

109. *Id.* § 901(a).

110. *Id.* § 922.

111. *See* Black Lung Benefits Reform Act of 1977, Pub. L. No. 95-239, § 2, 92 Stat. 95, 95 (1978) (codified as amended at 30 U.S.C. § 902 (2002)).

112. Mullins Coal Co. v. Dir., Office of Workers' Comp. Programs, 484 U.S. 135, 141 (1987).

113. *Id.* at 141-42. The four medical requirements include:

(1) a chest x-ray establishes the presence of pneumoconiosis;

3. Claims Processing

The Department of Labor handles claims processing under the BLBA.[114] Several statutory presumptions exist to establish entitlement to BLBA benefits which are "rebuttable presumptions" applicable to coal miners employed for at least ten years in the mines: that pneumoconiosis is work related and that death is attributable to pneumoconiosis if the miner dies of a respiratory disease.[115]

Claims filed after January 1, 1974 were to become the responsibility of approved state workers' compensation programs. If the Department of Labor determined that state law was not providing adequate coverage then benefits were to be paid by the responsible coal operator. In the event that no such operator could be identified, the Department of Labor would pay benefits from general revenues.[116]

4. Compensation

The Black Lung Benefits Revenue Act of 1977 imposed an excise tax on coal, and established the Black Lung Disability Trust Fund (BLDTF).[117] By late 1980, the BLDTF "had a deficit of nearly one billion dollars" and in an effort to "revitalize the BLDTF, the Black Lung Benefits Amendments of 1981 doubled the dedicated excise tax on coal."[118] The excise tax increase terminates on January 1, 2014.[119]

> (2) ventilatory studies establish the presence of a respiratory or pulmonary disease—not necessarily pneumoconiosis—of a specified severity;
> (3) blood gas studies demonstrate the presence of an impairment in the transfer of oxygen from the lungs to the blood; or 4) other medical evidence, including the documented opinion of a physician exercising reasonable medical judgment, establishes the presence of a totally disabling respiratory impairment . . . None of the methods requires proof of causation[.]

Id. at 141-43.

114. 30 U.S.C. § 921(a) (2000). The responsibility of claims processing was initially granted to the Social Security Administration but was transferred to the Department of Labor.

115. *Id.* § 921(c)(1)(2).

116. Decarlo, *supra* note 107, at 1339. *See* 30 U.S.C. § 931 (2000).

117. Black Lung Benefits Revenue Act of 1977, Pub. L. No. 95-227, 92 Stat. 11.

118. Burk & Boczar, *supra* note 77, at 856. *See also* Black Lung Benefits Amendments of 1981, Pub. L. No. 97-119, Title II, 95 Stat. 1635 (codified as amended at 26 U.S.C. § 4121 (2000)).

119. *See* 26 U.S.C. § 4121(e)(2) (2000).

The basic monthly benefit for a totally disabled miner or surviving spouse is $445.10 per month which may be increased to a maximum of $890.20 per month for claimants with three or more qualified dependents.[120] Additionally, "[b]enefit payments are reduced by the amount received for pneumoconiosis under state workers' compensation awards and by excess earnings in some cases."[121] However, in *Usery v. Turner Elkhorn Mining Co.*[122] the United States Supreme Court upheld the constitutionality of the BLBA.

Commentators have noted that the BLBA program unraveled as fewer claims were filed and state workers' compensation programs made compensation more readily available.[123] The BLBA also has been criticized because of over inclusive provisions resulting in a huge number of claims, many of which are fraudulent.[124]

G. AIDS Vaccine Compensation Fund (California)

1. Goals and Intent

While the federal government has implemented compensation fund alternatives to mass tort liability, at least one state government has enacted a fund approach as an alternative to tort litigation. In 1986, the California state legislature enacted comprehensive legislation establishing an AIDS Vaccine Victims Compensation Fund (the "AIDS Fund").[125] The establishment of the AIDS Fund was a consequence of the substantial number of Americans diagnosed with Acquired Immune Deficiency Syndrome (AIDS).[126] Both the potential liability facing vaccine

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120. These numbers available at http://www.hrnext.com/content/view.cfm?article_id=343 (last visited Nov. 9, 2002).

121. *Id.*

122. 428 U.S. 1 (1976). Coal mine operators challenged a number of the black lung benefit provisions as unconstitutional arguing that the BLBA violated the Fifth Amendment Due Process Clause by requiring them to compensate former miners who had ceased to work in the industry before the BLBA had been passed. The United States Supreme Court held that Congress was justified in its decision to provide for the retroactive application of liability under BLBA, making it clear that "legislative Acts adjusting the burdens and benefits of economic life come to the Court with a presumption of constitutionality." *Id.* at 15.

123. *See* Allen R. Prunty & Mark E. Solomon, *The Federal Black Lung Program: Its Evolution and Current Issues*, 91 W. VA. L. REV. 665, 735 (1989).

124. Burk & Boczar, *supra* note 77, at 857.

125. CAL. HEALTH & SAFETY CODE § 199.50 (2001).

126. *See* H. William Smith III, Note, *Vaccinating AIDS Vaccine Manufacturers Against Product Liability*, 42 CASE W. RES. L. REV. 207, 207-08 (1992). According to this article,

manufacturers, and the need to stimulate research into the development of an AIDS vaccine, contributed to the creation of the AIDS Fund. One commentator has noted that the AIDS Fund is "this country's first direct response to liability and compensation issues likely to arise in conjunction with development of an AIDS vaccine."[127]

2. Eligibility

A claimant will be deemed eligible for compensation under the AIDS Fund if the claimant is "injured by vaccines made and manufactured in California."[128]

3. Claims Processing

At the same time that the California legislature enacted the AIDS Fund, the legislature created an AIDS Vaccine Injury Compensation Policy Review Task Force.[129] The Task Force consists of fourteen members.[130]

"[a]s of November 1990, more than 150,000 Americans had been diagnosed as having Acquired Immune Deficiency Syndrome (AIDS). The death toll from the disease and related complications is high; more than 94,375 Americans have died as a result. According to one estimate, an additional 1.5 million people may already be infected with HIV." *Id.*

127. *Id.* at 210.

128. Burk & Boczar, *supra* note 77, at 854. Due to the fact that "adverse reactions to new vaccines and the epidemiology of the underlying disease itself will not be well established, it will be difficult to quickly identify and compensate injured victims. For vaccines which fall into this category, a more flexible approach is needed. Specifically, the assumptions upon which compensation is made must continually be evaluated." Smith, *supra* note 126, at 253-54. *See also* CAL. HEALTH & SAFETY CODE § 121270(c)(1)(2)(3) (2001) which states:

> (c) The board shall pay from the fund, contingent entirely upon the availability of moneys as provided in subdivision (o), damages for personal injuries caused by an AIDS vaccine that is sold in or delivered in California, and administered or dispersed in California, and administered or dispersed in California to the injured person except that no payment shall be made for any of the following:
>
> (1) Damages for personal injuries caused by the vaccine to the extent that they are attributable to the comparative negligence of the person making the claim.
>
> (2) Damages for personal injuries in any instance when the manufacturer has been found to be liable for the injuries in a court of law.
>
> (3) Damages for personal injuries due to a vaccination administered during a clinical trial.

Id.

129. *See* Solange E. Ritchie, Comment, *Manufacturers Concerns of Potential Product Liability in the Production, Research and Development of AIDS Vaccines: A Sea of Uncharted Waters*, 20 W. ST. U. L. REV. 661, 689 (1993).

The Task Force recommends the processes and procedures that will govern the AIDS Fund, the method by which manufacturers will pay into the AIDS Fund, and the requirements for a victim to be compensated.[131] Claimants will submit an application for payment for personal injuries to the State Board of Control. The Board will then, within forty-five days, make a determination whether to allow the claim.[132]

Under the AIDS Fund, statutory limits are imposed on "manufacturer liability for injuries caused by negligence or willful misconduct, and statutory exemptions from liability for failure to warn of potential adverse affects."[133]

4. Exclusivity of Remedies

In contrast to other federal fund legislation, claimants under the California AIDS Fund are not required "to avail themselves of a remedy through the compensation scheme before seeking other redress."[134] California's AIDS Fund is not an exclusive remedy and allows plaintiffs to sue vaccine manufacturers at the same time they are seeking redress from the state compensation system.[135] Also, the AIDS Fund is "subrogated to any other claim an injured party is entitled to assert, and the fund may seek indemnity from third parties liable for injuries."[136]

5. Compensation

The AIDS Fund is funded by a ten-dollar surcharge on the sale of an AIDS vaccine.[137] The legislation includes a $550,000 cap on recovery for personal injuries, lost income and pain and suffering.[138]

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130. *Id.*

131. *Id. See also* CAL. HEALTH & SAFETY CODE § 121270(n)(1)-(5).

132. *See* CAL. HEALTH & SAFETY CODE § 121270(e)(1)(A)-(B).

133. Burk & Boczar, *supra* note 77, at 854-55.

134. Ritchie, *supra* note 129, at 689.

135. CAL. HEALTH & SAFETY CODE § 121270(m). This section states:

> This section is not intended to affect the right of any individual to pursue claims against the fund and lawsuits against manufacturers concurrently, except that the fund shall be entitled to a lien on the judgment, award, or settlement in the amount of any payments made to the injured party by the fund.

Id.

136. Burk & Boczar, *supra* note 77, at 854. *See also* CAL HEALTH & SAFETY CODE § 121270(k).

137. CAL. HEALTH & SAFETY CODE § 121270(o).

138. Burk & Boczar, *supra* note 77, at 854. *See also* CAL. HEALTH & SAFETY CODE § 121270(b)(3).

H. The Agent Orange Fund (Agent Orange Veterans' Payment Program)

1. Goals and Intent

Agent Orange, an herbicide containing small amounts of dioxin, was used as a defoliant by United States forces in Vietnam.[139] The Agent Orange litigation arose when Vietnam veterans claimed that, as a result of their exposure to Agent Orange they suffered various injuries, including disability and death of veterans and birth defects in their children. Vietnam veterans and their families brought a class action suit against seven chemical companies and settlement was reached on May 7, 1984.[140]

The Agent Orange Fund was the vehicle through which the settlement was implemented and was established by court order.[141] The Agent Orange Fund is managed by investment managers and incorporates a payment program to distribute cash payments to eligible veterans and families of deceased veterans who were exposed to Agent Orange during the Vietnam War.

2. Eligibility

The payment program established under the Agent Orange Fund does not involve establishment of the normal tort elements: causation, fault, and proof of damages.[142] In order to be deemed eligible, Vietnam veterans and families[143] of deceased veterans must demonstrate that the veteran was exposed to Agent Orange in or near Vietnam at any time from 1961 through 1971, suffers from a long-term total disability or has died, and that

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139. *See* Harvey P. Berman, *The Agent Orange Veteran Payment Program*, 53 LAW & CONTEMP. PROBS. 49 (1990). Six hundred cases filed on behalf of Vietnam veterans and their wives and children were transferred to the United States District Court for the Eastern District of New York. The cases were assigned to Chief Judge Jack Weinstein and are collectively known as *In re Agent Orange Product Liability Litigation*. *Id.* at 49-50.

140. *Id.* at 49. Agent Orange claims were settled through a class action settlement in 1984, but subsequently were approved by appellate courts in 1987. *Id.* at 51.

141. Judge Jack Weinstein of the United States District Court for the Eastern District of New York appointed Kenneth R. Feinberg as special master to develop a plan for the distribution of the settlement money in the Agent Orange Fund. *Id.* at 50-51.

142. *Id.* at 54.

143. The term "family" has been determined by the court to include eligible survivors, the veteran's parents, adult children, and siblings if there is no spouse or child. *See id.* at 55.

injuries arose principally from causes other than trauma, accident, or self-inflicted injury.[144]

3. Claims Processing

Eligible claimants to the Agent Orange Fund must submit an application to the claims administrator, Aetna Technical Services, Inc.[145] After the claims administrator "acknowledges completed applications, reviews them for completeness, and requests additional information as necessary,"[146] the administrator then determines whether the claimant meets the three eligibility requirements and notifies the claimant of denial or approval of the application.

4. Exclusivity of Remedies

The Claims Administration Agreement specifies that "disputes between the parties are to be submitted to binding arbitration if they cannot be resolved by negotiation."[147] In addition, such proceedings become subject to the jurisdiction of the United States District Court for the Eastern District of New York.[148]

5. Compensation

The total amount of compensation available to claimants is dependent upon the "total number of disabled or deceased veterans for whom claims

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144. *Id.* at 54. A more complete discussion of the three eligibility requirements is also available in the Berman article. Berman, *supra* note 139.

145. The Claims Administration Agreement "governs the relationship between the Fund and Aetna and, among other things, describes the duties and responsibilities of the claims administrator." *Id.* at 52. According to the Claims Administration Agreement, the duties of the claim administrator include:

> Document development, maintenance of veteran mailing lists and of the claim-file database, veteran information services, liaison with other consultants, claim processing (including application of eligibility criteria and adherence to performance standards), banking services, reports, quality control and audit of claims administration services, testing and staff training, and actuarial services involving analysis of claims experience.

Id. at 52-53. The form to be submitted is reproduced in *In re Agent Orange Product Liability Litigation*, 689 F.Supp. 1250, 1287-1318 App. B (E.D.N.Y. 1988) (approving the appointment of Aetna Technical Services, Inc. as claims administrator and reproducing the terms of the agreement).

146. Berman, *supra* note 139, at 56.

147. *Id.* at 53.

148. *Id.*

are submitted, and the number of claimants meeting exposure and other eligibility requirements."[149] Once the administrator establishes eligibility, compensation awards are payable in yearly installments depending on the veteran's age and the duration of the disability.[150] Payments from the fund may be increased if the fund's earnings are higher than projected and the number of claims is lower than expected.[151]

The Agent Orange Fund was not a legislatively enacted fund. Critics have argued that the Agent Orange Fund:

> compromised every goal of the tort system: the overall award bore no discernible relationship to the injury claims of the victim class; the claimants, on the whole, appear to have been strongly alienated by the litigation process; the administrative costs and delay in resolving the controversy were enormous, even by comparison to other categories of tort litigation—which are widely criticized on the same grounds; and the final award cannot be regarded as satisfying any conceivable definition of optimal deterrence.[152]

CONCLUSION

The Victim Compensation Fund will continue to be the source of enduring controversy. Arguments surrounding the Fund, however, deserve some contextual perspective. The Fund is not as novel an approach as its critics would suggest. The Victim Compensation Fund is one of several governmentally enacted fund solutions that Congress has enacted in the past four decades.

The Victim Compensation Fund shares many common attributes with these other funds. It was enacted to help preserve an industry deemed vital to national interests and the national economy. It provides for an election of remedies to the exclusion of other remedies. It offers fixed compensation values based on established demographic charts, grids, or

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149. *Id.* at 56.

150. *Id.* at 57.

151. *See id.* It was expected that adjustments with regards to the payments would be made periodically throughout the life of the program "based upon claim incidence in the first year, changes in projected investment earnings, and other relevant factors. The objective of such adjustments, of course, is to provide for the maximum payout possible while maintaining funds to support payments over the life of the program." *Id.*

152. Rabin, *supra* note 76, at 952-53 (citing Robert L. Rabin, *Tort System on Trial: The Burden of Mass Toxics Litigation*, 98 YALE L. J. 813, 817-22 (1989)).

statistics. It limits defenses and defendants' liability. Initially, it capped awards. It limits exemplary damages. It involves a claims processing mechanism with provisions for hearings and reviews.

All these characteristics are common to other fund approaches that Congress has enacted in the past. Rather then being novel, the Victim Compensation Fund has many overlapping or common features with these funds.

Will the Victim Compensation Fund be a model for future mass tort resolution? Each of these funds share common characteristics, but each is unique in its own features. This is also true for the Victim Compensation Fund. It is *sui generis*, created to respond to specific events. But as a generic fund-approach, it aligns with these other fund solutions to provide a possible model for resolving mass disaster claims.

THE SEPTEMBER 11TH VICTIM COMPENSATION FUND: PAST OR PROLOGUE?

*Larry S. Stewart, Daniel L. Cohen & Karen L. Marangi**

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INTRODUCTION

September 11, 2001, began as a clear, sunny day on the eastern seaboard of the United States. By 8:00 a.m., millions of people were already well into their daily routines. In New York City, there was a city election and many paused on the way to work to cast ballots—acts that would save countless lives. In the World Trade Center Towers, thousands were already at work. At Windows On The World, the stunning restaurant atop the north Tower, breakfast meetings were winding down.[1] And, nineteen terrorists were in the process of unleashing attacks that would slaughter thousands of innocent people and change history.

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1. Jim Dwyer, et al., *102 Minutes: Last Words at the Trade Center; Fighting to Live as the Towers Died*, N.Y. TIMES, May 26, 2002, at 1.

The first attack occurred at 8:45 a.m., as American Airlines flight 11 slammed into the north tower of the World Trade Center. As a stunned nation watched on live television, the attacks unfolded and the death and destruction mounted. At 9:03 a.m., a second plane, United Airlines flight 175, crashed into the south tower of the World Trade Center. A short while later, at 9:40 a.m., the Federal Aviation Authority closed American airspace and ordered all planes aloft to immediately land. The events were, however, already out of control. Three minutes later, at 9:43 a.m. American Airlines flight 77 crashed into the Pentagon near Washington, D.C.

At 10:05 a.m., the death and destruction mounted to staggering proportions as the south tower of the World Trade Center collapsed. Five minutes later a portion of the Pentagon collapsed and United Airlines flight 93 crashed near Shanksville, Pennsylvania. And, at 10:28 a.m., the north tower of the World Trade Center collapsed. Across the nation buildings and airports were evacuated, states of emergency were declared and armed forces were ordered into action.

At 8:30 p.m., President Bush addressed a stunned nation saying "thousands of lives were suddenly ended by evil" and asked the nation for prayers for the families and friends of the victims.[2] The reaction was immediate and overwhelming. Blood banks across America were swamped with donors. Americans opened their hearts and wallets in an outpouring of grief and sympathy that was unprecedented. Hundreds of millions of dollars were contributed to help the victims and victims' families.[3]

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2. A full description of events can be found in *September 11: Chronology of Terror*, Sept. 12, 2001, *at* http://www.cnn.com/2001/US/09/11/chronology.attack/index.html (last visited Nov. 9, 2002). The magnitude of these attacks was unprecedented. It was initially believed that over 6,000 people were killed, thousands more were injured and property damage was expected to exceed $100 billion dollars. Shankar Vendantam, *Discourse Does Not Match Falling Sept. 11 Death Toll*, WASH. POST, Nov. 22, 2001, at A18. The official death toll has now been fixed at 2,823 and injuries are estimated to be less than 500. Peter Freundlich, *What Counts; The Death Toll Is Far Less Than Feared: Can we Accept That?*, WASH. POST, Dec. 16, 2001, at B1. *See also, N.Y. Official: 800 Victims of 9/11 Will Not Be ID'd*, WASH. POST, July 14, 2002, at A12.

3. The Red Cross alone collected approximately $500 million in just seven weeks. Jacqueline L. Salmon, *Red Cross Stops Seeking Donations to September 11th Fund*, WASH. POST, Oct. 31, 2001, at A20. Citizens across the globe, from London to Moscow to South Africa, were saying prayers, holding vigils and otherwise remembering the victims. Kevin Sullivan, *War Supports Ebbs Worldwide; Sept. 11 Doesn't Justify Bombing, Many Say*, WASH. POST, Nov. 7, 2001, at A1.

The impact of the terrorist attacks continued in the days following September 11th. As American airspace remained closed, it quickly became apparent that the American aviation industry would soon collapse with a cascading effect on the economy and the nation. Within eleven days of the attacks, the United States Congress passed unprecedented legislation to bail out the aviation industry and establish a federally-funded "September 11th Victim Compensation Fund."[4]

The Victim Compensation Fund was the first federal entitlement program in over twenty-five years. It was an unprecedented action: in the speed of its enactment, in its provisions, and in the benefits it will provide to the victims. Some have questioned whether this Act will serve as a model for future compensation plans or even "tort reform" legislation. This article examines how this law came to be in just eleven days. It details additional responses of Congress, the Department of Justice and state governments, some of which are contrary to all political norms. And it compares this legislation to other federal compensation programs and efforts to limit liability, concluding that each of these programs was born out of unique events and political forces. Finally, this article concludes that in all probability, the Victim Compensation Fund will not be a prototype for compensation systems developed in response to other mass disasters, nor will it serve as a model to "reform" the American civil justice system.

I. CREATION OF THE VICTIM COMPENSATION FUND

September 11th was not the first terrorist attack on Americans. There had been others including the 1993 bombing of the World Trade Center, the 1995 Oklahoma City bombing, the 1996 attack on the Khobar Towers complex in Saudi Arabia, the 1998 bombings of the United States' embassies in Kenya and Tanzania and the attack on the USS Cole in 2000. As grievous and as shocking as each was, none prompted any attempt to enact victim compensation programs. Yet, in just eleven days after September 11th, Congress passed and the President signed into law a compensation plan that will deliver as much as $6 billion to the victims and victims' families.

To understand the reasons why this unprecedented law was enacted, one has to examine the events of those eleven historic days. It was a time of unparalleled national shock, outrage and grief. There was an overriding

4. This Fund was established as part of the Air Transportation Safety and System Stabilization Act, Pub. L. No. 107-42, 115 Stat. 230 (2001) (codified at 49 U.S.C. § 40101 note) (hereinafter ATSSSA).

national sense that these attacks would not be allowed to change America or its way of life.[5] In New York City, a massive search and rescue effort was launched as thousands of volunteers and firefighters stormed the rubble pile of the World Trade Center seeking to find survivors. Similar efforts were underway at the Pentagon. Thousands of family members roamed New York and the Pentagon searching for missing loved ones. Pictures were posted at impromptu memorials, and each story was more devastating that the one before. All national and local networks and other media switched to round-the-clock coverage of the attacks and their aftermath.[6]

At the same time, the attacks and the shutting of United States airspace crippled the airline industry and it hovered on the verge of collapse. Prior to September 11th, the airline industry was already reeling from the economic decline caused by the implosion of the technology industry. Several United States air carriers, such as US Airways and America West, were on the verge of bankruptcy. And, US Airways' effort to merge operations with United Airlines, in an attempt to stay afloat, had fallen through only a month earlier.[7]

The terrorist attacks brought the airline industry to the brink of financial disaster. United States airspace was closed for two and a half days. Reagan Washington National Airport, which is located only five miles from the White House and the United States Capitol, was closed indefinitely and there were strong rumors that it might never re-open.[8] As fighter jets flew over the major cities across the United States, numerous businesses and families decided to delay or cancel upcoming travel by air.[9]

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5. *President Says Terrorists Won't Change American Way of Life: Remarks by the President in Photo Opportunity With Members of Congress*, Oct. 23, 2001, *at* http://www.whitehouse.gov/news/releases/2001/10/print/20011023-33.html (last visited Nov. 9, 2002).

6. Round-the-clock coverage continued for many days and was followed by extensive special newscasts and other frequent reports. By any standard, the September 11th attacks were, and continue to be, the most publicized events in history.

7. Laurence Zuckerman, *After the Attacks: Financial Struggles; Airlines, in Search of Relief, Warn of Bankruptcy*, N.Y. TIMES, Sept. 15, 2001, at A1.

8. Craig Timberg & Lyndsey Layton, *Officials Push to Reopen National; Travelers Expected to Face Extensive Security Precautions*, WASH. POST, Sept. 15, 2001, at A16.

9. Susan Levine & Sabrina Jones, *Families Revisiting Travel Traditions; Most Decide Against Skipping The Trip, but Fewer are Flying for Thanksgiving Get-Togethers*, WASH. POST, Nov. 16, 2001, at B1.

Airline industry losses were reported to be $1 billion and growing.[10] Airline employee cuts of twenty percent or more, as well as bankruptcy, were imminent.[11] Airline insurance and lines of credit were also in jeopardy.[12] The airlines immediately began lobbying Congress for financial help and protection from potential liability claims.[13]

While the airline industry was beginning its efforts to obtain government protection, the leadership of the Association of Trial Lawyers of America (ATLA) was meeting to address the plight of the victims. It decided that comforting the victims and victim families and supporting national unity must take precedence over any litigation.[14] As a result, on Thursday morning, September 13th, just two days after the attacks, ATLA issued a first-ever call for a moratorium on all lawsuits.[15]

Against this backdrop, a financial bailout package for the airline industry was first proposed on Friday, September 14th. This package would have provided the airlines with $2.5 billion in cash, up to $12.5 billion in loans or loan guarantees, and delayed airline payments to the United States government for at least six months.[16] Representatives Don Young and Jim Oberstar sought to bring the proposal to the House for a vote, but a group of members blocked the proposal.[17] Members from New York, who had just returned from a visit to Ground Zero with President Bush, were particularly concerned that this bailout plan might divert funds needed to assist in the New York City recovery.[18] Other Members were

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10. Edmund Sanders, *Federal Board may Decide Which Airlines will Survive*, L.A. TIMES, Oct. 6, 2001, at 1.

11. Scott McCartney, Susan Carey & Greg Hitt, *Mayday Call: U.S. Airline Industry Faces Cash Crunch, Pleads for a Bailout*, WALL ST. J., Sept. 17, 2001, at A1.

12. Lizette Alvarez, *A Nation Challenged: The Airlines: Rescue Plan Advances; House to act Today*, N.Y. TIMES, Sept. 21, 2001, at C7.

13. Zuckerman, *supra* note 7. *See also* Mike Dorning, *Airlines Seek Shield From Damage Claims*, CHI. TRIB., Sept. 15, 2001 ("There's a pretty strong [lobbying] effort going on," according to Senator Hollings' spokesman.).

14. Kathleen Burge, *Facing Terror/Next Moves/Lawsuits; Grieving Family Retains a Lawyer*, BOSTON GLOBE, Sept. 14, 2001, at A32.

15. *Trial Lawyers Ask for Moratorium*, DAILY JOURNAL, Sept. 14, 2001; Mike Dorning, *Airlines Seek Shield from Damage Claims*, CHI. TRIB., Sept. 15, 2001, at 1.

16. McCartney, *supra* note 11.

17. Rob Hotakainen & Sarah McKenzie, *House Rejects Oberstar Plan to Aid Airlines; His House Committee Sent a $15 Billion Package to Shore up the Industry*, STAR TRIB., Sept. 15, 2001, at A27.

18. McCartney, *supra* note 11.

also worried this proposal might open the floodgates to a myriad of other claims; and therefore, the proposal went nowhere.[19]

The political environment was highly charged. In New York City, the massive effort to find and rescue victims was going on around-the-clock with constant media coverage. The nation was also rallying to support the victims in unprecedented ways. The trial lawyers had called for a moratorium on lawsuits; and, at the same time, the airlines were seeking to shield themselves from liability.

By Monday, September 17th, the airline industry's economic situation worsened. Stock values were falling fast—down an average of forty percent and the drumbeat became louder in support of financial assistance for the airlines.[20] The airlines renewed their requests, now seeking $24 billion in federal assistance. At the same time, the airlines began to implement job cuts.[21] The danger of a cascading impact on the entire United States economy increased as a growing list of industries sought financial assistance from Congress.[22]

The White House announced that President Bush had ordered his advisors to "develop specific proposals for propping up the airline industry;"[23] and, on the evening of September 19th, President Bush proposed a financial package of $5 billion in cash payments to the airlines and protection for the airlines from liability claims beyond their insurance coverage.[24] In addition, for the first time in United States history, the federal government agreed to cover any claims beyond the value of the airlines' insurance policies.[25]

That same day, Leo Boyle, then President of ATLA, met with Representative Richard Gephardt, then the House Minority Leader, and his

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19. *Id.*

20. Shailagh Murray & John D. McKinnon, *Push for More Federal Funds Gains Steam—Daschle Says $40 Billion is Just a 'Down Payment': Wary of 'Feeding Frenzy'*, WALL ST. J., Sept. 17, 2001, at A3. *See also* Zuckerman, *supra* note 7.

21. US Airways announced it was laying off 11,000 of its 46,000 employees and cutting back on its routes, mainly due to the ongoing closure of Reagan National Airport. Frank Swoboda & Keith L. Alexander, *US Airways Cuts Jobs; Bush Pledges Aid for Ailing Industry*, WASH. POST, Sept. 18, 2001, at A1.

22. John D. McKinnon, *Airlines Aren't the Only Ones Seeking Aid*, WALL ST. J., Sept. 20, 2001, at A3.

23. Swoboda & Alexander, *supra* note 21.

24. Lizette Alvarez & Laura M. Holson, *A Nation Challenged: The Airlines: White House to Seek $5 Billion as Part of Airline Rescue Plan*, N.Y. TIMES, Sept. 20, 2001, at C1.

25. *Id. See also* Greg Schneider et al., *Airline Aid Plan Gains; Layoffs Near 86,000*, WASH. POST, Sept. 20, 2001, at A1.

staff to discuss the various proposals being considered to assist the airline industry.[26] ATLA was particularly concerned about efforts to restrict or eliminate the rights of victims or victims' families. It was becoming increasingly clear that litigation could result in bankruptcy, not only for the airline industry, but also for all potential defendants.[27] Victims and victims' families could be relegated to fighting over assets that would be woefully inadequate to compensate them for their losses. Given the high degree of certainty that some financial protection would be provided to at least the airline industry, ATLA urged Congressional leaders to "not leave the victims behind."[28] To accomplish that goal, ATLA began exploring alternative ways to compensate the victims and consulted with Senator Tom Daschle, then the Majority Leader in the Senate, Senator Patrick Leahy, then Chairman of the Senate Judiciary Committee, and Representative Richard Gephardt and their staffs.[29]

Meanwhile, the White House proposal was not considered sufficient by Congress.[30] By Wednesday, September 19th, ATLA had developed an alternative draft proposal for a victim compensation fund to be administered by a new Article I "Compensation Court" to be headquartered at the District Court for the Southern District of New York. Under this proposal, claimants would not have had to prove causation or negligence and would have been entitled to receive broad based compensation for both economic and non-economic losses.[31]

On Thursday, September 20th, forty Senators traveled to New York City to visit "Ground Zero." It was an emotionally trying experience for most.[32] Clearly, this tour helped solidify bipartisan support for a victim assistance program. At the same time, the pace of legislative activity increased as the ATLA draft proposal was revised and converted into draft legislation for a victim compensation fund. Normal legislative processes,

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26. Alvarez & Holson, *supra* note 24.

27. Joseph Treaster, *After the Attacks: The Liability; Airlines Seek to Limit Lawsuits Over Attacks*, N.Y. TIMES, Sept. 14, 2001, at A19.

28. Julie Kosterlitz, *Who Counts?*, NAT'L J., May 4, 2002, at 1296.

29. Gerard Baker, *Matters Best Kept Out of Court: The Spirit of Restraint is Evident Among American Lawyers. Will it Last?*, FIN. TIMES (London), Sept. 27, 2001. *See also* Carrie Johnson, *Lawyers May Bypass Victim Fund: Some Consider Filing Suits Over Attacks*, WASH. POST. Sept. 26, 2001, at E1.

30. Alvarez & Holson, *supra* note 24.

31. *See* ATLA Draft Proposal, Sept. 19, 2001 (on file with the authors).

32. Alvarez, *supra* note 12. As Senator Daschle was quoted as saying, "It is one thing to see it on television, to hear about it on the radio and watch it as we have from day to day. It's another thing altogether to be here, to experience the loss." *Id.*

such as Committee review, hearings and "mark-ups" were bypassed. Instead, the House and Senate leaders met with White House staff on Thursday evening and into the early hours of Friday morning, to craft the final version of the legislation.[33]

When Congress convened on Friday, September 21st, companion bills were quickly introduced in both the House and Senate. The legislation contained $5 billion in cash payments for the airlines, $10 billion in a loan guarantee program and a compensation fund for the victims.[34] The bill was passed first by the Senate by a vote of ninety-six to one.[35] The Senate version included a unanimous consent agreement, which allowed the House bill to be automatically deemed passed by the Senate if it was identical to the Senate bill.[36] At 11:00 p.m., the House passed its identical bill.[37] The Senate's unanimous consent agreement allowed the bill to be sent to the President immediately without the need for a Conference Committee. The President signed the bill the following day.[38] Thus, in just eleven days, as America struggled to come to grips with the staggering dimensions of the terrorist attacks and its leaders were preparing to launch a war on terrorism, Congress passed an unprecedented program to financially rescue the victims of the attacks.

II. KEY PROVISIONS OF THE FUND

The Victim Compensation Fund is a hybrid program, which allows September 11th victims to pursue a claim either through the Fund or to sue in court. As part of the economic rescue of the airlines, airline liability was capped at the limits of their insurance coverage.[39] To financially rescue the victims, the Fund provides an alternative means of compensation so the victims would not be left with only a limited remedy due to the limitation

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33. Kosterlitz, *supra* note 28, at 1298-99.

34. In recognition of this historic legislation and the enormity of the national tragedy, ATLA pledged to provide free legal services to the September 11th victims to represent them in claims in the fund. CONG. REC., Sept. 21, 2001, at S9600; CONG. REC., September 19, 2001, at H5911. In October, ATLA created Trial Lawyers Care, Inc. which undertook to make free legal care available to all victims. *See* Diana B. Henriques, *Lawyers Offer Free Advice in Tapping Federal Fund*, N.Y. TIMES, Oct. 15, 2001 at B11.

35. Roll Call Vote No. 284, 107th Congress, 1st Session (2001). CONG. REC. H9604-5 (daily ed. September 21, 2001).

36. CONG. REC. S9604 (daily ed. September 21, 2002).

37. Roll Call Vote No. 348, 107th Congress, 1st Session (2001). Cong. Rec. H5918 (daily ed. Sept. 21, 2001).

38. H.R. 2926 became Pub. Law No. 107-42 on September 22, 2001.

39. ATSSSA § 408(a).

of the airlines' liability. The Fund covers all the victims on the planes, in the affected buildings and those in the immediate vicinity of the crashes. Rescuer victims who were injured during attempts to find survivors in the days following the crashes are also covered.[40] While eligible victims and victims' families have the choice of pursuing a lawsuit or filing a claim with the Fund, they cannot pursue both courses. To file a claim through the Victim Compensation Fund, pending lawsuits must be dismissed and filing a claim in the Fund waives the right to file a lawsuit.[41]

The Act creates an exclusive federal remedy for all litigation arising from the terrorist attacks; and it requires all such cases be filed in the United States District Court for the Southern District of New York.[42] The substantive law for such cases was set as the law of the state in which the crash occurred, including the choice of law principles of that state.[43] Thus, the judges of the Southern District of New York are faced with the potential prospect of hundreds, or even thousands, of cases which would have to be decided under the liability and damage laws of at least three different jurisdictions and, depending on the resolution of choice of law issues, perhaps many other jurisdictions.

On November 18, 2001, amendments to the Act were signed into law to extend the liability insurance limitations to the aircraft manufacturers, the airport owners and operators, and the owner and/or lessee of the World Trade Center.[44] Those amendments also limited the liability of New York City to the greater of its liability insurance or $350 million.[45] Given these limitations, the Chief Judge of the Southern District of New York was sufficiently concerned about the difficulties of litigation that on April 10, 2002, he took the highly unusual step of imposing a requirement that any plaintiffs who file terrorist-related lawsuits would have to acknowledge in writing that they understand the risks of litigation and what they are giving up by electing not to file a claim with the Victim Compensation Fund.[46]

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40. *Id.* § 405(c).

41. *Id.* § 405(c)(3)(B). There are two exceptions to the exclusivity requirements. Notwithstanding the filing of a claim in the Fund, lawsuits can be brought to recover collateral source obligations, and against any person who was a knowing participant in any conspiracy to hijack any aircraft or commit any terrorist act. *Id.* § 408(c).

42. *Id.* § 408(b).

43. *Id.* § 408(b).

44. The airlines' liability is capped at the limits of their liability insurance. That limit includes any claims for punitive damages. ATSSSA § 408(a).

45. Aviation and Transportation Security Act, Pub. L. No. 107-71 § 201(b)(2).

46. Milo Geyelin, *Judge Wants Victims of Sept. 11 Who Sue to Know Risks of Action*, WALL ST. J., Apr. 11, 2002, at B2.

Unlike with litigation, claims filed in the Victim Compensation Fund are certain and expeditious. There is no need to prove liability, awards are required to be made within 120 days of claim completion, and payment is due twenty days after an award is made.[47] Claimants are entitled to a hearing, at which they have a right to be represented by an attorney and present witnesses and evidence.[48] The definitions of economic and non-economic loss are broad and encompassing.[49]

There are also no limitations or "caps" on the amounts of the awards, either individually or in the aggregate,[50] and awards are obligations of the United States government.[51] Thus, Congress has no control or influence over the Fund because its funding is not dependent upon or subject to the appropriations process. Awards are, however, required to be reduced by all collateral sources, received or to be received, including life insurance.[52]

The entire claims process was placed under the authority and control of a Special Master appointed by the Attorney General of the United States.[53] The Special Master is charged with the responsibility of administering the program, promulgating rules for its administration, and deciding claims.[54] Most significantly, the decisions of the Special Master are deemed final and are not subject to judicial review.[55]

III. POST ACT DEVELOPMENTS

The "September 11th Victim Compensation Fund of 2001" legislation provided a basic framework for the Victim Compensation Fund, but much remained to be added by implementing regulations. Congress was also not finished in dealing with this national tragedy.

The Act required that implementing regulations be promulgated by December 21, 2002,[56] and the regulation drafting process began immediately, even before the appointment of the Special Master. On

47. ATSSSA § 405.
48. *Id.* § 405(b)(4).
49. *Id.* § 402(5) and (7).
50. The Special Master has estimated that the average award will be $1.85 million. Kosterlitz, *supra* note 28, at 1300. If the families of nearly 3,000 death victims were to file claims, based on that estimate, the total payout from the fund would be $5.55 billion.
51. ATSSSA § 406(b).
52. *Id.* § 402(4); §405(B)(6).
53. *Id.* § 404(a).
54. *Id.* § 404(a)(1)(2)(3).
55. *Id.* § 405(b)(3).
56. *Id.* § 407.

November 5, 2001, the Department of Justice formally requested public input on a number of issues.[57] Over 800 comments were received from individuals, organizations, members of Congress and elected leaders of various state governments.[58]

On November 26, 2001, the Attorney General appointed Kenneth R. Feinberg as the Special Master.[59] And, on December 21, 2001, the Department of Justice published an interim final rule and provided a thirty-day period for public comment.[60] Hundreds more comments were received and on March 7, 2002, the Final Regulations—consisting of a series of amendments to the interim rule—were issued. Claim forms for death claims were published on March 11, 2002, and for personal injury claims on March 25, 2002.[61]

The regulation drafting process was not without controversy. Some advocated that compensation should closely follow the corrective justice model of the tort system, whereby compensation is based on the harm suffered by each individual. Others wanted all victims compensated by a distributive justice model without regard to means or needs, similar to what is done in some government assistance programs. Political agendas concerned with the role of government and so-called "family value" issues were also injected into the process. When surviving family members expressed perceived unfairnesses, others accused them of being greedy—a charge categorically rejected by the Special Master.[62]

In the end, the regulations represented many compromises. Awards are to be determined according to a "Presumed Loss Methodology," which allows consideration of individual circumstances for economic loss but assigns a set amount to non-economic loss.[63] The methodology for economic loss is detailed in an Explanation and a series of tables and

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57. 66 Fed. Reg. 55901 (Nov. 5, 2001) (codified at 28 C.F.R pt. 104 (2002)).

58. *See* September 11th Victim Compensation Fund, Final Rule, CIV 104F, AG Order No. 2584-2002, 67 Fed. Reg. 11233, 11235 (March 13, 2002) (codified at 28 C.F.R. § 104 (2002).

59. September 11th Victim Compensation Fund, Final Rule, CIV 104F, AG Order No. 2584-2002, 67 Fed. Reg. 11233, 11235 (March 13, 2002) (codified at 28 C.F.R. § 104 (2002).

60. September 11th Victim Compensation Fund, Final Rule, CIV 104F, AG Order No. 2584-2002, 67 Fed. Reg. 11233 (March 13, 2002) (codified at 28 C.F.R. § 104 (2002).

61. *September 11th Victim Compensation Fund of 2001 Forms, available at* http://www.usdoj.gov/victimcompensation/forms.html (last visited Nov. 9, 2002).

62. *See* Final Rule, AG Order No. 2584-2002, 67 Fed. Reg. at 11234-35.

63. 28 C.F.R. §§ 104.43 – 104.46 (2002).

charts.[64] While these provisions are regimented, there is an "extraordinary circumstances" exception to allow modification if the Special Master determines that it is warranted in a particular case.[65]

In addition, the regulations are largely silent on the status and rights of domestic partners and fiancés. These claims await clarification in the claims process, as is the case with a host of other specialized situations such as the particularized emotional trauma of certain survivors and the treatment of family members with special needs.[66] Nonetheless, the amendments made by the final regulations will have the overall effect of increasing the size of the individual awards.[67]

While the regulation drafting process was underway, Congress undertook other action to help the victims by enacting the "Victims of Terrorism Tax Relief Act of 2001," which was signed into law on January 23, 2002. This provision provides broad tax relief, including the forgiveness of all federal income tax liability for the years 2000 and 2001, relaxation of estate tax rates and requirements, and provisions which make it clear that charitable payments to victims and victims' families are tax free.[68] It also clarifies that the Victim Compensation Fund awards are not to be taxed.

On May 9, 2002, the New York legislature also passed significant legislation to help the victims. Its bill, the "September 11th Victims and Families Relief Act,"[69] addressed a number of issues. It eliminated any worker compensation liens on Fund awards and protected future worker

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64. The Special Master has also issued special Explanations for certain classes of victims, principally firefighters, police officers, and members of the military. *See* Explanation of Economic Loss Calculations for FDNY or NYPD Victims, Revised May 15, 2002, *at* http://www.usdoj.gov/victimcompensation/fdny_nypd.pdf. *See also* Explanation of Economic Loss Calculations for Military Victims, May 6, 2002, *at* http://www.usdoj.gov/victimcompensation/military.pdf (last visited Nov. 9, 2002).

65. 28 C.F.R. §§ 104.31(b)(2)-104.33(f)(2) (2002).

66. *See* Ray Delgado, *Legal Affairs, Gay Rights After Sept. 11; Grieving man Stakes his Claim to Equality; Novato Resident who Lost Partner Struggles for Official Recognition,* SAN FRAN. CHRON., April 21, 2002, at A3; Erica Goode, *Program to Cover Psychiatric Help for 9/11 Families*, N.Y. TIMES, Aug. 21, 2002, at A1; Jane Gross, *U.S. Fund for Tower Victims will aid Some gay Partners*, N.Y. TIMES, May 30, 2002, at A1.

67. *See* Final Rule, AG Order No. 2584-2002, 67 Fed. Reg. at 11233-4.

68. *See* Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, §§ 101, 103-104, 115 Stat. 2427 (2001). This applies not only to the victims of September 11th but also includes the victims of the 1995 Oklahoma City bombing and the 2001 anthrax bio-terrorism incidents.

69. A.11290, 2002 Legislative Sess. (N.Y. 2002) (May 6, 2002) *available at* http://assembly.state.ny.us/leg/?bn=A11290&sh=t.

compensation benefits.[70] It exempted Fund awards from all New York state and local taxes.[71] It expedited processes for the appointment of Personal Representatives, and clarified Personal Representative's authority to file claims with the Fund.[72] And, through the bill, the New York legislature expressed its intent that domestic partners of victims should be eligible to file claims with the Fund.[73]

Shortly thereafter, Congress passed the "Mychal Judge Police and Fire Chaplains Public Safety Officers' Benefit Act of 2002" which was signed into law on June 24, 2002.[74] The law is an amendment to 42 U.S.C. Section 3796(a), the federal death benefit program for public safety officers killed in the line of duty. Father Mychal Judge was the much beloved chaplain of the Fire Department of New York who was killed at the World Trade Center while administering last rites to a fallen firefighter. He is listed as the first official death of the September 11th attacks. It was widely reported in the media that Father Judge was gay and, as a result, his beneficiaries were not entitled to any benefits under the federal program.[75] The Father Judge Law was retroactive to September 11, 2001, and allows the beneficiaries of all unmarried "public safety officers"—firefighters, rescue personnel, ambulance crews and state and federal civil defense workers—to receive federal death benefits as long as they were designated as beneficiaries on the decedent's most recently executed life insurance policy.[76] Thus, Congress and the President opened the door for claims by domestic partners, including same-sex partners.

Efforts were also made to extend the benefits of the Victim Compensation Fund to other terrorist victims. On May 21, 2002, the House of Representatives passed the "Embassy Employee Compensation Act"[77] extending Fund eligibility to the American victims of the 1998 United States embassy bombings in Kenya and Tanzania. In the Senate, however, that legislation met with two diametrically opposed responses. Some wanted to expand the Fund to even more terrorist victims, including the victims of the 1993 bombing of the World Trade Center, the 1995

70. *Id.* at 2, lines 14-16.
71. *Id.* at 2, lines 26-27.
72. *Id.* at 3, lines 14-30.
73. *Id.* at 2, lines 28-34.
74. Mychal Judge Police and Fire Chaplins Public Safety Officer's Benefit Act of 2002, Pub. L. No. 107-196, 116 Stat. 719 (2002).
75. Prior to the Father Judge amendment, benefits under 42 U.S.C. § 3796(a) (2000) were restricted to spouses, children and parents of a decedent.
76. Pub. L. No. 107-196, § 2(b)(4) (2002).
77. H.R. 3375, 107th Cong. (2002).

Oklahoma City bombing, the 2000 attack on the USS Cole and the 2001 anthrax bio-terrorism incidents.[78]

To make that expansion more palatable, the proponents of expansion also proposed the creation of a new "Compensation for Victims of International Terrorism Act of 2002." This new compensation plan would provide a one-time benefit of approximately $260,000[79] for the death or injury to any American victim of an act of international terrorism.[80] This proposal would thus close the door on any future terrorist compensation plans similar to the September 11th Victim Compensation Fund.[81] The opponents of this legislation, on the other hand, objected to any expansion of the Fund and the proposed amendment died without ever receiving even a committee hearing, thus effectively closing this unique chapter in American history.

In retrospect, the September 11th Victim Compensation Fund and its related legislative activity were all enacted during a time when normal political processes and ideology were suspended and the legislation was enacted despite deeply held positions that, in normal times, would have prevented any consideration of the subjects. This is not surprising, however, given the intense feelings that were unleashed by the September 11th attacks and the fact that, just after the first anniversary of the attacks, their impact is still too raw and immediate to fully assess.[82] Time may give perspective to look beyond the human dimensions of September 11th, but

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78. *Id.*

79. *See* http://www.ojp.usdoj.gov/BJA/topics/PSOBProgram.html (last visited Nov. 9, 2002). Compensation would have been tied to the amount available under the Omnibus Crime Control and Safe Streets Act of 1968, 42 U.S.C § 3796 (2000), which is annually adjusted on October 1 for the percentage change in the Consumer Price Index for All Urban Consumers. *See id.*

80. Victims claiming under the September 11th Victim Compensation Fund would be excluded from receiving benefits under this new plan.

81. See proposed Senate substitute for H.R. 3375 (on file with the authors).

82. In addition to 3,000 deaths and hundreds of injuries, the September 11th attacks left over 6,000 children without a parent, and in some cases, without any parents. As of July 2002; remains of only about 1,000 victims had been identified with 20,000 body parts yet to be identified; thousands of surviving family members have been devastated and the number of survivor divorces, suicides and incidents of alcoholism will dramatically increase; and thousands will suffer debilitating, long-term emotional trauma. Dan Barry, *At Morgue, Ceaselessly Sifting 9/11 Traces,* N.Y. TIMES, July 14, 2002, at 1. *See also* SWICK, DECHANT & JELLINEK, THE CHILDREN VICTIMS OF SEPTEMBER 11: PSYCHOLOGICAL IMPACT AND EMOTIONAL DAMAGE TO INJURED VICTIMS AND SURVIVING LOVED ONES, (Trial Lawyers Care, Inc., (2002) (on file with the authors).

these attacks scarred the nation in ways that it will take generations to fully comprehend.

IV. HISTORICAL PERSPECTIVE

A. Compensation Programs

In the years before September 11th, Congress had enacted only a very few victim compensation plans. The reasons for their enactment varied widely. One was enacted to remedy injustice; another to solve a perceived national crisis; and two others to atone for past misconduct. Only one of those plans was part of a "tort reform" agenda. There was no commonality among the plans. Each differed in scope, process and results and none has served as a precedent for the others.

The first federal compensation plan was enacted to remedy an injustice in the mining industry. In the nation's coalmines, thousands of miners breathed air chocked full of coal dust. In their lungs, the dust caused pneumoconiosis, the so-called Black Lung disease. It is a debilitating disease that can have long latency periods and, once contracted, is very disabling and eventually fatal. Miners, however had no remedy because lawsuits against the mine owners were barred under worker compensation laws but those laws did not recognize black lung disease as a compensable injury. With little success, miners fought to change the state worker compensation laws. In November 1968, a devastating mine explosion occurred at Farmington, West Virginia, in which seventy-eight miners were killed. The public reaction was immediate outrage that, a year later, lead to the enactment of the "Black Lung Benefit Act."[83] This program provides what is, in essence, a federal worker compensation program with a schedule of fixed benefits. Claims are filed with the Secretary of Labor and hearings are held before Administrative Law Judges pursuant to the Administrative Procedure Act.[84] It is an adversarial process in which most claims are highly contested by the employer, as evidenced by the large body of case law that has developed. Awards are the obligation of the "responsible" mine operator,[85] but, where the operator is not known or is unable to pay the award, there is a government trust fund available.[86]

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83. 30 U.S.C. § 901 (2000).
84. *Id.* § 903; 5 U.S.C. § 554 (2000).
85. 30 U.S.C. § 932 (b).
86. 26 U.S.C. § 9501 (2000).

The second government compensation plan was created in 1976 in response to a perceived national crisis over a potential Swine Flu epidemic. The Center for Disease Control had discovered influenza among army recruits that was believed to be caused by the same agent that caused the 1918-19 flu pandemic in which 500,000 Americans died. The government determined that the entire population had to be vaccinated and authorized a national program.[87] Due to the emergency nature of the program, the vaccine had to be rushed into production and there was no time to properly test the vaccine. To facilitate the development of the vaccine and the immunization of the population, Congress assumed all liability for any swine flu vaccination injuries by creating an exclusive federal remedy under the Federal Tort Claims Act.[88] There were no limits or restrictions on liability. Ultimately, only about forty million Americans were ever vaccinated and the program ended in August 1977.[89] After the program ended, the enabling legislation was repealed.

Congress next addressed victim compensation in an entirely different context. By the mid-1980s, injuries and deaths from mandated childhood vaccines had become a serious problem. Because the vaccines often contained either killed bacteria or live but weakened viruses, some children suffered severe reactions, injuries and even death. This was at a time of massive "tort reform" campaigns that were based on so-called litigation abuse claims by the insurance industry that coincided with sharp drops in investment income due to a decline in the economy and the United States stock market. Vaccine manufacturers pushed forward proposals to limit their liability which led to the creation of the "National Vaccine Injury Compensation Program," enacted in 1986.[90] This compensation program was in essence a pre-litigation administrative process that required any prospective plaintiff who has suffered a vaccine-related injury or death to first petition for compensation with the United States Court of Federal Claims.[91] A Special Master hears the administrative petition and the claims are defended by the Department of Justice. Rules of proof are relaxed and

87. 42 U.S.C. § 247(b) (2000).

88. Federal Tort Claims Act, Pub. L. No. 94-420, § 3, 90 Stat. 1301 (1976). *See, e.g.*, Weldon v. United States, 70 F.3d 1 (2nd Cir. 1995).

89. Paul Mickle, *Death of Fort Dix Man Leads to Panic,* THE TRENTONIAN, Sept. 13, 1999, at 19.

90. 42 U.S.C. § 300aa—300aa-11 (2000). In 1989 the Act was expanded and "Childhood" was removed from its title. Pub. L. 101-239, Title VI, § 6601(b), 103 Stat. 2285.

91. 42 U.S.C. § 300aa-11(a).

certain presumptions are available as set forth in a Vaccine Injury Table.[92] In the administrative process, there are compensation limits, including a limit of $250,000 on pain and suffering and emotional distress, and death claims are also limited to $250,000.[93] Once an administrative award is made, the plaintiff has an election to either accept the award or reject it and proceed to litigation.[94] If a party elects to proceed with a civil action, certain rules are imposed, including a requirement of a trifurcated trial.[95] Compensation for the program comes from Congressional appropriations.[96]

Congress has also enacted compensation plans to atone for past wrongs. In the early days of government nuclear programs, many individuals were exposed to dangerous radiation levels and were at risk for or had already contracted cancer or other serious illnesses. They included members of the military who had been exposed to nuclear fallout during atmospheric testing, uranium miners, and workers in federal nuclear facilities. In 1990, Congress enacted the "Radiation Exposure Compensation Act,"[97] to provide lump sum benefits ranging from $50,000 to $100,000 to qualifying members of the military and uranium miners. And, ten years later, in 2000 Congress created the "Energy Employees Occupational Illness Compensation Program Act of 2000,"[98] to provide a lump sum benefit of $150,000 plus medical benefits to workers at federal nuclear facilities who suffer designated illnesses because of exposure to radiation, beryllium or silica.

Congress also enacted anticipatory provisions to create a compensation plan in the event that a catastrophic nuclear accident occurs. Those provisions are part of the "Price-Anderson Act."[99] That Act established a federal cause of action with exclusive federal jurisdiction for nuclear accidents with liability limits of $560 million for any nuclear incident.[100] If the damages from any single nuclear accident are "likely to exceed" the liability limit, then the Atomic Energy Commission is required to report to

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92. *Id.* § 300aa-14(a) (2000). The Vaccine Injury Table was substantially revised in March 1995, 60 Fed. Reg. 7, 678 (Feb. 8, 1995). Revised Interpretative Aids were also issued. 42 C.F.R. §100.3 (2001).

93. 42 U.S.C. § 300aa-15.

94. *Id.* § 300aa-21.

95. *Id.* § 300aa-23.

96. *Id.* § 300aa-15(i).

97. Radiation Exposure Compensation Act, Pub. L. 101-426, Oct. 15, 1990, 104 Stat. 920. *See also* 42 U.S.C. § 2210 (2000).

98. 42 U.S.C. § 7384d.

99. *Id.* § 2210(i).

100. *Id.* § 2210(e)(1).

Congress and the President is required to recommend to Congress a compensation plan for the damages in excess of the limits.[101] Congress did not, however, attempt to fix any parameters for the plan or how it would be operated, administered or funded.

Although there have been many other devastating instances of mass injuries including those resulting from terrorist attacks, none have prompted Congressional action. This paucity of action provides some indication of the degree of difficulty Congress has in reaching the necessary consensus to enact federal victim compensation plans. In no instance has that been more evident than the twenty-year debate over liability for asbestos injuries. The numerous efforts to limit liability of asbestos defendants have prominently featured victim compensation plans. Yet, notwithstanding highly financed lobbying campaigns, these proposals have gone nowhere. For example, a bill to provide for an exclusive, preemptive compensation remedy for asbestos victims,[102] and most recently, two bills to establish procedures for the inefficient and inexpensive resolution of personal injury claims arising out of asbestos exposure have been unsuccessful in Congress.[103]

In contrast, on September 11th, Congress faced an event of such horrifying proportions that it defied typical political analysis. The death of thousands of innocent people at the heart of America's greatest city and at the Pentagon caused a national outpouring of grief and support that united the nation and Congress as never before. The victims and victims' families needed massive help and, without a federal compensation plan, they would have had little hope of relief. At the same time, the nation faced a financial crisis of potentially huge magnitude. Congress acted swiftly and decisively. While some aspects of the Victim Compensation Fund resembled earlier plans, such as exclusive federal jurisdiction and remedies, and no limits on recoveries, those prior programs did not form the basis of this new plan. It was formed for a new purpose—to financially rescue the victims—and its terms were developed and negotiated in a time of intense national unity that suspended all normal political processes. Indeed, many observers believe that the Fund could never have been created had it not been a time of great national crisis.

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101. *Id.* § 2210(e)(2).

102. *See, e.g.*, Occupational Disease Compensation Act, H.R. 3175, 98th Cong. 1st Session (1983).

103. H.R. 1283, 106th Cong., 1 (1999) and S. 758, 106th Cong., 1 (1999).

The lesson from these experiences is that each of these programs was a unique response to a particular situation that, in most instances, involved great public interest and, in some cases, public outrage. The details of each program were largely molded by the political forces of the times, forces that are constantly changing. That reality makes it extremely unlikely that the September 11th Victim Compensation Fund will serve as a model for any future compensation plans.

B. Federal Efforts to Limit Liability

Given the difficulties in imposing federal limitations on tort liability, the September 11th Victim Compensation Fund will also not likely serve as a model for future "reform" of the American civil justice system. Despite massive, well-funded campaigns, such efforts have been largely unsuccessful. Comparing the long, drawn-out Congressional debates of the past several decades over tort reform efforts with the extraordinary consensus that was reached in just a few days to limit the airlines' liability and establish the Fund suggests that, absent extraordinary unifying events, bipartisan support for legislation capping liability or creating a government-funded compensation program is highly unlikely in the future.

The first effort to impose federal limitations on tort liability was the unsuccessful attempt to enact federal motor vehicle "No-Fault" legislation in 1973.[104] Following that abortive effort, there was a lull in activity until the issuance of the Final Report of the Interagency Task Force on Product Liability Reform in 1977.[105] Since the 95th Congress, various House and Senate Committees have debated the merits of broad tort limitations, ranging from product liability to workplace injury to medical liability caps.[106] Despite these debates, and notwithstanding a number of attempts

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104. National No-Fault Motor Vehicle Insurance Act, S. 354, 93rd Cong. (1973).

105. The Final Report of the Interagency Task Force On Product Liability, U.S. Dept. of Commerce, October 31, 1977.

106. *See, e. g.*, among numerous other hearings, hearings on H.R. 5626, the "National Product Liability Act" and H.R. 7000, the "Uniform Product Liability Act," before the Subcommittee on Consumer Protection and Finance, Committee on Interstate and Foreign Commerce, U.S. House of Representatives, 96th Cong., 2nd Session, April 23, 29 and 30, 1980; hearings on H.R.5735, a bill to preclude tort actions and establish an exclusive administrative remedy for damages arising from certain occupational disease, before the Subcommittee on Labor, Committee on Education and Labor, U.S. House of Representatives, 97th Cong., Second Session, April 21 and 22,1982; hearings on S. 44, a bill to preempt state tort law and establish uniform standards for product liability actions, before the Consumer Subcommittee of the Committee on Commerce, Science and Transportation, U.S. Senate, 98th Cong., 1st Session, April 6 and 27, 1983; hearing on H.R. 5400, the

to pass a comprehensive federal product liability bill, no such bill reached the President's desk for nearly two decades.[107]

"Alternative Medical Liability Act," before the Subcommittee on Health, Committee on Ways and Means, U.S. House of Representatives, 98th Cong., 2nd Session, June 28, 1984; hearings on compensation for injuries arising from occupational exposure to asbestos, before the Labor Standards Subcommittee, House Education and Labor Committee, U.S. House of Representatives, 99th Cong., 1st Session, March 25, June 11 and 25, 1985 (note: five days prior to the first of the three hearings, Subcommittee Chairman Austin Murphy (D-PA) introduced H.R. 1626, the "Asbestos Workers Recovery Act" to establish an exclusive administrative remedy for injuries, including disability and death, resulting from occupational exposure to asbestos); hearings on S. 1999, the "Product Liability Voluntary Claims and Uniform Standards Act," before the Consumer Subcommittee, Committee on Commerce, Science and Transportation, U.S. Senate, 99th Cong., 2nd Session, February 27 and March 11, 1986; oversight hearing on the "impact of the liability insurance crisis on health care in America" including consideration of S. 1804, a proposal to provide federal incentive grants to states that cap damages and limit contingent fees in medical malpractice cases, before the Committee on Labor and Labor and Human Resources, U.S. Senate, 99th Cong., 2nd Session, May 7, 1986; hearings on H.R. 1115, the "Uniform Product Safety Act" (a bill to preempt state law and enact uniform product liability standards), before the Subcommittee on Commerce, Consumer Protection and Competitiveness, Committee on Energy and Commerce, U.S. House of Representatives, 100th Cong., 1st Session, on May 5 and 20, June 18, July 9 and 21, August 6 and October 7, 1987; oversight hearing on "issues relating to medical malpractice," before the Subcommittee on Health, Committee on Ways and Means, U.S. House of Representatives, 100th Cong., 2nd Session, on April 26,1990; H.R. 4566, a bill to require the arbitration of medical malpractice claims brought by Medicare beneficiaries.

107. In 1994, Congress enacted the General Aviation Revitalization Act of 1994, Pub. L. No. 103-298, 108 stat. 1552, 49 U.S.C. 40101 (2000). It is not, however, either comprehensive tort reform, or substantial in scope (it applies only to suits arising from accidents involving an aircraft with a maximum seating capacity of nineteen passengers, which was not engaged in scheduled passenger operations). Its nearly decade-long legislative history is a further illustration of Congress' reluctance to enact tort reform—even a popular bill on behalf of a favored industry. Only after eight years of debate was Congress able to pass it and even then, almost all the tort protections had been deleted from the bill.

Prior to becoming law, the bill had been introduced in five consecutive Congresses. As far back as 1986, versions of the bill had been favorably reported by various Committees in both the House and Senate but, until 1994, none of these bills passed either House. And, in 1990, after one version of the bill was approved by the Senate Commerce Committee, the Senate Judiciary Committee claimed jurisdiction and voted to disapprove it.

As initially introduced in the 99th Congress, and during several successive Congresses, the bill proposed comprehensive federal liability standards for tort suits against general aviation aircraft manufacturers. Among other things, the bill would have increased negligence and design defect standards, created various new defenses, eliminated joint and several liability, and made it more difficult to prove punitive damages. In order to finally get a bill enacted, Congress eventually deleted all of those provisions. As passed, the Act is a simple statue of repose that bars actions for damages against manufacturers if the accident causing harm occurred more than eighteen years after the aircraft was deliver to its first

It was not until the 104th Congress that the so-called "Common Sense Product Liability Legal Reform Act of 1996"[108] finally mustered a majority in both Houses. And President Clinton summarily vetoed that bill. Even the House of Representatives (which contained some of the most zealous proponents of tort reform) failed by a wide margin to override the President's veto.[109]

The 104th Congress, which convened in January 1995, represented a clear turning point in the federal tort reform debate. In the 1994 Congressional elections, Republican candidates pledged in a "Republican Contract With America," to bring ten specifically identified bills to a vote within the first 100 days of the 104th Congress. One of those bills, identified in the "Contract" as the "Common Sense Legal Reform Act" called for "[l]oser pays laws, reasonable limits on punitive damages and reform of product liability laws to stem the endless tide of litigation."[110] These proposals were brought before the House of Representatives in the early months of 1995.[111] The "loser pays" proposal, which would have adopted a modification of the English Rule in civil litigation, was put forth separately from the broader tort reform bill.[112] The broader bill sought to limit punitive damages in all civil actions and established numerous additional limitations on juries in product liability cases.

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purchaser or lessee, or to a seller. The bill provides for numerous exceptions to the time limitation, including its non-applicability to claims for injury or death made by persons not aboard the plane at the time of the accident.

It is also worth noting that numerous times since enactment of the "General Aviation Revitalization Act," Congress has sought, without success, to use the eighteen year statute of repose created under that Act as precedent for enacting similar statutes of repose for manufacturers of other products.

108. H.R. 956, 104th Cong. 1 (1996).

109. *See* CONG. REC. H4764 (daily ed. May 9, 1996) (Roll Call Vote No. 162, U.S. House of Representatives, 104th Cong., 2nd Session, (1996) failed by the Yeas and Nays 258-163; 2/3 required.).

110. *See* http:// www.house.gov/house/Contract/CONTRACT.html (last visited Nov. 9, 2002).

111. For nearly two decades prior to the 104th Congress, fights on tort reform were confined almost entirely to the Senate. The only tort reform bill of even narrow scope that reached the House Floor during those years was the "Commercial Fishing Vessel Liability and Safety Act" debated in 1986. H.R. 5013, 99th Cong., (1986). And even that bill was not a proposal to preempt state tort law. Instead, it would have amended the federal Jones Act to prohibit suits under the Act for non-temporary injuries and to cap damages in actions for permanent disability or death. The House defeated the bill, 241-181. H.R. Roll Call Vote No. 336, 99th Cong. (1990).

112. The Attorney Accountability Act of 1995, H.R. 988, 104th Cong., 1st Session (1995).

The "loser pays" bill passed the House on March 7, 1995, and was never heard from again.[113] The Senate never considered it, not even in a Committee. The eventual passage of the broader product liability bill is instructive, however.[114] It represents the only time in recent history that any consensus has developed on substantial tort reform, albeit fleetingly, since Congress failed to override President Clinton's veto.[115]

The Senate passage of the 1996 product liability bill came after nearly twenty years of failed efforts to pass similar bills, and that no other liability limiting bills were passed before September 11th,[116] shows the extreme difficulty in reaching any consensus to limit the state tort laws or the role of civil juries in finding fault and assessing damages. Reviewing the seventeen-month history, albeit short by tort reform standards, of the passage of the "Common Sense Product Liability Legal Reform Act"

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113. *See* H.R. Roll Call Vote No. 207, 104th Cong. (Mar. 7, 1993).

114. *See* H.R. 956 as passed by the House, the "Common Sense Product Liability and Legal Reform Act;" as passed by the Senate, the "Product Liability Fairness Act"), 104th Cong., (1995).

115. *See* H.R. Roll Call Vote No. 162, 104th Cong., (May 9, 1996).

116. While the Volunteer Protection Act of 1997 (now Public Law No. 105-19) is a federally enacted limitation on tort liability, it is not substantial tort reform. Under the Act, Congress afforded limited tort liability protection to volunteers of nonprofit organizations and governmental entities who cause harm by an act or omission on behalf of the organization or entity. The Act contains a host of specified exceptions that narrow the scope of its protection. For example, harm caused by the operation of a motor vehicle is excluded; gross negligence and willful misconduct are excluded; sexual misconduct is excluded; conduct constituting a hate crime or a crime of violence is excluded; conduct while under the influence of drugs or alcohol is excluded. The Act enumerates additional exceptions, too, as well as specific conditions that must be met before any volunteer may qualify for liability protection. Most striking of all, Section 4(c) of the Act makes clear that only individual volunteers are intended to be protected from liability for harm caused to any person; nonprofit organizations and governmental entities themselves may still be held fully liable for the same harm. If the Act can be usefully cited for any purpose here, it would be to demonstrate, yet again, how small an appetite Congress has had for even the slightest modification of tort law. First introduced on February 2, 1987, the bill was eventually introduced and considered in both Houses for six consecutive Congresses before finally becoming law. Volunteer Protection Act of 1997, Pub. L. No. 105-19, 111 Stat. 218. Other minor tort liability restrictions enacted by Congress since 1996 include the Aviation Medical Assistance Act of 1998, Pub. L. No. 105-170, 112 Stat. 47, relating to the Good Samaritan use of automated external defibrillators on aircraft and to the provision of other inflight emergency medical assistance (air carriers themselves would not be absolved of liability for the acts of their own employees or agents, and individuals would not be protected in the case of gross negligence or willful misconduct); and the Public Health Improvement Act, Pub. L. No. 106-505, 114 Stat. 2314, relating to the placement of automated external defibrillators in public buildings and the liability of Good Samaritans regarding the emergency use of such defibrillators.

emphasizes this point. By the time the House version of that bill, H.R. 956, had completed two days of debate on the House Floor, various amendments had enlarged the scope of the bill well beyond product liability issues.[117] In addition to broadly limiting plaintiffs' rights and the role of juries in product liability cases, the House bill, as enacted, also limited punitive damages and extinguished the doctrine of joint and several liability in *all* civil cases.[118] It also broadly curtailed plaintiffs' rights in medical malpractice cases and cases against health care insurers. In those cases, the House capped non-economic damages at $250,000, providing also that "[t]he jury shall not be informed about the limitation on non-economic damages, but an award for non-economic damages in excess of $250,000 shall be reduced."[119] Moreover, the House voted to prevent juries from even considering awarding punitive damages in cases alleging harm caused by FDA-approved drugs and medical devices. In the Senate, where for twenty years passing even narrowly tailored tort reform measures had proven impossible, the broader tort reform package that arrived from the House was impassable.

During an extended Senate debate on the bill, lasting from April 24th to May 11th, 1995, no version of the bill was able to muster the necessary votes to end debate and move to final passage so long as it included *any* provisions that applied to medical malpractice cases or to *any* civil actions other than product liability—even provisions with limitations far narrower than those contained in the House bill. Limiting the role of the jury in assessing civil damages was so firmly opposed in the Senate, and so politically untenable, that even an amendment to double the size of the House-passed damages cap to $500,000 was summarily tabled.[120] Finally, stripped down just to product liability claims, and containing limits on product liability cases far less severe than in the House bill, the Senate agreed by a *single vote* to end debate and pass the bill.[121]

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117. *See, e.g.*, House Amendment 287, offered by Representative Cox, to eliminate joint and several liability for non-economic losses in *all* civil lawsuits involving interstate commerce. *See* Roll Call Vote No. 225, 104th Cong., (Mar. 9, 1995). Also, House Amendment 288, offered by Representative Cox, to limit the maximum award of non-economic damages in health care liability actions to $250,000. *See* Roll Call Vote No. 226, 104th Cong., (Mar. 9, 1995).

118. H.R. 956, Sec. 202(a), 104th Cong., 1st Session (1995).

119. *Id.*

120. On May 2, 1995, the Senate agreed to a Motion to Table Senate Amendment No. 611. *See* S. Record Vote No. 141, 104th Cong., (1995).

121. Beginning on April 25, 1995, the Senate debated the bill on the Floor of the Senate for several weeks, not completing action until May 10, 1995. Even as various amendments

A year later, the bill that finally emerged from the House-Senate Conference Committee and then went to the President differed little from the narrow Senate-passed version that applied solely to product liability cases.[122] Moreover, in the end, the Senate was never called upon to override the President's veto, the House itself proving unable to muster the necessary votes.

The intensely partisan debates in the 104th Congress made it even less likely that consensus could ever be achieved to support votes on liability limitations in Congress. Since then, votes on tort reform measures have largely been in accordance with political party affiliation, passing by slim margins in the House of Representatives and being rejected in the Senate.[123]

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were being offered, considered and either accepted or rejected by the Senate, opponents of the bill were engaged in a filibuster to prevent the Senate from being able to proceed to final passage. On three occasions during consideration of the bill, notwithstanding that petitions to invoke cloture had been filed repeatedly, the Senate failed by Roll Call vote to end the filibuster and proceed to passage of the bill. Cloture failed twice on May 4, 1995, by votes of 46-53 and 47-52. *See* S. Roll Call Vote Nos. 151 and 152, 104th Cong., (May 4, 1995). Cloture failed a third time, by a vote of 43-49 on May 8, 1995. *See* S. Roll Call Vote No. 153, 104th Cong., (May 8, 1995). Finally, with only product liability limitations left in the bill, the Senate on May 9th invoked cloture with not a single vote to spare, 60-39. *See* S. Roll Call Vote No. 156, 104th Cong., (May 9, 1995). The next day, the Senate passed the bill. *See* S. Roll Call Vote No. 161, 104th Cong., (May 10, 1995).

122. Conference Report H. Rept. 104-481, 104th Cong., 2nd Session (1996).

123. *See, e.g.*, Senator McConnell's amendment to the Terrorism Insurance bill, S. Amd. 3836 to S. 2600, which would have made punitive damages virtually unrecoverable in civil actions arising from terrorism incidents. The amendment was rejected in a vote of 50 to 46 on a Motion to Table. S. Roll Call Vote No. 152, 107th Congress, (June 13, 2002). *See also* Representative Norwood's amendment to the "Bipartisan Patient Protection Act," H.R. 2563, 107th Cong. (2001). This amendment established caps on non-economic and punitive damages and passed by a vote of 218 to 213, with 214 Republicans supporting the amendment and 206 Democrats opposing it. H.R. Roll Call Vote No. 329, 107th Congress, (August 2, 2001). Damage limitations on health care liability actions and actions against the manufacturers and sellers of FDA-approved medical devices that were included in the House's failed 1995 bill were subsequently included in, among other bills, the House versions of the Health Insurance Portability and Accountability Act of 1996, H.R. 3103, 104th Cong. (2nd sess. 1996) Pub. L. No. 104-191, 110 Stat. 1936; the Medicare Reform Bill, H.R. 2425, 104th Cong. (1995); the D.C. Appropriations Bill, H.R. 2607, 105th Cong. (1997); the House version of the Patients' Bill of Rights, H.R. 4250, 105th Cong. (1998); and the Budget Reconciliation bill, H.R. 2015, 107th Cong. (1998). The Senate either took no action on the House bills, dropped the tort provisions and then failed to come to agreement with the House on a final bill, or summarily dropped the House provisions from the versions of these bills before they were enacted. *Compare* S. Cong. Rec. and Record Vote No. 311, 105th Cong. *with* S.947, 105th Cong., (1997) *and* Conference Report H. Rept. 105-217 (July 29, 1997). Even in 2001, in extending new remedies under the

This history can be explained in terms of the political process, but, at a more subtle level, it also reflects the exalted position that the right to trial by jury holds within the American judicial structure. Trial by jury is one of the bedrock principles upon which this nation was established, and is guaranteed in the Bill of Rights.[124] It is also one of the basic tenants of American democracy whereby ordinary citizens have a direct "voice" in community standards and can pass judgment on other citizens. In many ways, in the United States, the jury box is as important as the ballot box.

As this history shows, any legislation seeking to establish a limitation on liability will be exceedingly difficult to enact. Only a national crisis, which changes the political climate and created an extraordinary consensus in the House and Senate, allowed the Victim Compensation Fund to become law.

Employment Retirement Income Security Act to patients injured by managed care providers, the House limited the power of a jury to assess damages by placing strict caps on both non-economic and punitive damages. H.R. 2563, 107th Cong., (2001). The Senate version of the same bill, passed earlier in 2001, contained no such limitations. S. 1052, 107th Cong., 1st Session (2001) as passed by the Senate on June 29, 2001. The House amendment to include the damages caps passed the House by 218-213 on an almost straight party line vote.

Other tort reform measures passed by the House in recent years, except for the Fund, also succeeded with only narrow partisan margins. In the 106th Congress, the Workplace Goods and Jobs Competitiveness Act, H.R. 2005, 106th Cong. (1999), that would have barred tort claims against the manufacturer or seller of a workplace product for harm caused more than eighteen years after the product is delivered to its first purchaser, passed the House in February, 2000, with only 222 votes.

123. H.R. Roll Call Vote No.7, 106th Cong., (Feb. 2, 1999). Two weeks later, a bill to cap punitive damages and limit the recovery of non-economic damages in civil actions against small and medium-sized businesses, and to prohibit juries from holding product sellers liable under a strict liability theory (which is permissible in a majority of the states) passed the House with just 221 votes, or only three votes more than a bare House majority. *See* H.R. Roll Call Vote No. 25, 106th Cong., (Feb. 24, 1999). The full Senate considered neither of those bills.

124. U.S. Const. Amend VII. Inclusion of a right to trial by jury was fundamental to ratification of the constitution. JOSEPH STORY, COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES 653 (R. Rotunda & J. Nowak eds., 1987). *See also* Dimick v. Schiedt, 293 U.S. 474, 486 (1935) ("Maintenance of the jury as a fact-finding body is of such importance and occupies so firm a place in our history and jurisprudence that any seeming curtailment of the right to a jury trial should be scrutinized with the utmost care.").

CONCLUSION

Only rarely has Congress acted to assist the victims of mass or anticipated mass disasters. On each occasion the compensation program has been unique and has not served as a model to be replicated for any of the other programs. Given the highly unique circumstances of the enactment of the September 11th Victim Compensation Fund, there is no reason to believe that it will serve as a model for the consideration of any future compensation programs.

Beyond that, there is even less basis to believe that the Fund will serve as a model to "reform" the American civil justice system. It was, after all, the result of an effort to save the national economy and rescue the victims and their families, rather than an effort to limit liability *per se*. And, it increased, not limited, victims' chances for compensation. Efforts to limit liability run counter to this nation's strong commitment to trial by jury, and the role that juries play in the American system of democracy. In light of the largely unsuccessful past efforts to enact federal liability limitations, there is no reason to conclude that the existence of the Victim Compensation Fund will in any way advance such an agenda.

The terrorist attacks of September 11th were in many ways the worst, most horrifying disaster the nation has ever faced. That Congress responded with compassion and generosity is the mark of a great nation. It does not, however, foreshadow any predilection that Congress will impose liability limitations for other industries or interests, either with or without a compensation program.

WILL THE HISTORIC RELATIONSHIP BETWEEN CEDENT AND REINSURER BECOME A CASUALTY OF THE WAR ON TERRORISM?

*Paul E. Traynor**

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Human life passes rapidly through many sorts of disasters
And every man has had different kinds of days.
In the course of fate sadness will be mixed with joy;
No one has had success every day,
No one always enjoys predictable happiness.
Nothing remains eternal under the tall dome of the sky,
All things change at different times.
One day smiles, the next laments a catastrophe,
No stability is granted by a token of luck.[1]

INTRODUCTION

On September 11, 2001, nearly three thousand innocent people were killed or injured with thousands more innocents whose lives were affected by that loss. The magnitude of the horror, the destruction of human life and the properties involved were watched in awe by millions more across the globe.

Within days of the event, the United States Congress acted to shore up the airline industry in the United States by passing legislation aimed at providing assistance from the federal coffers.[2] Representatives of the insurance industry, from those companies already defined as most affected by the disaster, met with the President of the United States.[3] Exiting the White House, they announced that any possible applicable exclusion which may have applied to the property and casualty losses (estimated, but yet to be conclusively determined) would be waived.[4]

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1. Alcuin, *The Destruction of Lindisfare*, in POETRY OF THE CAROLINGIAN RENAISSANCE 118, 126-27 (Peter Godman ed., 1985). The Latin text reads as follows:

> Per varios casus mortalis vita cucurrit, Diversosque dies omnis habebat homo. Fatali cursu miscentur tristia laetis, Nulli firma fuit regula laetitae. Nemo dies cunctos felices semper habebat, Nemo sibi semper gaudia certa tenet. Nil manet aeternum celso sub cardine caeli, Omnia vertuntur temporibus variis. Una dies ridet, casus cras altera planget, Nil fixum faciet tessera laeta tibi.

Id. Alcuin was a poet from Northumbria during the time of Charlemagne (b. 768—d. 814 A.D.). *Id.*

2. Lizette Alvarez & Stephen Labaton, *An Airline Bailout,* N. Y. TIMES, Sept. 22, 2002, at A1.

3. *See IIAA Reassures President Bush on State of the Insurance Industry,* PR NEWSWIRE, Sept. 21, 2001, at 1.

4. *Id. See also*, Phil Porter, *Insurers Might Ignore Clause Excluding War,* COLUMBUS DISPATCH, Sept. 15, 2001 at F1.

As the estimates of the losses in terms of lives, property and liability began to mount and be amended, discussion quickly turned to the concern that, as the terrorists responsible threatened, more terrorist attacks would ensue upon the nation causing greater disruption in the private insurance market. Indeed, one of the stated goals of the al-Qaeda network was the destruction and further damage to the economy of the United States. Following the use of the nation's transportation network as an instrument of terror, the means by which written communication was transported across the country started to also be utilized as a weapon upon the people and their government. The President and members of Congress began speaking of a war against terror. "The final casualty toll at Pearl Harbor was smaller than the toll of the terror attacks: 2,403 military and civilians killed, 1,178 wounded."[5] The most recent numbers killed as a result of September 11, 2001, is estimated at the World Trade Center to be 2,823 people.[6] More innocent civilian deaths resulted from the attacks in Pennsylvania and in Washington, D.C., "[b]ut both were surprise attacks, unprovoked; both were heinous; both brought home a conflict that was raging elsewhere and drew us in."[7]

The purpose of this article is to provide a review of the tragedy's magnitude to the insurance industry and, specifically, what problems may be encountered in the relationship between cedent companies and their reinsurers. Finally, this article will attempt to examine the need for a response to the potential risks of future losses to the insurance industry and the most logical means, including what role government may play, in reducing that threat and assisting in risk management.

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5. Richard Rhodes, *The Suffering Find Their Champions and They are not all Ghandhis,* N.Y. TIMES MAG., Sept. 23, 2001, at 91.

6. Jim Dwyer, *Fighting to Live as the Towers Died,* N.Y. TIMES, May 26, 2002, at A1.

7. Rhodes, *supra* note 5. Of the number lost in New York, approximately 343 were firefighters and seventy-eight were other uniformed personnel. Dwyer, *supra* note 6. The total number of civilians killed as a result of the terrorist attacks on September 11, 2001, surpasses the total lost as a result of Pearl Harbor's surprise attack. Rhodes, *supra* note 5. The losses from the September 11, 2001, attacks in New York, Virginia and Pennsylvania claimed over 3,000 lives making it the most costly attack on the United States by a foreign enterprise in the nation's history. Canada Life Assurance Co. v. Converium Ruckversicherung (Deutschland) AG, 2002 U.S. Dist. LEXIS 6924, at *4 (S.D.N.Y. Apr. 19, 2002)

I. INDUSTRY INSTABILITY IN REINSURANCE RELATIONSHIPS

In an article appearing in the January 2002 edition of *Best's Review*, produced by the company principally responsible for the rating of insurance companies and their solvency, the top ten factors were identified in the changing risk environment as a hard market hit the United States much faster than industry analysts had been predicting.[8] Factor number two discussed the acceleration of a hardening market that occurred faster than the industry or the public could react. "While insurance pricing has firmed over the past two years, the events of Sept. 11 caused every line of significantly exposed business to record its greatest loss ever."[9]

Financial estimates to primary insurers ranged from $30 billion to $45 billion,[10] making the disaster at the World Trade Center the largest single event loss in history. This loss surpassed the previous $15 billion record losses arising from Hurricane Andrew in 1992 by two or three times:[11]

> This event is unprecedented not only in size but also in the nature of risk. Various coverages—property, aviation, workers' compensation, liability, life, health—previously viewed as non-correlated risks, were all affected by this single event. Risk models, which had not contemplated the interdependencies of these risks, must now be reevaluated.[12]

The unprecedented nature of the September 11th attack risks is one of the difficulties the insurance industry is coming to grips with as the impact becomes clear. For years major insurers have been diversifying their lines of business in other insurance products and financial services as a result of

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8. BEST'S REV./PREVIEW, Jan. 2002, Property and Casualty Edition A.M. [hereinafter BEST'S REVIEW PREVIEW]. *Best's* states that one of the most critical problems caused by the losses of September 11th are the increased exposure property and liability lines have to catastrophic risks that cannot be priced using current actuarial models. This has served to create an affordability and availability problem for reinsurance and most reinsurers today are unwilling to cover terrorism risks.

9. BEST'S REVIEW PREVIEW, *supra* note 8, at 3. Industry earnings for 2001 have been destroyed as a result of the terrorist attacks as the fourth quarter of 2001 becomes a dumping ground for insurers to write off the year and clean up balance sheets. *Id.* Given the increased risk of large losses following the terrorist attacks, Best estimates that the pressure market forces create will force financially strong insurers and reinsurers to re-price even traditional coverage. *Id.*

10. *Id.* at 10.

11. Joseph Sanders, *A Catastrophe Too Far?*, MILLIMAN UK, Sept. 2001. Hurricane Andrew, the largest single event loss prior to September 11th, cost $15 billion in 1992. *Id.* In today's money, that loss would be $25 billion. *Id.* Present thinking is that the losses from September 11th will total $40 billion to $200 billion. *Id.*

12. BEST'S REVIEW PREVIEW, *supra* note 8, at 10.

market competition from historically non-insurance entities like banks and financial services firms. Traditional thinking was that by doing so, insurers further insulated themselves from losses in one line of business by spreading risk and overall company performance across a variety of financial and insurance products. Actuarial models did not take into account that losses would spread across lines never previously compared because of their historical differences to each other.[13]

Aiding the industry with this dilemma is the investment of new capital into the insurance market and the securitization of risk in the alternative risk market. "Prior to the terrorist acts of Sept. 11, market observers already had been forecasting a significant increase in the future demand for catastrophe-risk securitization products due to a hardening in the reinsurance market that began with the January 2001 renewals."[14] For some time, the reinsurance market has grappled with a problem of its capacity to assume and adequately spread risk. The alternative market has been growing for several years to fill that void. In addition, new capital, roughly $16 billion, has or will be placed into the insurance market for both new ventures and existing operations.[15] The problem, however, is that much of it is flowing to such off-shore domiciles such as Bermuda.[16]

In addition to the crisis in the primary insurance market, the reinsurance market will be hit particularly hard by the losses resulting from terrorism. Lloyd's has estimated that its overall losses for 2001 reach $4.51 billion.[17] Of that estimate, $2.87 billion is directly attributable to the September 11 terrorism losses.[18] Chief among the legal issues confronting

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13. *Id.*

14. *Id.* at 11.

15. *Id.* at 10.

16. David Hilgen, *Bermuda Bound: Bermuda is Quickly Becoming Crowded With new Insurers, Which will Need Strong Management, Good Underwriting and a Little Luck to Reap Long Term Success*, BEST'S REV., Mar. 1, 2002, at 20. Just as when Hurricane Andrew hit, many insurers and reinsurers are establishing operations in Bermuda. Then, as now, new insurers and their financial backers looked at record losses for the industry and saw the potential for profits. Companies are being forced to tighten underwriting and re-evaluate their relationships, and several start-up companies are being established in places like Bermuda to fill that void within the industry. Those start-up reinsurers are forcing many primary insurers to accept terms which guarantee to them large returns on equity. Many companies are being forced to accept these terms in order to maintain reinsurance so that they can remain in business. The question remains, how many of them will survive should the current hard market continue too long.

17. Brendan Noonan, *Lloyds Unveils First Annual Results Amid Heavy Sept. 11 Losses*, BESTWIRE, Apr. 10, 2002.

18. *Id.*

the reinsurance relationship will be whether the attacks of September 11, 2001, constitute one occurrence or several. As this document will explain, this is not a simple legal question between insured and primary insurer, but will remain a central point of contention between the primary insurer/cedent and the reinsurer. This is on top of losses Lloyd's experienced for 1999 and 2000.[19] In fact, the losses from September 11th were worse than risk assessment models Lloyd's had performed in the worst case scenario for an airline disaster over New York City.[20] If the losses from September 11th were excluded from Lloyd's 2001 performance, it would have turned a profit with low catastrophe losses, soft pricing and abundant capital.[21]

A number of issues are raised by the losses of September 11. Those issues will confront lawyers and the courts for many years to come. The specific issues between cedents and reinsurers will be reviewed since the traditional means of doing business between them is at great peril.

II. PRIMARY DISPUTE—NUMBER OF OCCURRENCES

The battleground over the reinsurer's duty to indemnify will largely depend upon whether the attacks constituted one occurrence for purposes of coverage or more than a single occurrence. The nature of the attacks are different in this important respect as compared to asbestos exposure litigation which was the last great crisis within the reinsurance industry.

> The vast majority of courts (including two courts which have interpreted the precise language of the definition of occurrence in the Lloyd's policy) have concluded that although injury must be suffered before an insured can be held liable, the number of occurrences for purposes of applying coverage limitations is determined by referring to the cause or causes of the damage and not to the number of injuries or claims.[22]

The prevailing rule on the number of occurrences is whether there is "one proximate, uninterrupted and continuing cause which resulted in all of the

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19. *Id. See also* Susanne Scafane, *Insurers Endure "Kitchen Sink" Quarter*, NAT'L UNDERWRITER, Apr. 1, 2002, at 26-27 (listing the varied losses insurers and reinsurers endured throughout 2001 in addition to the Sept. 11th losses).

20. Sanders, *supra* note 11.

21. Noonan, *supra* note 17.

22. Mich. Chem. Corp. v. Am. Home Mut. Reins. Co., 728 F.2d 374, 379 (6th Cir. 1984).

injuries" or damages claimed.[23] Therefore, the number of claims filed is not the test to be followed, and it is necessary to look to the proximate and uninterrupted cause of the injuries that caused damages.[24] In *International Surplus Lines Insurance Co. v. Certain Underwriters and Underwriting Syndicates At Lloyd's of London*,[25] the Court was called upon to determine if several deductibles applied to a number of asbestosis claims filed against ISLIC by Owens-Corning, its insured.[26] Owens-Corning took the position that the claims arose from a single occurrence, namely the decision to manufacture asbestos.[27] ISLIC accepted that theory and covered Owens-Corning on that basis.[28] However, its reinsurer defendants took exception

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23. Appalachian Ins. Co. v. Liberty Mut. Ins. Co., 676 F.2d 56, 61 (3d Cir. 1982). *See also, Mich. Chem.*, 728 F.2d at 379; Meg Green, *Swiss Re, Silverstein Asked to Complete Discovery by May,* BESTWIRE, Dec. 18, 2001. Larry A. Silverstein signed a ninety-nine year lease of the World Trade Center properties just prior to September 11, 2001. Meg Green, *Swiss Re, Silverstein Asked to Complete Discovery by May,* BESTWIRE, Dec. 18, 2001. The dispute between Silverstein and Swiss Re centers upon whether the destruction of the World Trade Center should count as one insured loss, which would limit the liability to $3.55 billion, or two insured losses, which would raise the liability to $7.1 billion. Swiss Re carries twenty-two percent of the liability for the trade center building and filed the declaratory action for a judicial determination that the attacks constituted one occurrence. *Id.* Silverstein filed a counterclaim seeking prompt payment of the $3.55 billion, the amount which is not in controversy. *Id.* Swiss Re's share is twenty-two percent of the amount in excess of $10 million, or $778.1 million. *Id.* Silverstein is also requesting that the Court declare the attacks upon the World Trade Center as two events resulting in a recovery against insurers of $7 billion. *Id.* Legal costs are also being sought. *Id.*

24. Champion Int'l Corp. v. Cont'l Cas., 546 F.2d 502, 505-06 (2d Cir. 1976) (existence of over 1,400 separate claims constitutes a single occurrence in a standard CGL policy). *Champion* was a products defect case in which vinyl products were placed into a variety of consumer goods. *Id.* at 504. Over 1,400 claims arising out of over 1,400 separate occurrences. *Id.* Coverage was afforded by Continental Casualty on a "per occurrence" basis. *Id.* at 505. The Court determined that despite the number of separate occurrences giving rise to the claims, for excess insurance purposes, only one occurrence existed. *Id.* at 506. A standard ISO Commercial General Liability definition of "Occurrence" "means an accident, including continuous or repeated exposure to substantially the same general harmful conditions." Insurance Services Office, Inc., *Commercial General Liability Coverage* (1997) (on file with the author). In contrast, the reinsurance agreement in treaty reinsurance provides a broader definition which may encompass several occurrences arising out of one single event or common cause. This will pose an interesting challenge to and a dilemma for the cedent/reinsurance relationship. *See generally*, Graydon S. Staring, The Law of Reinsurance, Sec. 2.5 (CBC 1993) (aggregation of losses having a common origin "may be formulated in ways limited only by imagination.").

25. 868 F.Supp. 917 (S.D. Ohio 1994).

26. *Id.* at 919.

27. *Id.*

28. *Id.*

arguing that several "occurrences" had taken place within the definition of the term provided to Owens-Corning.[29] The Court, however, accepted ISLIC and Owens-Corning's position by stating:

> because application of multiple deductibles would create virtually no coverage, any interpretation of the term "occurrence" as a per claim term would render the umbrella policies meaningless. Certainly, Owens-Corning's position was influenced by this fact, and it was not unreasonable for ISLIC to accept Owens-Corning's position that the term referred to a single 'occurrence."[30]

Applying the standard remains problematic. It can be stated that the number of claims does not dictate the number of occurrences. However, the question remains whether the deliberate destructive act of crashing two passenger airliners into two buildings within one enormous office complex is one occurrence or two occurrences. Perhaps the key resides with whether the standard of "proximate, uninterrupted, and continuing cause" is met by the single act of hijacking civilian aircraft for the common purpose of concerted, organized action. Indeed, it is as much the proximate, uninterrupted, and continuing act that resulted in the massive damages sustained as the decision to manufacture asbestos caused the massive litigation experienced by the insurance industry over the past thirty years.

III. "FOLLOW THE FORTUNES" DOCTRINE MAY BIND REINSURERS

In a typical reinsurance arrangement between cedent and reinsurer, the loss settlement clause found in the contract binds the reinsurer to those settlements made while exercising the duty of utmost good faith by the cedent company.[31] The "follow the fortunes" doctrine, which originated in French law, gives rise to the modern day duty of the reinsurer to follow the settlement actions of the reinsured. While the first application is unknown historical research indicates that it was in use by 1850.[32] Its development

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29. *Id.*

30. *Id.* at 921.

31. William C. Hoffman, *Common Law of Reinsurance Loss Settlement Clauses: A Comparative Analysis of the Judicial Rule Enforcing the Reinsurer's Contractual Obligation to Indemnify the Reinsured for Settlements*, 28 TORTS & INS. L.J. 659, 661 (1993).

32. *Id.* at 665. The derivation of this concept comes from French law. It was known as the doctrine of "suivre la fortune" and was common within French, Swiss and German reinsurance agreements as early as 1850. By 1864, it came into usage in an English treaty with a Swiss reinsurer and was translated as "follow the fortunes." The doctrine, however, was not put into use in English reinsurance agreements on a regular basis until sometime

in Great Britain and the United States came later and the doctrine became internationally recognized as a principle of reinsurance law in 1984.[33] The principle is not an absolute and legal defenses to its application do exist, such as in situations where there is a breach of the duty of utmost good faith.[34]

Although internationally recognized within the past twenty years, New York applied the doctrine earlier in *Insurance Co. of North America v. United States Fire Insurance Co.*[35] This dispute arose under an open marine insurance policy issued to cover anhydrous ammonia while in transit in United States ports to the United Kingdom. One of the shipments was destroyed by a hurricane in 1969. The Court recognized the limitations of the doctrine by stating "it would be an unwarranted and indeed tortured construction of that clause to hold a reinsurer bound, for example, to pay if the prime insurer paid monies to its insured on a claim completely outside the scope of the policy and not in good faith."[36] The

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later. The doctrine today has multiple meanings and is treated under the two distinct but related concepts of the "original risk principle" and the duty to "follow the actions." The "original risk principle" is an implied-in-law duty that binds the reinsurer by its share of all aleatory obligations that may arise out of the primary insurance relationship automatically, that is, without the reinsured having to take any action. In contrast, the duty to "follow the actions" is not implied in law and refers only to settlements regarding liability or damages and other actions taken by the reinsured after a loss has occurred. In modern usage, the doctrine of "follow the actions" or "follow the fortunes" gives rise to the reinsurer's duty to follow the settlement actions of the reinsured. *Id.* at 665-67.

33. *Id.* at 668. The development of this French concept came into general usage in Great Britain after the abrogation of the Statute of George II 1746 which forbade the usage of the doctrine in reinsurance contracts. England, despite being able to write the doctrine into its reinsurance contracts, continued to wrestle with the concept on a legal level until international acceptance of the doctrine. The evolution of the doctrine within the United States was advanced over that of the British since the American courts took the view that the English Parliament never intended to bind the Statute of George II 1746 upon the colonies. *Id.*

34. *Id.* at 681. At least four defenses are widely accepted:

> The first and second relieve the reinsurer of its obligation under the loss settlement clause if, as a matter of law, the claim settled did not fall within the scope of the reinsurance or of the underlying insurance. The third and fourth defenses permit the reinsurer to deny the indemnity if dishonesty or other intentional breaches of the duty of good faith, including fraud, collusion, or "bad faith" on the part of the reinsured, can be proved, or to the extent that the reinsured failed to exercise due care in investigating the loss and ascertaining its amount.

Id. at 681.

35. 322 N.Y.S.2d 520 (1971).

36. *Id.* at 523.

Court determined that the stoppage of cargo as a result of the hurricane was an interruption in transit and did not create a risk insured under the contract of insurance.[37] "The defendant never consented to reinsure this loss not covered in the original insurance policy. Plaintiff's contention that, by implication, the defendant consented, in that defendant paid out some small warehouse claims is of no merit in determining the true contractual relationship between the parties."[38]

The Second Circuit has also addressed the limits of the "follow the fortunes" doctrine in an attempt to cover an award of punitive damages.[39] The Court determined that punitive damages were outside the scope of coverage provided in the reinsurance agreement and, therefore, it would be unfair to expect the reinsurance company to indemnify the cedent.[40] A recent case discussing the follow the fortunes doctrine found that it could be used to cover other costs associated with the claims that were paid by the cedent.[41] The follow the fortunes clause was intended "to prevent reinsurers from second guessing good-faith settlements and obtaining de novo review of judgments of the reinsured's liability to its insured."[42] There is no distinction between judgments or settlements in application of the doctrine.[43] In fact, judicial interpretation has, on occasion, damaged the traditional handshake relationship so prevalent within the historical reinsurance agreement.[44] As losses from terrorist attacks mount, the danger increases that reinsurers will simply not have the capacity to assume or spread the risk for future losses and that they view current claims payments and loss adjustment expenses with heightened skepticism. Indeed, the

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37. *Id.* at 524.

38. *Id.*

39. Am. Ins. Co. v. N. Am. Co. for Prop. & Cas. Ins., 697 F.2d 79 (2nd Cir. 1982). *See also*, John Morrison, *Punitive Damages and Why the Reinsurer Cares*, 20 THE FORUM 73 (1984). In *American Insurance*, the Second Circuit determined that punitive damages are similar to ex gratia payments of the cedent, that is, they are not contemplated as requiring the reinsurer to indemnify the cedent under the follow the fortunes clause in the reinsurance agreement. *Am. Ins.*, 697 F.2d at 81.

40. *Id.*

41. N. River Ins. Co. v. Cigna Reins. Co., 52 F.3d 1194, 1205 (3d Cir. 1995); *but see* Bellefonte Reins. Co. v. Aetna Cas. & Sur. Co., 903 F.2d 910, 914 (2d Cir. 1990) (holding that loss adjustment expenses incurred by the cedent are included within the limitation of liability of the reinsurer for indemnification of the cedent for paid losses).

42. *N. River*, 52 F.3d at 1199 (quoting Int'l Surplus Lines Ins. Co. v. Certain Underwriters of Lloyd's of London, 868 F. Supp. 917 (S.D. Ohio 1994)).

43. *Id.* at 1205.

44. *See generally*, Aetna Cas. and Sur. Co. v. Home Ins. Co., 882 F. Supp. 1355 (S.D.N.Y. 1995).

problem is already pervasive. "Insurance for losses from terrorism is disappearing, particularly for large businesses and those perceived to be at some risk. This withdrawal is happening fastest among reinsurers."[45] Such crises have arisen in the reinsurance market before with the huge losses sustained from environmental settlements and judgements in the 1970s and 1980s. It resulted in several reinsurance policies being uncollectible and nearly eighty primary insurers' insolvencies largely attributed to reinsurance breach of contract.[46]

Reinsurers base their premiums upon the risk reinsured and the experience of the cedent. If the cedent company has no liability to its insured, it cannot support a recovery against the reinsurer.[47] Historically, however, as long as the cedent enters into bona fide settlements, the reinsurer will usually be bound to its obligation to indemnify the cedent.[48]

IV. CUSTOM AND USAGE BETWEEN PARTIES MAY BIND REINSURERS

One final concept, which may be affected within the traditional reinsurer/cedent relationship as a result of the waiver of the war risk exclusion by cedents and the exposure of the reinsurer, is the custom and usage within the reinsurance industry. This is important in both arbitration disputes and litigation. This concept, however, must demonstrate custom and usage that is "definite or certain, uniform, reasonable, and well known, and it must be established by clear and satisfactory evidence, so that it may be justly presumed that the parties had reference to it in making their contract."[49] Custom and usage derives from common law and, therefore, may have limitations upon its relevance or the weight it may have as evidence.[50] A good discussion more contemporary than *American Guaranty*, is found in *Seven Provinces Insurance Co. v. Commerce and Industry Insurance Co.*[51] This case applied the traditional common law

45. GAO Report 02 472T, *Rising Uninsured Exposure To Attacks Heightens Potential Economic Vulnerabilities*, (Hillman, Feb. 27, 2002) [hereinafter Hillman].

46. Freedman, *When Reinsurers Renege*, BEST'S REV., Apr. 1987, at 30.

47. Mich. Millers Mut. Ins. Co. v. N. Am. Reins. Corp., 452 N.W.2d 841, 842 (Mich. App. 1990).

48. *See* N.Y. State Marine Ins. Co. v. Prot. Ins. Co., 18 F. Cas. 160 (D. Mass. 1841) (No. 10,216).

49. Am. Guar. Co. v. Am. Fid. Co., 260 F. 897, 899 (6th Cir. 1919).

50. Nat'l Am. Ins. Co. of Cal. v. Certain Underwriters at Lloyd's of London, 93 F.3d 529, 536 (9th Cir. 1996).

51. 65 F.R.D. 674, 685 (W.D. Mo. 1996).

concepts of custom and usage found in *American Guaranty*.[52] The Court found that it is not enough for a plaintiff asserting custom and usage that reinsurers, in a similar position as that within a given fact pattern, would have indemnified the cedent insurer.[53] The cedent must prove that custom and usage within its unique and individual relationship with the reinsurance defendant supports indemnification within a given fact pattern.[54] This concept is prevalent in the reinsurance relationship and continues to be a powerful motivator for a number of reasons. First, reinsurance contract interpretation has traditionally been left to a limited pool of arbitrators.[55] Second, because of the need for specialization in the reinsurance relationship, companies have been loathe to litigate disputes.[56] Third, the terms used in reinsurance agreements usually require arbitrators to resolve disputes by custom and usage instead of strict rules of law.[57] As reasoning as to why companies within the traditional reinsurance industry do not litigate cases and typically arbitrate disputes, one needs to look no further than the following quote from Hoffman in his treatise:

> [I]n a recent series of cases, the first court's use of the term "custom" in dicta was misunderstood by the second court to mean that the asserted reinsurance usage had been proved in the first case, and this misunderstanding was cited uncritically by at least three other courts in later cases as authority for the proposition that the asserted "custom" supplied an implied term in all reinsurance contracts.[58]

As used in the reinsurance industry, usage may include a standard meaning or word usage in addition to a method of performing a task.[59] Custom refers to a practice that is factually known to be so widespread that it has become established to be followed within its circle of critical influence.[60]

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52. *Id.*
53. *Id.*
54. *Id.*
55. William Hoffman, *On the Use and Abuse of Custom and Usage in Reinsurance*, 33 TORT & INS. L.J. 1, 3 (1997).
56. *Id.*
57. *Id.*
58. *Id.* at 6. *See also*, Mentor Ins. Co. Ltd. V. Norges Brannkasse, 996 F.2d 506 (2d Cir. 1993).
59. Hoffman, *supra* note 55, at 9.
60. *Id.* at 10. *See also*, Joseph H. Levie, *Trade Usage and Custom Under the Common Law and the UCC*, 40 N.Y.U. L. R. 1101, 1102 (1965).

V. IMPACT UPON THE REINSURANCE RELATIONSHIP

World Trade Center claims principally arose for the property and casualty industry from the personal property of employees in the damaged or destroyed buildings or in the vicinity surrounding the destruction zone. Approximately $100 million resulted in auto losses alone for locally parked cars.[61] The business relationship between primary insurers and their reinsurers has historically been one described as relying upon a handshake. These relationships have, in most instances, long-term legal and financial commitments.[62]

Reinsurance relationships have relied upon contracts between the parties that have been described as gentlemen's agreements.[63] The written contracts use terms that are in standard use internationally and engage the parties in business and contractual relationships over many years.[64] These long-term relationships were severely tested in the 1970s by the asbestosis litigation and by arbitrations, with the latter being the more common dispute resolution mechanism utilized by parties to these arrangements. The number of disputes required the industry to reply by establishing an industry-wide solution known as the Wellington Agreement.[65] The Wellington Agreement allowed companies to subscribe to a third party mechanism for dispute resolution that was purely voluntary.[66] However, this still did not guarantee that litigation would not ultimately result.[67] It remains to be seen exactly how the losses of September 11, 2001, will impact the traditional reinsurance relationship. However, most industry

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61. Larry Mayewski, *Everything Changes In a New York Minute*, Jan. 2002, at 15 (on file with the author). Even though this calculates direct losses as a result of the terrorist attacks, nationally personal lines carriers and, conversely, consumers will be affected indirectly through increased reinsurance costs already adversely affected from weather related losses through the latter 1990s.

62. *See generally*, Unigard Sec. Ins. Co., Inc. v. N. River Ins. Co., 4 F.3d 1049 (2d Cir. 1993).

63. Deborah F. Cohen, *Uberrimae Fidei and Reinsurance Rescission: Does a Gentlemen's Agreement Have a Place in Today's Commercial Market?*, 29 TORTS & INS. L.J. 602 (1994). As this work demonstrates, the traditional relationship between cedent and reinsurer was being questioned even before the losses of September 11th.

64. *See generally* Hoffman, *supra* note 31.

65. Unigard Sec., 4 F.3d at 1056.

66. *Id.*

67. *Id.*

executives and analysts agree that it will cause enormous disruptions within the industry for many years.[68]

The reinsurance industry has yet to determine whether, any provisions within their reinsurance treaties notwithstanding, they will take the same posture as the primary insurance companies have with respect to the September 11th losses. Even more problematic will be what position both cedents and reinsurers will take with respect to any future losses. Because insurance companies believe that neither the frequency nor the magnitude of future terrorist losses can be estimated, they are withdrawing themselves from the market. Insurance for losses from terrorism is disappearing, particularly for large businesses and those perceived to be at some risk. This withdrawal is happening fastest among reinsurers. It has been long established in the relationship between cedent insurer and reinsurer that their relationship is one built upon utmost good faith.[69] However, reinsurance treaties are written in such a manner so as not to expand the scope of coverage it provides to the cedent company so that the obligation of the reinsurer to indemnify the cedent only arises if the primary policy of insurance issued to the insured provides coverage.[70] In the event the cedent does make payment outside the scope of coverage issued to the insured under its policy, the reinsurer may be excused from performance under the reinsurance treaty.[71]

One of the more significant cases concerning the duty of utmost good faith between cedent and reinsurer is *Compagnie De Reassurance D'ile De France v. New England Reinsurance Corp.*[72] In this case, a dispute arose between a group of companies within The Hartford Insurance Companies which included the New England Reinsurance Corporation as a defendant.[73] The dispute centered around whether the defendant companies had exercised complete disclosure of all material facts before entering into the reinsurance relationship with plaintiff companies.[74] The Court established a high standard for the relationship of utmost good faith by determining that a claim of fraud in the reinsurance relationship may be

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68. Hillman, *supra* note 45.

69. *Unigard Sec.*, 4 F.3d at 1054.

70. *See* N. River Ins. Co. v. Cigna Reins. Co., 52 F.3d 1194 (3d Cir. 1995). *See also*, Hoffman, *supra* note 31 at 670. *See also* Indep. Ins. Co. v. Republic Nat'l Life Ins. Co., 447 S.W.2d 462 (Texas Civ. App. 1969).

71. *Id.*

72. 57 F.3d 56 (1st Cir. 1995).

73. *Id.* at 61.

74. *Id.* at 73 (discussing the meaning of facultative reinsurance in the relationship between cedent and reinsurer).

founded on innocent misrepresentation and concealment.[75] The Second Circuit has also addressed the doctrine of utmost good faith upon which the reinsurance relationship is based.[76]

In *Unigard*, an analogous case, defendant North River Insurance Company issued two excess insurance policies to Owens-Corning Fiberglass Corporation that provided coverage for asbestos related bodily injuries.[77] It subsequently purchased reinsurance to cover one hundred percent of its exposure, thus removing any warranty of retention.[78] Unigard was one of the reinsurers for North River through a facultative reinsurance relationship.[79] Unigard had the right to associate in the defense of the environmental claims which arose under the insurance policies issued by North River; however, North River had subscribed to a claims mechanism in order to handle the mounting costs associated with asbestos litigation and claims payments.[80] A delay in the notice to Unigard by North River frustrated Unigard's ability to participate in the defense under the insurance policies issued to Owens-Corning.[81] Because information regarding the risk lies with the cedent company, the reinsurance market depends upon a high level of good faith to ensure prompt and full disclosure that avoids duplication of resources.[82] By agreeing to the claims handling mechanism, North River caused a loss of Unigard's right to associate in the defense of the claims.[83] This sufficed to change the coverage rules that caused North River to pay some aspects of the losses which it otherwise would not have had to pay.[84] Be that as it may, the Court stated that Unigard must show more than the mere loss of a right

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75. *Id.*

76 Unigard Sec., 4 F.3d at 1064.

77. *Id.* at 1055. The Wellington Agreement created a third-party administrator to handle and process the increasing number of asbestosis claims throughout the industry. *Id.* at 1056. Several companies subscribed to the agreement. *Id.* Reinsurers created a similar mechanism known as Equitas. *See* Ostrager and Vyskocil, *Modern Reinsurance Law and Practice*, 2d ed. 2000, 13-51.

78. *Unigard Sec.*, 4 F.3d at 1055.

79. *Id.* at 1062.

80. *Id.* at 1068.

81. *Id.* at 1069. Reinsurers' and cedents' interests are essentially the same as to liability, but good faith coverage decisions do not generally constitute prejudice.

82. *Id.* at 1066. Loss of the right to associate in the defense of the claim for the reinsurer is insufficient to constitute prejudice without actual proof of economic injury. *Id.* at 1069.

83. *Id.* at 1068.

84. *Id.*

absent some economic injury.[85] The Court went on to discuss the standard appropriate for a showing of bad faith between cedent and reinsurer.[86] In doing so, the Court stated that the standard should be one of gross negligence or recklessness.[87] If the reinsurer observes routine practices of bad faith by the cedent, it may excuse performance by the reinsurer thereby excusing performance by the reinsurer.[88]

Therefore, while the obligation is of utmost good faith in the reinsurance relationship, the cedent cannot merely cover claims it does not owe. The burden is upon the reinsurer to prove both a breach of that duty of utmost good faith and that it sustained some tangible economic injury as a result.[89] In the context of the September 11th losses and the resulting claims, cedent insurers, by waiving the war risk exclusion, are obligated to provide coverage.

VI. INDUSTRY DAMAGE COMPOUNDED BY INDIRECT SOURCES AND UNCERTAINTY

It is still true today that most disputes between cedent companies and their reinsurers are handled through arbitration with well-established customs of the industry. However, this did begin to change with huge losses through asbestos and pollution claims in the 1980s arising under reinsurance contracts written in the 40s, 50s, 60s and 70s. The historic relationship allowed an increase in premium in a subsequent year to offset the current year's losses. Because these were the first long tail losses that reached back so many years, premium offset was not available. That, combined with the magnitude of losses, began the erosion of the traditional handshake relationship. The historic relationship allowed an increase premium in a subsequent year to offset current year's losses:

> Private compromise through informal, friendly communication between cedent and reinsurer is no longer the norm; of the ultimate concern is protecting against losses that might challenge the economic viability of the company, whether reinsured or reinsurer. Where once the parties could rely upon their own understanding of the reinsurance agreement, as manifested by their ongoing course of dealing,

85. *Id.* at 1069.
86. *Id.*
87. *Id.*
88. *Id.*
89. *Id.*

> many now turn to the courts, with an eye toward either maximizing recovery or minimizing exposure. The result has been less predictability and greater inconsistency in defining the nature and scope of the parties' obligations under the reinsurance arrangement.[90]

Despite the doom and gloom of that observation, the fact remains that the disruption in the relationship between reinsured and reinsurer has occurred as major losses mounted. It is a virtual certainty that terrorism losses, if repeated, will again test that relationship on a scale unforeseen. For the industry, the attacks came at a particularly difficult time:

> The terrorist attacks left the reinsurance market in a vulnerable position right at the time of treaty renewals. Reinsurers are pulling back capacity and examining deals more carefully than ever before. They are looking to pull capacity from marginally profitable lines, such as accident and health, so they can make the money available to property/casualty lines on which they can get greater return.[91]

Indeed, some industry observers have indicated that a successful negotiation in today's market may have changed from capacity at a given price to getting capacity at any price.[92] The problem today is summed up

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90. Debra Baker, *The Effect of Industry Custom and Practice and the Parties' Course of Dealing on the Application of "Follow the Fortunes" in Reinsurance Contracts*, 31 TORT & INS. L .J. 947, 948 (1996). Reinsurance disputes are problematic for courts because of the historically limited use of litigation to resolve disputes regarding reinsurance and the unique reinsurance relationship against application of the type of traditional strict contract interpretation approach that courts have utilized in interpreting the rights and obligations as between the original insured and the insurance company under insurance policies. *Id.*

91. Lynna Goch, *A Hard Landing*, BEST'S REVIEW, Dec. 2001 at 32 (*quoting* Norm Tardif, President of the management group of NiiS/Apex Holding Group, a reinsurance/insurance consulting firm).

92. *Id. See also*, Steven J. Dreyer, *Terrorism Coverage Remains in Doubt*, STANDARD AND POORS, Apr. 15, 2002. Reinsurers notified primary insurers soon after Sept. 11th that they would drop terrorism coverage when policies came up for renewal. *Id.* at 1. About two-thirds of property insurers lost their terrorism reinsurance coverage on January 1st and the remainder will lose it on July 1st. *Id.* Primary insurers in five states (California, Florida, Georgia, New York, and Texas) have not received permission to cancel terrorism coverage when corporate policies come up for renewal. *Id.* at 2. Many are turning, therefore, to the alternative risk market to avoid a regulatory squeeze. *Id.* Many sectors such as real estate, construction and airports now have either no terrorism coverage or reduced amounts that cover only a fraction of their exposure, and they are paying significantly more for it. *Id.* at 1.

in a statement made by Richard J. Hillman, Director, Financial Markets and Community Investment for the General Accounting Office:

> Faced with continued uncertainties about the frequency and magnitude of future attacks, at the same time government and military leaders are warning of new attacks to come, both insurers and reinsurers have determined that terrorism is not an insurable risk at this time. As a result, in the closing months of last year insurers began announcing that they could not afford to continue providing coverage for potential terrorism losses. The effects of this trend have yet to be fully realized, but there is some indication that it has begun to cause difficulties for some firms in certain economic sectors.[93]

One of the historical goals of terrorism is to disrupt the status quo, thus motivating people to pressure their governments to act. Certainly, a prime motivator for the western governments whose economic orders are based upon private ownership of property and a free market would be the collapse or major disruption of that economic order. Disruption or partial collapse of the private insurance system would, undoubtedly, cause a major disruption to the world economy sufficient to impact directly and indirectly all other sectors of the economy. One of the interesting ironies of this predicament is that the private insurance industry has taken steps to prevent this from happening. However, as we shall see, the best drafted exclusions do not always serve to insulate companies from assuming risks they did not intend to cover.

VII. PRIOR RESPONSES INSUFFICIENT AND EXISTING LAW IMPEDES RELIEF

"There are barbarians out there who hate America and Americans are struggling to understand why."[94] The fact that so-called trophy targets, especially those whose existence celebrated the success of the Western capitalist model of economy and government, were targets of terrorists should have been obvious in the 1993 bombing of the World Trade Center. That resulted in a criminal trial and conviction of terrorists with ties to the world terrorism network.[95] It is estimated that the international terrorist

93. Hillman, *supra* note 45.

94. Dreyer, *supra* note 92.

95. Richard Bernstein, *Trade Center Bombers get Prison Terms of 240 Years*, N.Y. TIMES, May 25, 1994, at A1.

network involves up to 3000 people operating in about thirty countries.[96] For decades the West has known that international airline routes were terrorism targets and that Western support of certain regimes in the Middle East increased the risk of terrorism to the United States.[97]

A Presidential Commission on Aviation Security and Terrorism was established in 1989 with three specific functions.[98] First, to evaluate policy options with aviation security; second, to conduct a comprehensive study and appraisal of practices and policy options with respect to preventing terrorist acts in aviation; third, the Commission was charged with investigating practices, policies and laws respecting the treatment of families of terrorism victims.[99] The Commission was established specifically in response to the destruction of Pan American World Airways Flight 103.[100]

Domestic terrorism has been a fixture in American history for generations and the fact that terrorist cells may operate within the boundaries of the United States has been known for years. After the pipe bomb explosion at Centennial Olympic Park in 1996, President Clinton ordered a three-part strategy to combat terrorism.[101] First, to rally the world community to stand with the United States against terrorism. Second, tougher enforcement and punishment within the United States and, third, tightening security on airplanes and at airports within the United States.[102]

The federal executive branch was not the only governmental entity addressing acts of terrorism. In terms of domestic terrorism, legal means at common law with remedies for money damages have long existed. Indeed,

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96. Tim Weiner, *The Building of a Network That is Global and Reliable*, N.Y. Times, Sept. 23, 2001 at B7.

97. President's Commission on Aviation Security and Terrorism, PUB. PAPERS, Aug. 4, 1989 [hereinafter President's Commission]. *See generally*, Pan Am. World Airways, Inc. v. Aetna Cas. & Sur. Co., 505 F.2d 989 (2d Cir. 1974); Eisenfeld v. Islamic Republic of Iran, 172 F. Supp.2d 1, 5 (D.C. Cir. 2000) (In a *60 Minutes* interview, admitted terrorist Idassan Salamah admitted receiving indoctrination training in Sudan and that additional terrorist training was provided through the support of Syria and Iran. This case arose out of a 1996 terrorist attack).

98. President's Commission, *supra* note 97.

99. *Id.*

100. *Id.*

101. Weekly Radio Address, PUB. PAPERS, Aug. 10, 1996.

102. *Id.* It is tragically ironic that the first component of President Clinton's strategy is today a central theme of President Bush's "war on terrorism." Additional acts of terrorism planned against other major targets, such as the Holland Tunnel in New York, have been thwarted.

only recently did U.S. courts allow money damages against organizations whose members had committed murder and destruction of property.[103] The problem becomes more difficult for U.S. victims of terrorist destruction when foreign cells commit such acts and, especially, when such cells do not operate within public view of their host nations. Despite this, Congress has provided private remedies against host nations whose governments are liable for money damages under specific circumstances.[104] Understanding that governments in certain regions of the globe actively allowed or participated in allowing terrorist organizations to operate within their borders without interference, Congress amended the Foreign Sovereign Immunities Act in 1996.[105] In certain circumstances, private citizens can succeed in obtaining judgements for money damages against nations identified as sponsoring terrorism by the U.S. government.[106]

The question posed to the industry is whether the government actions and public events within the United States and around the world that affected private citizens were adequate and, if so, why did we not see this coming? It would be unfair to lay blame upon the government or the insurance industry and it is not the intention of this article to do so. Rather, this question needs to be posed to government and industry leaders in order to avoid repetition of this type of event.

It is only recently that claims against the frozen assets of terrorist governments have been successful in the federal courts.[107] In *Eisenfeld* v.

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103. Pub. L. 104-132, Title II, sec. 221(a) (April 24, 1996), 110 Stat. 1241, 28 U.S.C. § 1605 (2000).

104. *See* Foreign Sovereign Immunities Act of 1976, 28 U.S.C. §§ 1602-1611 (2000). The federal statute grants federal court jurisdiction over suits involving foreign states, their officials, agents and employees under specific and narrow circumstances.

105. *Id.* The amendments themselves allowed a private cause of action against foreign organized governments. The original 1976 wording allowed no such claim. Therefore, the premise is obvious—why else would Congress allow a private cause of action against governments on the State Department's list of terrorist states? That is why *Eisenfeld* and *Weinstein* were both successful claims against assets seized by the U.S. of Iran and why *Daliberti* was successful against Iraq.

106. *See e.g.,* Weinstein v. Islamic Republic of Iran, civil action no. 00-2601 (RCL) (D.C. Cir. 2002); Daliberti v. Republic of Iraq, 97 F. Supp. 2d 38 (D.C. Cir. 2000); Eisenfeld v. Islamic Republic of Iran, 172 F. Supp. 1 (D.C. Cir. 2000).

107. *Daliberti,* 97 F. Supp. 2d at 38. In *Daliberti,* the plaintiff was a victim of torture by forces of the Iraqi Government in an effort to induce plaintiff to admit to spying. *Id.* at 41. In seeking money damages against the frozen assets of the Iraqi Government held in the United States, the plaintiff had to have met three conditions in order to sustain a claim. *Id.* at 44. First, the foreign state must have been designated as a state sponsor of terrorism. *Id.* Second, if the actionable conduct of that state occurred within its territory, then the state must be given the opportunity to arbitrate the claim. *Id.* Third, the plaintiff must be a

Islamic Republic of Iran[108] a wrongful death claim was brought against the Islamic Republic of Iran by the heirs at law of Matthew Eisenfeld who was killed by a terrorist bomb while studying in Israel in 1996.[109] The Islamic terrorist organization Hamas claimed responsibility for the bombing.[110] Hamas, an organization known to engage in terrorist acts, was supported in its actions by The Islamic Republic of Iran.[111] The wrongful death action was brought pursuant to the Foreign Sovereign Immunities Act of 1976 against the state of Iran, its intelligence service acting as its agent, and three officials acting in their official capacities.[112] This federal statute was amended by Congress in 1996 by the Antiterrorism and Effective Death Penalty Act which abrogated the immunity of foreign states for sponsorship of terrorism.[113] The 1996 amendments create a private cause of action against foreign states officially designated by the United States Department of State as state sponsors of terrorism for their material support of terrorist organizations.[114] However, successfully obtaining the judgement and levying upon the assets of such nations is another matter. As the Court stated in *Eisenfeld*, "plaintiffs have been unable to collect on their judgement, and the court views with considerable dismay the fact that the rule of law is being frustrated in that case."[115] In addition, often one of the obstacles to a successful collection of an award of money damages by private U.S. parties is the U.S. government.[116]

VIII. WAR RISK EXCLUSION SERVES AS AN IMPEDIMENT

War risk exclusions have been a fixture of commercial insurance policies and aviation policies for many years. A standard commercial general liability insurance policy would contain such an exclusion similar to the example below:

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citizen of the United States. *Id.* Daliberti met all of the conditions. *Id.* at 46. Those states determined by the U.S. State Department as state sponsors of terrorism include Iraq, Cuba, Iran, Libya, North Korea, Sudan, and Syria. *Id.* at 44.

108. *Eisenfeld*, 172 F. Supp. 2d (D.C. Cir. 2000).

109. *Id.* at 4.

110. *Id.* at 5.

111. *Id.* at 5.

112. 28 U.S.C. §§ 1602-1611 (2000). *See also Eisenfeld*, 172 F. Supp. 2d at 10.

113. 28 U.S.C. § 1605 (2000).

114. *See Eisenfeld*, 172 F. Supp. 2d at 7 (establishing in personam jurisdiction upon foreign states of terrorism).

115. *Id.* at 9.

116. *See generally*, Weinstein v. Islamic Republic of Iran, 184 F. Supp. 2d 13 (D.C. Cir. 2002); Daliberti v. Republic of Iraq, 97 F. Supp. 2d 38 (D.C. Cir. 2000).

> "Bodily injury" or "property damage" due to war, whether or not declared, or any act or condition incident to war. War includes civil war, insurrection, rebellion or revolution. This exclusion applies only to liability assumed under a contract or agreement.[117]

Aircraft exclusions are similar, but appear broader and more complex in their terminology.[118]

This exclusion was closely examined by the Second Circuit Court of Appeals in *Pan American World Airways, Inc. v. Aetna Casualty & Surety Co. et al.*[119] On September 6, 1970, a group of terrorists from the Popular Front for the Liberation of Palestine (PFLP) forced the crew of a commercial airliner to fly the hijacked plane to Beirut, Lebanon.[120] Once there, a demolitions expert from the same terrorist cell boarded the plane

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117. Insurance Services Organization, CG-00-01-10-01, standard CGL policy language (on file with the author).

118. An example of such an exclusion in an aircraft liability policy may read as follows:

> LOSS OR DAMAGE NOT COVERED . . .
> This policy does not cover anything herein to the contrary notwithstanding loss or damage due to or resulting from:
> 1. Capture, seizure, arrest, restraint or detention or the consequences thereof or of any attempt thereat, or any taking of the property insured or damage to or destruction thereof by any government or governmental authority or agent (whether secret or otherwise) or by any military, naval or usurped power, whether any of the foregoing be done by way of requisition or otherwise and whether in time of peace or war and whether lawful or unlawful (this subdivision . . . shall not apply, however, to any such action by a foreign government or foreign governmental authority . . . to a foreign country by any person not in lawful possession or custody of such insured aircraft and who is not an agent or representative, secret or otherwise, of any foreign government or governmental authority);
> 2. War, invasion, civil war, revolution, rebellion, insurrection or warlike operations, whether there be a declaration of war or not;
> 3. Strikes, riots, civil commotion . . . .

Pan Am. World Airways, Inc. v. Aetna Cas. & Sur. Co., 505 F.2d 989, 1994 (2d Cir. 1974)

119. 505 F.2d 989 (2d Cir. 1974). It is interesting to note that the Court took notice of the fact that the London market at the time of this case was the only private source of aviation war risk insurance and that American underwriters did not write war risk coverage for aviation risks. *Id.* at 994. As a result, the federal government was the only source of excess insurance over the London market limit. *Id.*

120. *Id.* at 993.

that was flown from Beirut to Cairo, Egypt.[121] The passengers were allowed to deplane and the aircraft was subsequently destroyed by the terrorists.[122]

The Second Circuit was called upon to apply the aircraft war risk exclusion mentioned above.[123] In doing so, the Court determined that a prerequisite for the exclusion to apply was that a de facto government was necessary and that the terrorists not act simply as an independent armed force.[124] The Court went on to analyze the specific terms that were involved in the exclusion as applied to the facts. In order for the word "war" to exclude coverage, the employment of force between governments was necessary.[125] Both English and American cases dealing with the term "war" in the insurance context deferred to the "ancient international law definition: war refers to and includes only hostilities carried on by entities that constitute governments at least de facto in character."[126] The Court determined that the loss of the Pan American 747 was not an act of war waged by or between organized states.[127] The fact that the PFLP had received financial support from several states did not suffice to give it the status of a "quasi-sovereign" state.[128]

The Court also analyzed the broader use of terminology in the exclusion whether the loss of the airplane was through "warlike operations." The Court determined that since the airplane was used for commercial purposes and not military, that its destruction could not

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121. *Id.*

122. *Id.*

123. *Id.* at 993-94.

124. *Id.* at 1009-11. This concept is very old in American jurisprudence. Cases growing out of the Civil War, the most clear example of usurped power in our history, are consistent with the rule that a de facto government is necessary to constitute a usurped power. *See* Ins. Co. v. Boon, 95 U.S. (5 Otto) 117, (1877). In *Boon*, a fire was set by soldiers of the Union Army during a battle with Confederate forces in Missouri. *Id.* The Supreme Court held that the Confederate soldiers were a usurped power and indicated that usurped power is either the power exerted by invading foreign enemies or by an internal armed force in rebellion "sufficient to supplant the laws of the land and displace the constituted authorities." *Id.* at 127. The concept that a military force requires the force of a quasi-governmental authority is deeply rooted in American jurisprudence deriving from this period.

125. Pan American, 505 F.2d at 1012-15.

126. *Id.* at 1012. *See also* Britain S.S. Co. v. The King, 1 A.C. 99 (1920) (in which Lord Atkinson states that "hostilities," a term certainly of no narrower scope than "war,"connotes the idea of belligerent enemy nations at war with one another).

127. Pan American, 505 F.2d at 1015.

128. *Id.*

constitute a "warlike operation." Similarly, the Court determined that the plane's destruction did not constitute property damage through "insurrection." In doing so, the Court applied a two part test to determine whether loss of the plane was an "insurrection." First, did its destruction arise from a violent uprising by a group or movement and, second, was the group or movement acting for the specific purpose of overthrowing a constituted government and seizing its powers?[129] While the first part of the test was met, the acts of the PFLP in destroying the 747 airplane did not arise for the express purpose of overthrowing a constituted government.[130] Therefore, the acts did not constitute an "insurrection."[131] Finally, Aetna argued that the all-risk policy's exclusion in part three excluded coverage because the destruction of the plane was "due to or resulting from . . . strikes, riots, civil commotion."[132] The Court, however, noted that the use of these terms carried a domestic flavor while the earlier terms, previously mentioned, had an international tone.[133] The Second Circuit also noted that clause three clearly was intended for domestic acts because, while the all risk insurers did not write insurance for war-related perils, they were willing to underwrite the clause three risk to the extent of $10 million in excess of $14 million.[134] Finally, coverage under the all risk policy for the destruction of the Pan Am 747 did exist since none of the terms employed in the war risk exclusion of the policy analyzed excluded coverage from Aetna.[135]

In another particularly lengthy and painfully twisted legal analysis interpreting a war risk exclusion under an all risk insurance policy, one New York Court considered the destruction of a Holiday Inn hotel located in Beirut, Lebanon, in 1974.[136] The policy excluded coverage for damages arising out of "[w]ar, invasion, act of foreign enemy hostilities or warlike

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129. *Id.* at 1022.
130. *Id.*
131. *Id.*
132. *Id.* at 1019.
133. *Id.*
134. *Id.* The Court took mention of the fact that "insurance authorities are in accord on the local nature of these perils." *Id.* at 1019.
135. *Id.* at 1022. What is particularly interesting about this opinion is not what it says, although logic appears to be placed on its head by the Court, but by what it does not say. No suggestion is made by the Second Circuit as to what the insurers could have stated in the exclusion for it to apply to the set of facts presented despite the sweeping scope of the exclusion as analyzed.
136. Holiday Inns, Inc. v. Aetna Ins. Co. v. American Commonwealth Assurance Company, Ltd., 571 F. Supp. 1460 (S.D.N.Y. 1983).

operations (whether war be declared or not), civil war, mutiny, insurrection, revolution, conspiracy, military or usurped power."[137] The Court reviewed the decision of the Second Circuit in *Pan American* and correctly noted that the insurer had the duty of proving that the proximate cause of the loss fell within one of the exclusions in the policy.[138] Similar to what the Second Circuit determined in *Pan American*, the court in *Holiday Inns* determined that the property's destruction did not arise from war, civil war or insurrection.[139] The court, however, also analyzed the use of the term "civil war" in its opinion.[140] However, it determined that "civil war" was not the proximate cause of the hotel's destruction since the terrorist group responsible for its ruin had never manifested an intention to declare a partition of that part of Lebanon it sought to control.[141] Partition of the country is an essential element for "civil war" to operate as an exclusion within the all risk policy.[142] The court, just as in *Pan American*, discarded revolution as a separate part of the exclusion since it merely served, like rebellion and civil war, as "progressive stages in the development of civil unrest, the most rudimentary form of which is 'insurrection.'"[143]

As both the *Pan American* and *Holiday Inns* courts observed, under an all risk or aviation insurance policy, it is not enough for an insurer to demonstrate that the damages fall within a war risk exclusion. Insurers also have the burden of proof that the loss was proximately caused by an excluded peril.[144] Given the destructive means of most terrorist groups and the secrecy within which they operate, this will be problematic for insurers looking to decline coverage.

In *New Market Investment Corp. v. Fireman's Fund Insurance Co.*,[145] the plaintiff, New Market, an importer of Chilean fruits, was forced to

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137. *Id.* at 1463. The underwriter who accepted the risk in this matter agreed to provide Holiday Inns with broader coverage than originally contemplated. Coverage for "civil commotion" was specifically provided by the terms of the policy. *Id.*

138. *Id.*

139. *Id.* at 1503.

140. *Id.* at 1493. Since the combatants did not intend to overthrow the government of Lebanon in their destruction of the Holiday Inn, this did not constitute a "civil war" for insurance purposes and was, therefore, not contemplated within the exclusion. *Id.* at 1497.

141. *Id.* at 1497.

142. *Id.*

143. *Id.* at 1494. *See also* Home Ins. Co. v. Davila, 212 F.2d 731 (1st Cir. 1954).

144. *Id.* at 1463.

145. 774 F. Supp. 909 (E.D. Pa. 1991) (use of the language "destruction of, or damage to" in the endorsement providing coverage for terrorism losses does not require that physical

destroy its products when an anonymous telephone call to the American Embassy in Santiago made threats to poison food products bound for export to the United States.[146] The caller stated that the poisoning of food products was being done to bring attention to the plight of the poor in Chile.[147] Shortly after the call, the Food and Drug Administration (FDA) and U.S. Customs Service lifted its ban on Chilean food products importation when the Department of State determined that the call had been a hoax.[148] However, increased inspection levels of products remained as a precautionary measure.[149] The loss to New Market increased when two Chilean grapes out of a shipment showed evidence of cyanide poison.[150] As a result, much of the fruit stock was destroyed, future shipments required increased inspection and testing and increased security was required in Chile of fruit bound for the United States.[151] New Market sought coverage under its Open Marine Cargo policy issued by defendant Fireman's Fund Insurance.[152] The policy contained an endorsement for Strikes, Riots and Civil Commotions under which coverage was sought.[153] A jury did find coverage for plaintiff and determined that the proximate and real efficient cause of the loss was due to terrorist acts of Chilean radicals.[154]

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damage to the property insured occur in order for liability to attach to the loss, thus Fireman's Fund cannot require that physical damage occur as a defense to its contractual duty).

146. *Id.* at 911-12.

147. *Id.* at 911.

148. *Id.* Two telephone calls from the same individual were made threatening damage to fruit products with the second call causing the FDA to increase inspection levels of fruit bound for the United States. *Id.*

149. *Id.*

150. *Id.* at 912. In response to the threat, a three-pronged approach to the increased inspection was agreed to between the Chilean trade organization of which plaintiff's subsidiary was a member and the FDA. *Id.* However, despite the efforts undertaken to restore consumer confidence in Chilean fruit products, substantial losses in market occurred, for which New Market sought coverage. *Id.*

151. *Id.*

152. *Id.* at 911.

153. *Id.* at 912.

154. *Id.* at 915. *See also* TRT/FTC Comm., Inc. v. Ins. Co. of Pa., 847 F. Supp. 28 (D. Del. 1993). In *TRT*, the plaintiff communications company brought a claim against their insurer for losses suffered in Panama during the conflict between the United States and the Republic of Panama; the loss was merely for stolen merchandise. *Id.* at 28-29. Defendant insurer had a war risk exclusion in its policy and in its Riot and Strike Endorsement. *Id.* The court determined that regardless of whether the men responsible for the loss were part

However, in *7200 Scottsdale Road General Partners v. Kuhn Farm Machinery, Inc.*,[155] plaintiff Scottsdale Resort sought reimbursement for losses when defendant Kuhn cancelled its convention as a result of the Gulf War.[156] Kuhn was frustrated in its attempts to unveil several new products to dealers and employees and many refused to attend based upon general statements of worldwide terrorism by Iraqi President Saddam Hussein.[157] The defendant countered that it was excused from performance as a result of "substantial frustration" and impracticability of performance.[158] The Court determined that Kuhn was not excused from damages under its contract with Scottsdale Resort under either impracticability of performance or frustration of purpose.[159]

In summary, insurers have an uphill battle in declining coverage under the war risk exclusion or similarly worded policy terms under most types of policies in use today. The proximate cause of loss must come from terrorist acts and it is insufficient, in most instances, if actual damage does not result. In addition, insurers will have difficulty under the majority judicial interpretation of these exclusions in using the exclusion as a basis for declining coverage.

What does this mean in terms of the attacks sustained against the United States on September 11, 2001? One informed expert has opined that it would not be difficult to make a compelling argument for the application of the "war risk" exclusion to the events of September 11th. Nonetheless, the consensus among some that quickly emerged was that the application of the "war risk" exclusion to the September 11th attacks, because they were apparently orchestrated by Osama bin Laden's al-Qaeda terrorist network, lacked the necessary sponsorship of a government or sovereignty to qualify as "war." However, if direct evidence, as seems to be suggested by some political leaders, indicates that an organized

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of the Panamanian forces or simply a band of looters, the damage sustained by TRT would not have occurred but for the declared war against the government of Panama. *Id.* at 30.

155. 909 P.2d 408 (Ariz. App. Div. 1995).

156. *Id.* at 410. The agreement signed by Kuhn exposed them to a graduated scale of damages depending upon when the cancellation took place. *Id.* at 410 n.1. Kuhn's postponement of the convention exposed it to liquidated damages in excess of $150,000. *Id.*

157. *Id.* at 411.

158. *Id.* at 410. Frustration of purpose occurs when the problem that arises when a change in circumstances makes one party's performance virtually worthless to the other. *Id.* Performance remains possible but the expected value of performance to the party seeking to be excused has been destroyed by a fortuitous event which supervenes to cause an actual but not literal failure of consideration. *Id.*

159. *Id.* at 418.

government may have responsibility for assisting the September 11th terrorists, then the war risk exclusion should afford a basis to decline coverage.[160] Such evidence, if it exists, has not been publicly revealed. However, the investigation into an organized government's complicity continues today. This will be key as to whether current judicial interpretations of the "war risk exclusion" will bind reinsurers through the "follow the fortunes" doctrine or make claim payments ex gratia. As has already been discussed, this may not be problematic for the cedent companies now, however, if through current judicial interpretation of the war risk exclusion an organized government or state is found to have been involved, reinsurers may be excused from indemnifying their cedent companies. After all, the investigation by the entity most capable of conducting a thorough investigation, the federal government, is still continuing.

In the event such evidence is one day developed, then insurers may have a legitimate basis for applying policy exclusions. The relationship between cedent and reinsurer, while already complicated by publicly known events, will inevitably become more complicated should such direct evidence some day come to light.[161]

As has already been mentioned, the losses sustained as a result of September 11, 2001, and the likelihood of additional terrorist actions will continue to challenge the insurance industry and, specifically, the traditional relationship between cedent and reinsurer. "One of the aspects of terrorism is its targeting of the innocent with the intent to create maximum emotional impact."[162] Based upon what has already occurred, it is more likely that as the United States wages its declared "war on terrorism" that our targets of that war will strike back against the United States and that their targets will not be limited to military losses.

> Prior to September 11, 2001, insured losses resulting from terrorism in this country were extremely infrequent. Insurance companies considered the risk so low that they did

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160. *See* Randy J. Maniloff, *The War Risk Exclusion-Looking Beyond The Events of Sept. 11th*, MEALEY'S LITIG. REP., Dec. 11, 2001 (quoting Senator Joseph Lieberman, D-Conn, in an October 29, 2001, article in *The Wall Street Journal*). The Bush Administration initially stated that it had no direct evidence linking the government of Iraq to the losses of September 11, 2001, but recently began calling for a renewed effort to return weapons inspectors to Iraq and has attempted to gain international support for a land war to remove the Iraqi government. *Id.*

161. *Id. See also* Christopher Oster, *Insurers to Pay Despite Chance for Exclusions,* WALL ST. J., Sept.17, 2001, at 12.

162. Eisenfeld v. Islamic Republic of Iran, 172 F. Supp. 2d 1, 9 (D.C. Cir. 2000).

> not identify or price potential losses from terrorist activity separately from the general property and liability coverage provided to businesses. But after the September 11th attacks, insurance companies recognized that their risk exposure was both real and potentially enormous . . . . Many insurers now consider terrorism an uninsurable risk, at least for the moment.[163]

While the closest comparison in terms of risk management is risk analysis and methodologies that have been applied to natural disasters, the fact is that risk management of losses by terrorist acts is much different to analyze.[164] The most important distinction is that while disasters such as hurricanes and crop disease are natural occurrences to which traditional modeling techniques apply, terrorism is an occurrence which requires both intelligence and intentional action.[165]

The most widely circulated solution to the risk is to establish a public/private insurance component with private insurers providing the primary layer of coverage (and perhaps secondary layers), but having the United States government serve as the excess insurer of last resort. This proposal would ensure that the private market underwrite the primary exposures with the public assuming a stop gap for the insurance industry in order to avoid unlimited exposure to them, not unlike the federal crop insurance system or the Medicaid system.[166] Such a system has been developed as a result of September 11th losses for the airline industry.[167]

Congress passed the Air Transportation Safety and System Stabilization Act on September 23, 2001.[168] The law creates a stop loss on

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163. Hillman, *supra* note 45.

164. JOHN A. MAJOR, ADVANCED TECHNIQUES FOR MODELING TERRORISM RISK (2002)(expanded version of a talk given at National Bureau of Economic Research Insurance Group Conference on Feb. 1, 2002).

165. *Id.* at ¶3. The "intentional acts exclusion" may also seek to deny recovery by insureds and, consequently, for primary insurers to obtain recovery against reinsurers. *Id.* However, this will largely depend upon whether the policy in question issued by the primary insurer/cedent is an all risk policy or a named perils policy. *Id.* The type of policy determines the degree of ultimate risk transfer from the insured to its primary insurer and from the primary insurer to the reinsurers. *Id.*

166. Amend to H.R. 3210, § 6 (2001). A Senate version has also received passage and both versions are in conference committee.

167. H.R. Doc. No. 2926 §101(a), 107th Cong., 1st Sess. (2001). It took Congress only eleven days after September 11, 2001, to provide relief to the seriously impacted airline industry. *See Bush Signs Measure Aiding Airline Industry*, L. A. TIMES, Sept. 23, 2001, at 18.

168. *Id.*

behalf of the airline industry from the full faith and credit of the United States up to a limitation in the aggregate of $5 billion,[169] and establishes a third-party mechanism for adjudicating relief.[170] The law also requires a reimbursement provision from the indemnified airlines to cover increases in insurance costs ending before October 1, 2002 and provides coverage for acts committed on or to an air carrier during the 180 days following enactment of the Act.[171] The Secretary of Transportation is empowered to certify that the damages arose from a terrorist act and limits the airlines' responsibility for losses suffered by third parties to $100 million in the aggregate for all claims arising out of such a terrorist act.[172] There are also limitations on liability for punitive damages.[173]

The law also establishes jurisdiction within the federal courts for losses sustained from the attacks of September 11, 2001, specifically, the United States District Court for the Southern District of New York.[174] A Special Master is appointed by the Attorney General as a means of arbitrating disputes with similar limitations upon the authority of the Special Master in monetary remedies as are found within the federal cause of action should the parties pursue remedies in court.[175] While exclusive jurisdiction resides within the federal judiciary for claims for damages by third-parties for loss as a result of airline terrorism, no similar federal law has been enacted to limit other types of insured losses from September 11, 2001, since the new federal law is very limited in scope. Early court rulings seem to apply a narrow construction of the federal law's applicability to aircraft related losses despite the need for some type of relief and federal response for the insurance industry.[176]

The insurance industry is not the only sector of the economy supporting this type of program. Several trade organizations, companies

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169. Air Transportation Safety and System Stabilization Act § 101(a)(2), Pub. L. No. 107-42, 115 Stat. 230 (2001) (codified at 49 U.S.C. § 40101 note) (hereinafter ATSSSA).

170. *Id.* § 102(b)(1).

171. *Id.* § 3201(b)(1).

172. *Id.* § 201(b)(5)(B)(2).

173. *Id.*

174. *Id.* § 408(b)(3).

175. *Id.* § 404(a).

176. *See* Canada Life Assurance Co. v. Converium Ruckversicherung (Deutschland) AG, 2002 U.S. Dist. LEXIS 6924 (S.D.N.Y. Apr. 19, 2002). The court declined to adopt an expansive application of the Air Transportation Safety and System Stabilization Act's liability limitation as narrowing legal liability to only losses directly pertaining to claims against the airline industry as a result of September 11, 2001, claims. *Id.* at 328-29. Thus, the court declined jurisdiction over the claim directly asserted.

and associations are pursuing some type of action since "the insurance industry has neither the capacity nor the willingness to underwrite comprehensive terrorism coverage at this point in time."[177] Additional support by the federal government has already been granted to the airline industry and additional solutions are being explored within the private industry in order to manage the increased risk of loss.[178] Unfortunately, however, the attention span of the nation's capitol to the needs of the rest of the country's private industries remains short despite broad support. Some private interest groups are also aligning against solutions that may limit the unlimited exposure of insurers by capping punitive damage exposures.[179] Congress is making progress, however, towards some comprehensive relief through a federal stop loss of catastrophic insured losses, particularly for commercial insurers.[180]

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177. Steven Brostoff, *Non-Insurer Coalition to Push Backstop,* NAT'L UNDERWRITER, Feb. 18, 2002 at 6. *See also* Steven J. Dreyer, *Terrorism Coverage Remains in Doubt,* STANDARD & POORS, Apr. 15, 2002, at ¶14. When a 1992 terrorist attack by the Irish Republican Army occurred, it led to the establishment of Pool Re, a mutual insurance company owned by more than 200 insurers and guaranteed by the British government. Carolyn Aldred & Mark A. Hofmann, *Government Role Seen in Terrorism Risk Pools*, BUS. INS., Mar. 25, 2002, at 3. It acts as an insurer of last resort. *Id.* The primary insurers individually cover the first layer of terrorism claims. *Id.* Claims are then paid by Pool Re through assessments on members. *Id.* If still more coverage is required, the government steps in as the insurer of last resort. *Id.* The French government covers the gap in insurance and reinsurance coverage in response to September 11 losses through a backstop provided by its government insurer, Caisse Centrale de Reassurance. *Id.* Germany has discussed mechanisms also, but the government insists on a liability cap. *Id.*

178. Ameet Sachdev, *Airlines Consider Creating Insurance Cooperative*, CHI. TRIB., March 1, 2002, at N1. Probably nowhere else in the global economy has insurance capacity dried up so completely and quickly as it has for air transportation. *Id.* The federal government has provided a reinsurance backstop for airlines with a "$15 billion airline aid package . . . with $10 billion going to federal loan guarantees and credits and $5 billion going to help with incurred losses and insurance costs." David Pilla, *Unprecedented Exposures,* BEST'S REV., APR 1, 2001 at 22. "[T]he insurance amount was capped at $50 million for each airline carrier." *Id.*

179. Robert Novak, *Bush vs. Trial Lawyers*, CHI. SUN. TIMES, April 8, 2002, at 27.

180. *See* HR H8593 and HR H6133. The bills have some similar features, including an industry-wide retention, aggregate limitations on federal risk exposure, industry reimbursement, and jurisdiction with the Treasury Department. The Senate version, however, appears to be broader in what defines a terrorism loss and the lines of insurance which qualify for federal relief. The Senate language also seems to be unambiguous with respect to the federal exception within the reverse preemption of the McCarran-Ferguson Act. *See* 15 U.S.C. § 1012(b) (2000).

The Senate version also provides clearly for the federal government's ability to subrogate against third parties for paid losses. It is silent on any private right of subrogation and whether there would be any priority of interest. The House version provides for industry

CONCLUSION

In light of the limited success of private parties to pursue money damages against states that sponsor terrorist organizations through the Foreign Sovereign Immunities Act, as amended in 1996, Congress may also consider not only making such claims easier to prosecute, but to collect upon for wrongful acts. Indeed, suits for money damages for the willful destruction of property or innocent life currently are limited by the construction of the FSIA and its amendments and by current judicial interpretations of the "war risk exclusion."[181] A partial solution to making terrorist destruction an easier risk to manage could be to allow private parties, including insurers who indemnify losses resulting from terrorism, to bring claims for money damages against terrorist organizations and to be able to collect from assets seized by international governments opposing terrorism. Of course, a governmental component to the risk management is essential. The federal government and its resources have the technical and intelligence expertise to assist private industry in risk modeling and loss analysis. In addition, the federal government has a responsibility to aid the private insurance industry in its efforts to manage and insure terrorism risks.

To do nothing means that the al-Qaeda network has already achieved one of its expressed goals in mounting the September 11, 2001, attacks, that is, to destroy the American economy by permanently damaging, possibly destroying, one important historic legal relationship of western economies—the cedent/reinsurer relationship.

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assessments unless insolvency is a concern. The House also allows for direct policyholder surcharges, while the senate bill is silent on the issue. The Senate bill provides for punitive damages and removes such damages as being within the scope of insured losses. The House version eliminates relief based upon punitive damages and limits noneconomic damages allocations to each defendant's percentage of fault.

Generally, the Senate language appears to be better drafted.

181. *See* 28 U.S.C. §§ 1330, 1332, 1602 (2000).

COMMENT: SPECULATING A STRATEGY: SUING INSURANCE COMPANIES TO OBTAIN LEGISLATIVE REPARATIONS FOR SLAVERY

Paige A. Fogarty[*]

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INTRODUCTION

The legacy of slavery is as much a "peculiar institution"[1] as the 246-year period during which African Americans were forced to labor without pay while their masters, businesses and the government reaped the tremendous financial benefits. The effects of slavery have shaped a culture of people who, to this day, question their collective sense of self and place in this nation. Yet, the United States has never formally made an attempt to make African Americans whole, financially or otherwise. To aggregate

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1. Slavery has been referred to by academics as the "peculiar institution" because slavery as an institution has no parallel in American history. The length of time that chattel slavery remained legal, considering the moral reprehensibility of owning fellow human beings, led scholars to dub slavery the "peculiar institution." As hard as other groups' plights have been, African Americans are the only group to suffer chattel slavery and zero compensation for their labor followed by 138 years of race-based discrimination. *See* 147 CONG. REC. E981-E982 (daily ed. May 25, 2001) (statement of Hon. Chaka Fattah).

the amount of wages earned by slaves in addition to financial losses suffered through years of discriminatory employment practices would likely be impossible, though some have made the attempt.[2] Compensating African Americans for centuries of pain and suffering would be just as difficult. The seemingly overwhelming nature of the problem has led many to throw their hands up in frustration and proclaim that the damage is simply no longer quantifiable or remunerable in traditional terms.[3] Alternatively, critics maintain reparations have been made in the form of existing social programs and through affirmative action.[4] However, there is a growing and crystallizing movement in favor of reparations being paid to African Americans for the ill-gotten gains of slavery. There is much dissention about how, and by whom, reparations should be made. This Comment will focus on the lawsuits that have already been and will continue to be filed against insurance companies who profited from insuring slaves' lives, with their masters as beneficiaries.[5]

Part I will discuss the background of the reparations movement and why the "peculiar institution" differs from other wrongs for which the United States has apologized and paid reparations. Further, this section will explain the reasons why a cohesive, serious attempt to obtain reparations has not and could not have occurred until recently. Additionally, previous attempts to sue the United States for reparations will illuminate some looming potential problems that, as will be shown in Part

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2. Jack E. White, *Don't Waste Your Breath: The Fight for Reparations is a Morally Just but Totally Hopeless Cause*, TIME, Apr. 2, 2001, at 48 (arguing that it would take $24 trillion to settle a claim for the pain, suffering and unpaid labor of millions of slaves). *See also* Vern E. Smith, *Debating the Wages of Slavery*, NEWSWEEK, Aug. 27, 2001, at 20 (estimating that in 1850, some ten to twenty percent of the entire U.S. wealth was human chattel).

3. Stuart Taylor, Jr., *Paying Reparations for Ancient Wrongs is not Right*, NAT'L J., Apr. 7, 2001, at 1005.

4. Cathy Young & Michael W. Lynch, *Internal Constraints: Author John McWhorter Discusses Negative Cultural Traits Among African Americans*, REASON, Oct. 1, 2001, at 36 (arguing that reparations are not necessary and that, in essence, we already have them in the form of "welfare, workfare, [and] affirmative action"). *See also* White, *supra* note 2, at 48 (noting that the reluctance of the government and corporations to pay reparations for slavery and stating that there are too many other pressing issues to "waste resources on a glorious lost cause.").

5. Smith, *supra* note 2, at 20 (stating that reparations activist Randall Robinson, along with attorneys Johnnie Cochran, Charles Ogletree, and others, are preparing a reparations suit to be filed next spring). *But see* V. Dion Haynes, *Drive Targets Racial Labels in California*, CHI. TRIB., Dec. 26, 2001, at 18 (stating that the suits were originally postponed because the events of September 11, 2001 have become a more dominant social concern).

II, will accompany any reparations suit. Finally, this section will both take up the formation of a more cohesive reparations effort, and set up the debate about those remedies that would be most appropriate and who should bear the financial burden of making African Americans whole.

Part II will use the proposed suits against insurance companies as a lens to analyze the likely legal claim of unjust enrichment. After setting out the meaning of unjust enrichment, the facts regarding the issuance of slave policies will be superimposed upon that framework to illustrate the weaknesses of this claim. This Comment will then examine the general weaknesses that will likely accompany any reparations suit, as they specifically impact suits against insurance companies. Deadria Farmer-Paellman has filed the most notable suit thus far and her unjust enrichment claim will be evidence of such weaknesses.[6] These potential pitfalls include standing, statutes of limitations and, if brought as a class action, class certification problems.

Finally, Part III will address the admitted alternative goal of the reparations suits: telling the tale of slavery on a judicial stage in order to get public and legislative notice. The author will make the case that these suits are a means to an end of legislative reparations. Statutes passed in California mandating the publication of information regarding policies issued by insurance companies on slaves' lives provide grist for the reparations suits mill, which in turn, can make legislatively based reparations a more viable goal.

I. BACKGROUND

A. Reparations for Slavery: Why now?

Slavery was abolished in the United States 138 years ago and yet only recently has a movement developed the strength to seriously contemplate legal claims that will hold up to a motion to dismiss, and get major cities[7] and some members of Congress[8] to rally behind the idea of paying

6. Farmer-Paellman Complaint ¶¶ 66-70 (on file with the author).

7. Diane Cardwell, *Seeking out a Just Way to Make Amends for Slavery*, N.Y. TIMES, Aug. 12, 2000, at B7 (noting that Chicago, Detroit, Cleveland and Dallas support Federal hearings on reparations).

8. Jeffrey Ghannam, *Repairing the Past,* 86 A.B.A. J. 38, 42 (Nov. 2000) (noting that Representative John Conyers (D-Mich.) has introduced a bill in the House of Representatives every year since 1989 calling for the president to appoint a commission to study reparations (which has, as yet, gone unanswered)). Also, Represenative Tony P. Hall

reparations in some form for chattel slavery. Much had to occur to get to this point.[9] Americans had to experience the worst in terms of race relations in order to get to the other side. Thus, Jim Crow eventually gave way to the Civil Rights Movement. On this continuum from literal and figurative slavery to physical and actual freedom, we, as a nation, are finally ready to address a wrong in our past that is arguably as bad as any other and whose ramifications are ongoing. As well, given the success of reparations movements for survivors and descendants of the Holocaust and Japanese Americans who were placed in internment camps, the African American reparations movement is gaining momentum.[10]

Further, the aggregate effects of the legacy of slavery are mounting to a level that can no longer be ignored. African Americans "continue to have the highest or near highest rates of poverty and infant mortality;" additionally, they "are more likely to be the victims of violence or suffer from HIV/AIDS than any other group" in the United States.[11] While it is debatable whether the current problems faced by African Americans can be traced back to slavery, the massive injuries inflicted on African Americans during slavery have impacted an entire culture.[12] The promise of forty acres and a mule that was made to former slaves has gone unfulfilled, and this truth has been passed down through generations of African Americans who feel they are owed compensation.

Out of this feeling that America's promise to African Americans has gone unfulfilled has come a group of scholars and lawyers that favor reparations for slavery. This group, that has grown and solidified into a movement, has proposed reparations in several forms. Fundamentally,

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(D-Ohio) has introduced the Apology for Slavery Resolution of 2000 (H. R. Con. Res. 356)), *available at* http://thomas.loc.gov.

9. Michael Eric Dyson, the Ida B. Wells Barnett Professor of religious studies at DePaul University in Chicago, Illinois, has stated, "[f]or so long it was just ludicrous for black folk to even bring up the notion that they might be entitled to some just compensation .... It was simply crazy." Cardwell, *supra* note 7, at B7.

10. Meg Green, *In Search of Policies Past: California Slave Policies*, BEST'S REV., Jan. 1, 2001, at 86.

11. Earl Ofari Hutchinson, *Congress Must Apologize for Lasting Evils of Slavery*, L.A. TIMES, June 20, 2000, at B9.

12. As early as 1973, Boris I. Bittker pointed out that slavery's consequences were "everywhere to be seen . . . had segregation not been enforced by law, the residue of slavery might be hard to identify today." BORIS I. BITTKER, THE CASE FOR BLACK REPARATIONS 28 (Random House 1973). Another prominent reparations scholar, Randall Robinson, noted that the gap between whites and blacks in America "has been resolutely nurtured since [the end of slavery] in law and public behavior. It has now ossified. It is structural." RANDALL ROBINSON, THE DEBT 204 (Plume Books 2000).

reparations supporters would like an apology from the federal government and private corporations who profited from the institution of slavery. The federal government, as recently as 1998, has declined to make any apology for slavery.[13] The Bush administration has strongly opposed legislation for reparations.[14] Former President Clinton was concerned with the legal implications of formal apology.[15] Clinton feared legal and moral pressure to make reparations to the descendants of slaves.[16] Legislative-based reparations would likely prove very expensive, and Clinton worried that it would also "inflame racial tensions."[17]

Having repeatedly tried to get Congress to examine their claims and take action to repair the ongoing damage rooted in slavery,[18] supporters of the reparations movement, as with most civil rights issues, have been relegated to the courts.[19] Judicially determined reparations are currently popular among reparations supporters.[20] Suits have been and will continue to be filed in both state and federal court seeking judicial redress for slavery. However, while going through courts by filing suits against the federal government and corporate entities, proponents could simply be attempting to put pressure on these future defendants to rally support for

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13. Douglas Stanglin, *Clinton Opposes Slavery Apology*, U.S. NEWS AND WORLD REPORT, Apr. 6, 1998, at 7. However, as the author will later discuss, an apology has been issued by Aetna, Inc. for its role in issuing insurance policies insuring slaves as the property of their masters.

14. Michael Kranish, *Blacks Rally on Capitol for Slavery Reparations*, BOSTON GLOBE, Aug. 18, 2002, at A3. Condoleezza Rice, herself an African American in a position of power within the Bush administration, believes that slavery was the "birth defect" of the United States, but that there was no justification for paying reparations, as it is better "to look forward and not point the finger backward." *Id.*

15. Stanglin, *supra* note 13, at 7.

16. *Id.*

17. *Id.* Indeed, Niger Innis of the Congress of Racial Equality, has elaborated on the potential for increased racial tension: "There will be an internal civil war within black America not to mention creating a wedge between black America and the rest of America." *CNN Saturday Morning News: Should Slave Descendants be Granted Reparations?* (CNN, Television Broadcast, Mar. 30, 2002), *available at* http://www.lexis.com. *But see Amer. Morning with Paula Zahn: Activists Discuss Reparations Lawsuits* (CNN, television Broadcast, May 2, 2002), *available at* http://www.lexis.com (where Charles Ogletree, a prominent figure within the reparations movement, noted that "we still see two Americans, one black and one white. They're separate and unequal. That's what we're trying to address [by bringing suit for reparations].").

18. Ghannam, *supra* note 8, at 39-40.

19. Smith, *supra* note 2, at 20.

20. Randall Robinson, Human Rights Semester Address at the University of Connecticut (Nov. 6, 2001).

more broad-based legislative action. The major obstacle to this strategy has been and continues to be finding a legal claim that will survive a well-crafted motion to dismiss.

B. Previous Ventures Into the Courtroom: An Exercise in Futility

1. Suing the United States: Barred by Statute of Limitations

In 1994, Kenneth I. Powell brought suit pro se against the United States seeking reparations for harms he claimed were suffered by himself, his ancestors, and other African Americans as a result of slavery, segregation, and continuing discrimination in the United States.[21] The United States District Court for the Northern District of California found that Powell's claims, though morally persuasive, lacked a cognizable legal basis.[22] Further, the court held that his claim was barred by 28 U.S.C. § 2401.[23] The statute provided that "every civil action commenced against the United States shall be barred unless the complaint is filed within six years after the right of action first accrues."[24] Slavery ended well over six years ago and under the very literal construction taken by the district court, the action was dismissed with the court advising that Congress was "a far more promising arena than the courts for advancing such claims."[25]

2. Overcoming the Statute of Limitations but Still Burdened by Sovereign Immunity

The Ninth Circuit's decision in *Cato v. United States* illustrated that a federal court was willing to fully examine a claim for reparations.[26] The plaintiffs sought substantial monetary damages that they argued were caused by slavery and subsequent discrimination against them.[27] In

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21. Powell v. U.S., No. C94-01877CW, 1994 U.S. Dist. LEXIS 8628, at *1 (Cal. Dist. Ct. App. June 20, 1994).

22. *Id.* at *2.

23. *Id.*

24. *Id.* at *1.

25. *Id.* at *1-2.

26. Cato v. U.S., 70 F.3d 1103 (9th Cir. 1995).

27. Specifically, Cato's complaint called for compensation of $100 million for forced, ancestral indoctrination into a foreign society; kidnapping of ancestors from Africa; forced labor; breakup of families; removal of traditional values; deprivations of freedom; and imposition of oppression, intimidation, miseducation and lack of information about various aspects of their indigenous character. She also requests that the court order an acknowledgement of the injustice of slavery . . . as well as of the existence of discrimination against freed slaves and their descendants from the end of the Civil War to the present. In addition, she seeks an apology from the United States. *Id.* at 1106.

addition, the plaintiffs requested acknowledgement of discrimination and an apology.[28] The court ultimately dismissed Cato's complaint, finding it frivolous within the meaning of 28 U.S.C. § 1915(d).[29] The frivolous nature of the complaint was rooted in the plaintiff's lack of standing as well as her inability to meet the burden of showing a waiver of sovereign immunity.[30]

Unlike *Powell*, however, this court did not find that the action was primarily barred by the statute of limitations.[31] Cato argued that the injury alleged fell under the continuing violation doctrine because African Americans are still subject to the effects of slavery.[32] The court agreed with Cato that this doctrine was applicable to constitutional and statutory violations.[33] However, the court found that the doctrine could not create jurisdiction where the plaintiff was unable to sue the United States for the acts alleged in the complaint.[34]

Cato argued that the Thirteenth Amendment created a "national right for African Americans to be free of the badges and indicia of slavery."[35] Further, Cato contended that the Federal Tort Claims Act provided theories of relief for intentionally inflicted harm and violation of duty by the federal government.[36] In response, the court reasoned that Cato lacked the requisite standing to raise these claims because the theory of the case presented to the court was that of a generalized, class-based grievance.[37] Cato did not allege a concrete personal injury that was traceable to the government conduct that was allegedly proscribed by the Thirteenth Amendment.[38]

Cato further submitted that the United States could be sued under the Thirteenth Amendment because the United States waives its sovereign immunity whenever Congress expressly provides a right of action in a statute.[39] She maintained that since the Thirteenth Amendment provided

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28. *Id.*

29. A complaint is frivolous within the meaning of 28 U.S.C. § 1915(d) if it lacks arguable basis either in law or in fact.

30. Cato, 70 F.3d at 1106, 1109.

31. *Id.* at 1107-09.

32. *Id.* at 1108.

33. Cato, 70 F.3d at 1108-09.

34. *Id.* at 1109.

35. *Id.*

36. *Id.*

37. *Id.*

38. *Id.*

39. *Id.* at 1110.

Congress with the power to enforce the Amendment with appropriate legislation, the right to sue the United States accrues because the obligation would be otherwise meaningless.[40] However, the Ninth Circuit pointed to precedent that sovereign immunity barred claims against the United States directly under the Thirteenth Amendment and the Federal Tort Claims Act.[41] On these grounds, the court affirmed the district court's dismissal with prejudice in accordance with 28 U.S.C. § 1915(d).[42] In affirming the dismissal, the Ninth Circuit echoed the *Powell* Court in stating that the legislature would be a more appropriate forum to address the plaintiff's grievances.[43]

3. One More Swing at the Ball: The Most Recent Effort to Sue the United States for Reparations

Tommie Lee Bell, Jr., a prisoner in Texas, instituted a civil action against the United States.[44] He contended that the government illegally enslaved African Americans and committed inhumane crimes against his African American ancestors.[45] Bell sought $35 million dollars for mental anguish and $65 million dollars as a "Special Damage Claim" for "Slavery Reparations."[46] The district court employed the doctrine of sovereign immunity to hold that the United States was immune from suit unless it specifically waived immunity.[47] This court also likened Bell's claim to Cato's by referring to it as a "generalized class-based grievance" that Bell lacked the standing to raise.[48] The court then dismissed Bell's complaint with prejudice.[49] Therefore, the problems of overcoming sovereign immunity and lack of standing remain cemented in the landscape of the fledgling reparations movement.

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40. *Id.*
41. *Id.* at 1110-11.
42. *Id.* at 1111.
43. *Id.* at 1105, 1111.
44. Bell v. U.S., No. 3:01CV0338D, 2001 U.S. Dist. LEXIS 14812, at *1 (N.D. Tex. July 9, 2001).
45. *Id.* at *2.
46. *Id.*
47. *Id.* at *4.
48. *Id.* at *4-5.
49. *Id.* at *7.

C. N'COBRA, Deadria Farmer-Paellmann and Charles Ogletree: Toward an Organized Reparations Movement

While individuals including Jewel Cato, Kenneth Powell and Tommie Bell have attempted and failed to obtain reparations from the United States government through the judiciary for damages arising out of slavery, organized groups have gained national attention and have worked to ascertain cognizable legal claims. The National Coalition of Blacks for Reparations in America (N'COBRA) was formed in 1987 by a group of activists after Congress voted to award $1.2 billion in reparations to Japanese-Americans interned in concentration camps during World War II.[50] N'COBRA has sponsored a reparations convention for the last eleven years and continues to advocate community organizing and pressuring the federal government.[51] However, the legislature persists in putting off the reparations issue and N'COBRA is now planning to file a class action lawsuit against the United States government for the injustices done to enslaved African Americans.[52] As well, Leon Finney co-chaired the National Reparations Convention in 2001 to determine how America should repay the descendants of African slaves.[53] Speakers at the convention recognized that the political and social climate was now "ripe" for a dialogue on reparations.[54] Charles Ogletree is currently leading a legal team known as the Reparations Coordinating Committee.[55] The group is extremely guarded about discussing its work but a few details have

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50. Salim Muwakkil, *Hot off the Fringes: Tide may Finally Have Turned on Reparations*, CHI. TRIB., Oct. 30, 2000, at N11.

51. Sabrina L. Miller, *Speakers at Reparations Forum Call for More Than Just Money*, CHI. TRIB., Feb. 3, 2001, at N5.

52. *Id. See also* Eric Y. Yamamoto, *Racial Reparations: Japanese American Redress and African American Claims*, 40 B.C. L. REV. 477, 504 (1998) (noting that N'COBRA announced its contemplated class action in the summer of 1997 on behalf of formerly enslaved African Americans against the federal and state governments).

53. Miller, *supra* note 51, at N5.

54. *Id.*

55. Paul Braverman, *Slavery Strategy: Inside the Reparations Suit*, AM. LAW., Jul. 2001, at 22. Ogletree's teams includes reparations author and founder of the TransAfrica Forum Randall Robinson; J.L. Chestnutt, Jr., a civil rights lawyer who represented Martin Luther King, Jr.; Alexander Pires, Jr. who worked with Chestnutt in winning a billion-dollar settlement for black farmers discriminated against by the U.S. Department of Agriculture; Stanley Chesley who represented Holocaust survivors in a reparations suit; and Johnnie Cochran. *Id. See generally* White, *supra* note 2, at 48; 147 Cong. Rec. E981, *supra* note 1 (daily ed. May 25, 2001) (statement of Hon. Chaka Fattah) (noting the reputations of the Reparations Coordinating Committee's members and the few known details regarding their proposed strategies).

emerged.[56] The group is taking a different strategy than N'COBRA and will likely file a number of suits in a number of different forums with defendants from both the public and private sectors.[57] As well, the remedy sought will be institutional rather than individual.[58] In this scenario, plaintiffs could potentially be limited to those who most directly felt the impact of slavery, such as those who suffered injury arising out of the Jim Crow laws or whose ancestors were slaves, with the damages being awarded in the form of funding to schools, hospitals and communities that need it most.[59]

If groups like the Reparations Coordinating Committee are indeed contemplating suit against private corporations, Deadria Farmer-Paellmann has provided the necessary information with which to identify proper defendants. Farmer-Paellmann has done extensive research into "slave policies" bought by slave-owners from insurance companies in case their slaves died or escaped.[60] Her research has resulted in identifying Aetna, Inc. as one of the insurance companies who issued such policies.[61] Farmer-Paellmann's exposure of Aetna's former practices led Aetna to issue a formal apology, though the company has declined to pay reparations at Farmer-Paellmann's request.[62] Paellmann remains dedicated to her belief

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56. Braverman, *supra* note 55, at 22.

57. *Id. But see* Michael A. Fletcher, *Putting a Price on Slavery's Legacy: Call for Reparations Builds as Blacks Tally History's Toll*, WASH. POST, Dec. 26, 2000, at A1 (speculating that Ogletree's team is plotting a strategy for a possible class action lawsuit seeking reparations). This illustrates the current lack of knowledge regarding strategy for these potential suits. Whether or not the suits are filed as class actions dramatically affects the issues involved and the likelihood of surviving a motion to dismiss.

58. *See* Braverman, *supra* note 55, at 22.

59. *Id.*

60. *See id. See also* Ghannam, *supra* note 8, at 43.

61. Green, *supra* note 10, at 86.

62. *See id.*

> Aetna has long acknowledged that for several years shortly after its founding in 1853, the company may have insured the lives of slaves. Despite limited and incomplete information in our archives on the extent of our participation, we express our deep regret over any participation at all in this deplorable practice.
>
> We are proud of our commitment to a diverse workplace and society. We believe that any policy decisions made in the distant past are today more than outweighed by our record of diversity and support of fairness and equality for all people.
>
> We have concluded that, beyond our apology, no further actions are required, considering our strong, consistent commitment to diversity over

that some corporations should make restitution to African Americans for their roles in maintaining slave labor.[63] On August 24, 2002, Paellman herself filed a class action lawsuit against Aetna and other corporations alleging conspiracy, human rights violations, conversion and unjust enrichment and seeking "an accounting, constructive trust, restitution, disgorgement and compensatory and punitive damages."[64]

In all likelihood, more lawsuits will be filed in the near future seeking reparations. In addition, the crystallization of groups such as the Reparations Coordinating Committee and N'COBRA and the discoveries of Deadria Farmer-Paellmann have major cities and state governments taking notice of the issue.[65]

> many years and the numerous philanthropic and workplace diversity initiatives we undertake and for which we have been publicly recognized.

Press Release, Statement of Aetna On Pre-Civil War Insurance Policies (Mar. 10, 2000), *available at* http://www.aetna.com/news/2000/prtpr_20000310.htm. Further, at Aetna's Annual Shareholders meeting, the following statement was made by John W. Rowe, M.D., Chairman, President and CEO, Aetna Inc.:

> I'm sure many of you have been reading about slavery reparations. In early 2000, the fact that Aetna had written insurance policies on slaves more than 140 years ago was brought to the attention of Aetna's management. They were deeply disappointed and embarrassed. At the time, the company expressed regret for its role in an awful period in our country's history. Today, I wish to reiterate a sincere apology for the actions of our company in its earliest days. Slavery is morally wrong and reprehensible. Today, there remain significant concerns about race in America. Major disparities continue to exist in education, in economic opportunity and in health care.
>
> The Aetna of today is determined to be a leader in addressing these problems. We are proud of our recent record, but also actively seeking additional ways to be a force for positive change. For example, we have an opportunity to make a difference in eliminating disparities in health care and in health status. I am determined that we will pursue initiatives in this area. The Aetna of today is a place driven by integrity, fairness and a commitment to equal opportunity . . . .

Press Release, Aetna, Excerpt of Remarks Delivered by John W. Rowe, M.D., Chairman, President and CEO, Aetna Inc. (Apr. 26, 2002) *available at* http://www.aetna.com/news/2002/slavery_reparations_issue.html.

63. Ghannam, *supra* note 8, at 43.

64. Farmer-Paellman Complaint, *supra* note 6 at ¶¶ 21, 50, 57, 62, 66.

65. In addition, African Americans have gained attention in their plight for reparations in other ways. The "Millions for Reparations" rally was held in front of the Capitol on August 17, 2002 to demand that the federal government provide immediate compensation for their ancestors' enslavement. Kranish, *supra* note 14, at A3.

D. The Debate Over Beneficiaries of, Accountability for and Form of Reparations

The indeterminacy surrounding facets of the reparations issue has been met with a variety of reactions. As was previously discussed, reparations can be made via legislative enactment, judicial remedy, apology or some combination of these forms. Judicial remedy could mean monetary judgments paid by corporate defendants or the government or both and may include ordered apologies. Legislative remedy could include increased funding to disadvantaged African American communities, a lump sum payment to some identifiable group of descendants of slaves and/or an official apology by the government for slavery and its ensuing effects on African Americans.

In addition to deciding which combination of remedies to pursue, a decision must be made as to how to effectuate reparations in any of its forms, given the extraordinary nature of this injury. One contingent argues that the entire issue is simply too removed from the actual injuries inflicted through slavery and that it is too late to do anything.[66] Another potential problem is deciding who should be compensated.[67] However, regardless of exactly which African Americans are compensated, there are a significant number of identifiable entities that have escaped accountability for profiting from the enslavement of African Americans.[68] Therefore, while you can rarely, if ever, equate a precise amount for being enslaved with a precise descendant of a former slave, ignoring the problem because it is complex is a poor message about human rights violations for the future.[69] In response to these ubiquitous questions of who should compensate, whom to compensate, and how much, a solution in the form of increased funding for educational and social programs directed at underprivileged African

66. Representative Henry Hyde (R-Ill.), chairman of the House Judiciary Committee, has said, "I never owned a slave. I never oppressed anybody. I don't know that I should have to pay for someone who did own slaves generations before I was born." Ghannam, *supra* note 8, at 70. Bittker also noted, "the wrongs were committed by persons long since dead, whose profits may well have been dissipated during their own lifetimes or their descendants' . . . ." BITTKER, *supra* note 12, at 9.

67. Taylor, *supra* note 3 (arguing that the passage of 138 years since the Emancipation Proclamation has changed the American landscape to the extent that makes it impossible to decide with any pretense of fairness which African Americans should receive compensation today and who should pay). *See also* Fletcher, *supra* note 57, at A1 (noting that opponents of reparations argue that reparations are usually paid to direct victims, which is not possible today, and that this is further complicated by the fact that not all blacks were slaves).

68. Ghannam, *supra* note 8, at 40.

69. *Id.*

American communities has been proposed in lieu of direct monetary compensation.[70] Even some of those who support a lawsuit to redress the wrongs done through slavery agree that funding social and educational programs is the most reasonable way to deal with the extremely complex process of making the descendants of former slaves whole.[71] The debate over the specifics of reparations can be divided into three sects: those that think it is too late to take any action; those who want reparations, but who wish to make the least noise possible on a national scale; and those willing to file suit to get their claims addressed in response to continuing federal legislative silence. This Comment deals mainly with this third sect and the ways in which the current and proposed suits against insurance companies illuminate the potential problems inherent in bringing a lawsuit to obtain reparations for slavery. Further, the relationship between desired legislative and judicial remedies within the context of insurance companies reveals a more uniform strategy than at first appears to be in place.

II. ANALYSIS OF THE PROPOSED SUITS AGAINST INSURANCE COMPANIES

One legal claim that has been publicly mentioned repeatedly by leading reparations proponents has been the restitutionary doctrine of unjust enrichment.[72] This analysis will focus on complaints that have been and may be drafted arguing that insurance companies were unjustly enriched as a result of the profits they reaped selling policies on slaves' lives to slave masters. This section of analysis is an effort to assess the strengths and weaknesses of this legal claim. Next, the strengths and weaknesses that will likely accompany any legal claim for reparations will be examined as a function of the potential case against insurance companies. The scope of this analysis will be those suits that may be filed in Connecticut state court or federal district court in Connecticut.[73] If a case were filed in federal

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70. Michael Conlon, *Slavery Reparations Issue Simmers in U.S.*, REUTERS, Aug. 27, 2001, *available at* http://www.yahoo.com (last visited Nov. 9, 2002); Taylor, *supra* note 3, at 1005; Ghannam, *supra* note 8, at 39.

71. Ghannam, *supra* note 8, at 70 (noting that Charles Ogletree, who has spearheaded the national effort to study legal strategies to support reparations, believes that individual monetary restitution would be "a cheap form of forgiveness and an insult to those millions of Americans who lost their lives to the slave trade.").

72. *See* Ghannam, *supra* note 8, at 43. *See also* Farmer-Paellman complaint, *supra* note 6, at ¶¶ 66-70.

73. Claims will likely be brought nationwide. Reparations supporters believe that they have the best chance obtaining both national attention and judicial relief by seeking

district court, diversity would be the likely ground of jurisdiction.[74] To that end, this Comment will focus on Connecticut substantive law and incorporate federal procedural law where applicable (in addition to Connecticut procedural law for claims that could be filed in state court).

A. Unjust Enrichment

1. Elements of Unjust Enrichment

When filing suit against insurance companies, descendants of slaves and their representatives will likely claim that insurance companies were unjustly enriched. Farmer-Paellman has already made such a claim that Aetna has improperly benefited from the immoral and inhumane institution of slavery, has failed to account for and return the profits derived from slave labor of African Americans' ancestors, and has therefore been unjustly enriched.[75] Similarly, future plaintiffs may argue that this unjust enrichment arose out of the slave policies issued by insurance companies to slave masters to insure the risk that slaves might die or escape. The theory is likely that since insurance companies profited from the sale of these policies and that slavery was immoral and is now illegal, insurance companies were unjustly enriched. In order to evaluate this claim, the elements of unjust enrichment must first be explained.

Unjust enrichment is a quasi-contractual doctrine rooted in restitution. The standard that must be met in order to prove unjust enrichment provides that the plaintiff must first show the defendant gained a benefit of some kind.[76] Then, the plaintiff must also show that between the two parties, the enrichment of the defendant was unjust.[77] The doctrine of unjust enrichment only applies when one party acquires money or its equivalent under circumstances where "in equity and good conscience he ought not to retain it."[78] Further, unjust enrichment applies where there is no remedy

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remedies in as many fora as are practicable. Robinson, *supra* note 20. However, since Aetna and other major insurance companies are headquartered in Connecticut, that state is a likely potential forum where these suits could be instituted.

74. Since unjust enrichment is not grounds for federal question jurisdiction, any venture into federal court would likely be made using diversity jurisdiction as potential plaintiffs could come from any number of states.

75. Farmer-Paellman Complaint, *supra* note 6, at ¶¶ 67, 68, 69.

76. Providence Elec. Co. v. Sutton Place, Inc., 161 Conn. 242, 246, 287 A.2d 379, 382 (1971).

77. Kerin v. U.S. Postal Serv., 116 F.3d 988, 994 (2d Cir. 1997).

78. Rule v. Brine, 85 F.3d 1002, 1011 (2d Cir. 1996).

available by an action on the contract.[79] The aggrieved party must bring an action in restitution by means of unjust enrichment to obtain compensation for the benefit he or she conferred. While a person who has been unjustly enriched at the expense of another must make restitution to the other person,[80] what constitutes a benefit is somewhat unclear. A person confers a benefit if he or she gives the other possession of or interest in "money, land, chattels, or choses in action, performs services beneficial to or at the request of the other, satisfies a debt or a duty of the other, or in any way adds to the other's security or advantage."[81]

Some dicta has been provided by the Connecticut Supreme Court that appears to favor a broad interpretation of the unjust enrichment theory. The court pointed out that the theory has been described as a doctrine "which is so broad as to include almost any case in which unfair dealing appears . . . ."[82] Further, the doctrine applies "wherever justice requires compensation to be given for property or services rendered under a contract, and no remedy is available by an action on the contract."[83] However, enrichment of the defendant alone does not suffice as grounds to award damages.[84] The plaintiff must show that the enrichment was unjust and that it caused the plaintiff harm.[85]

Within the insurance context, unjust enrichment is not a commonly used legal claim. Since insurance contracts are relied upon as the basis of the relationship between the insurer and the insured, the relief can usually be found by bringing suit directly on the contracts.[86] Bringing reparations

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79. Gagne v. Vaccaro, 255 Conn. 390, 401, 766 A.2d 416, 423-24 (2001), *citing* SAMUEL WILLISTON, CONTRACTS 272 (3d ed. 1970).

80. RESTATEMENT OF RESTITUTION § 1 (1937).

81. *Id.* at § 1 cmt. b.

82. Cecio Bros. v. Town of Greenwich, 156 Conn. 561, 564, 244 A.2d 404-05 (1968), *quoting* 3 WILLIAM PAGE, THE LAW OF CONTRACTS § 1503 (2d ed. 1920).

83. *Id.* at 405-06, *quoting* 5 SAMUEL WILLISTON, CONTRACTS § 1479 (Rev. ed. 1937).

84. *Kerin,* 116 F.3d at 994.

85. *Id.*

86. See Westchester Fire Ins. Co. v. Allstate Ins. Co., 236 Conn. 362, 672 A.2d 939 (1996), which provides an example of where unjust enrichment was dealt with in the insurance context. An uninsured motorist insurance carrier that paid underinsured motorist benefits to its insured want to bring a subrogation action against the tortfeasor's liability insurer. *Id.* at 940. The uninsured motorist insurer argued that the tortfeasor's liability insurer wrongfully denied coverage of the insured's claim against the tortfeasor. *Id.* at 941. Here, there was no direct contractual relationship between these two insurance companies. *See id.* The Connecticut Supreme Court held that it would not allow a tortfeasor to be unjustly enriched by virtue of having its debt paid by the insurance company of a party who

suits against insurance companies under the theory of unjust enrichment will be unique in the sense that plaintiffs would be seeking relief *because of* the insurance contracts' existence, not on the contracts themselves. Occasionally, under the theory of unjust enrichment, courts have been willing to infer the existence of an implied contract to prevent one party from unjustly retaining a benefit conferred on them by the other party without compensation.[87]

Two questions must be answered to fit proposed reparations suits against insurance companies into the framework of unjust enrichment. First, a court would have to decide whether insurance companies were actually benefited in any legally cognizable way by slaves. Second, a court would have to find that this benefit was unjust. A court will have to decide both that the slaves conferred a benefit and that it is unjust for the insurance companies to retain it in order for plaintiffs to prevail. As will be discussed, this puts reparations supporters on tenuous ground.

2. Fitting Reparations Suits Against Insurance Companies Into the Unjust Enrichment Framework

a. Were the Insurance Companies Benefited by Slaves?

There appears to be a lot of leeway in the unjust enrichment standard that, at first glance, allows the reparations claim to fit into the requirements. The insurance companies clearly benefited from the sale of slave policies as they have through the sale of any policy. By being insurable to their masters, slaves did add to the insurance companies' "advantage." But for the existence of slavery, this type of insurance contract would not have existed. In that sense, slaves, by virtue of being enslaved, provided a benefit to insurance companies by being a distinct form of insurable property. A court would have to accept a broader notion of what constitutes a benefit for this theory to succeed. Rather than money or services, reparations supporters may ask a court to see a benefit in the mere existence of African Americans as slaves.

While this view appears somewhat logical, it can easily be manipulated. The monetary benefit conferred on insurance companies came from the payment of premiums by slave masters. Masters decided their slaves were valuable property that needed to be insured. As a result of

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"had the foresight to obtain insurance coverage," simply because the insurance company could not participate in the suit against the tortfeasor. *Id.* at 944-45.

87. Lightfoot v. Union Carbide Corp., 110 F.3d 898, 905 (2d Cir. 1997).

this need, insurance companies profited by selling policies. Therefore, a court could find that slaves conferred no actual benefit on insurance companies because they did not pay premiums or perform services for the insurance companies. Reparations proponents are likely hoping that a court will find slaves did confer a benefit on the insurance companies by virtue of being insurable. However, even if a court were to find that a benefit was conferred on slaves by insurers, the resulting enrichment may not have been unjust.

b. If Insurance Companies Were Benefited, Was This Benefit Unjust?

Examining the matter with twenty-first century sensibilities, enrichment of the insurance companies because of policies insuring slaves as property certainly appears unjust. Members of the reparations movement are of the belief that these companies ought not retain the money they made at the expense of African American slaves. The potential death knell to this claim, however, is that at the time, slavery was legal and endorsed by the United States government. Restitution in the form of reparations paid to African Americans because of unjust enrichment is not possible unless the contract was breached or was invalid. A contract can be invalid because it is immoral or illegal,[88] but slave policies are seemingly only illegal and immoral retrospectively.

Generally, contract principles dictate that legal contracts should be enforced as written and agreed upon by the parties.[89] Slavery was a legal institution during the period in which insurance companies profited from these contracts. Slave owners and insurance companies agreed on the buying and selling of policies and both parties benefited from them. Masters received the benefit of knowing they would be compensated in the event that their slaves died or escaped. Insurance companies made substantial profits on these policies, as with policies insuring against all other risks. With this benefit, however, came the risk born by these companies that slaves would escape. Indeed, many slaves escaped, while many others succumbed to substandard living conditions and brutal abuse. Insurance companies likely paid claims on these policies regularly and as

88. "A promise or other term of an agreement is unenforceable on grounds of public policy if legislation provides that it is unenforceable or the interest in its enforcement is clearly outweighed in the circumstances by a public policy against the enforcement of such terms." RESTATEMENT (SECOND) OF CONTRACTS §178 (1981). There is no provision for new legislation to impact retrospectively on contracts.

89. Aetna v. Murphy, 206 Conn. 409, 412, 538 A.2d 219, 221 (1988).

between the insurer and the insured, a valid contract existed with the requisite consideration. Therefore, the contract between the insurer and the insured was a legal one.

The only conceivable way in which these contracts could be deemed illegal would be for a court to find that slavery, at the time that slave policies were issued, was immoral or illegal. At first glance, this argument appears impossible. Slavery was legal according to the United States government during the time when slaveholders insured the lives of their property. However, if a court wanted to stretch to find a way to accept this legal claim, there is a body of supporting research. As early as 1781 and 1858, some legal scholars made the case that slavery was contrary to natural law and some judges had begun to express "moral doubts" about the institution of slavery.[90]

In 1810, plaintiffs brought a case before the Massachusetts Supreme Court on a contract between themselves and defendants who were to have delivered slaves in return for certain "commodities."[91] Plaintiffs sued for the equivalent monetary value of the slaves that were not delivered.[92] The majority upheld the contract and ordered payment be made to the plaintiffs.[93] In his dissent, Judge Sedgwick provided a novel discussion concerning what he perceived to be the illegality of slavery and therefore the illegality of any contract arising out of slavery.[94] Sedgwick stated that the entire contract was void because it was immoral.[95] Further, the majority also characterized slavery as immoral and suggested that the case may have come out differently if the plaintiffs sued for compensation for the slaves themselves if payment for them had not been rendered on delivery, instead of for the non-delivery of slaves.[96] Retrospectively, this argument is merely persuasive. However, if a court were to agree with Judge Sedgwick that slavery was an institution so awful as to "pollute all contracts made with respect to it,"[97] a court could find the necessary injustice required in an unjust enrichment claim.

A court could find the requisite immorality to make slave policies unjust. However, a court may be reluctant to do so because it would look

90. ROBERT COVER, JUSTICE ACCUSED 8 (1975).
91. *Id.* at 92 (discussing Greenwood v. Curtis, 6 Mass. 359 (1810)).
92. *Id.*
93. *Id.*
94. *Id.*
95. *Id.*
96. *Id.* at 93.
97. *Id.*

as though the court was retrospectively importing modern sensibilities into a slavery-related issue. Further, if a court accepts immorality as a ground for making slave policies unjust, it would still have to accept a definition of benefit that included the very existence of slaves being a way for insurers to sell more policies. These litigants have the advantage of being entirely unique. They represent the only human beings to be insured as *property* of other humans. Since there is no parallel at common law, a court may be willing to find that the spirit of unjust enrichment applies here, even though the requisite elements may not be directly fulfilled. Plaintiffs have a stronger chance at prevailing if they can convince a judge that finding that insurance companies were unjustly enriched by selling slave policies would not create a slippery slope toward any redefinition of established restitution doctrine. Rather, this set of facts is so unique that expanding unjust enrichment in this realm will not do damage to contract law, as the expansion urged by potential plaintiffs will be limited to contracts arising out of slavery, an institution that has been illegal for 138 years.

Retrospectively, insuring slaves to their masters is morally reprehensible. The idea that an insurance company made money by selling policies on other people as their master's property offends modern sensibilities. Slaves could not work for an income that would allow them to insure anything or anyone. The idea that an insurance company could continuously reap monetary benefits from the institution of slavery appears unjust to most. However, slavery was lawful at the time these policies were issued. These contracts were valid and not breached. Bringing suit against insurance companies under the theory of unjust enrichment could be a futile effort. Another potential claim may be in tort but that is beyond the scope of this Comment.[98]

There are a number of other possible obstacles that could pose significant barriers to reparations lawsuits. Issues of standing, statutes of limitations and class certification in class actions could provide grounds for granting a motion to dismiss. Reparations proponents may lose their opportunity to tell the true story of slavery in a judicial forum if they cannot defeat what will likely be multiple grounds for a motion to dismiss. Dismissal would likely undermine a movement that has gained momentum within the last two years. This analysis will outline each potential pitfall as it applies to a suit against an insurance company.

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98. RESTATEMENT OF RESTITUTION, *supra* note 80, at ch. 7 Introductory Note (noting that "[i]f the defendant receives nothing of value, the person who has suffered has merely a tort remedy.").

B. Standing

Reparations plaintiffs, including Farmer-Paellman, may find their lawsuits met with motions to dismiss for lack of standing.[99] The insurance companies may argue that because the plaintiffs were not parties to the insurance contracts about which they are suing, they lack standing. Plaintiffs could argue that they do have standing as a result of having conferred a benefit on the insurance companies that was unjust for them to retain, as was previously discussed. Depending on whether a suit is filed in federal district court in Connecticut or state court, different standards regarding standing apply.[100] While Connecticut's standing requirements are more lenient than the federal requirements, both present significant impediments toward the success of reparations suits against insurance companies.

1. Standing in Connecticut State Court

The Connecticut Supreme Court has held that if the plaintiff has no interest in the cause of action, he or she lacks standing to raise any claims regarding the enforceability or validity of the contract.[101] The plaintiff has the burden of proving standing.[102] However, every presumption must be viewed in the light most favorable to allowing jurisdiction of the court.[103]

Plaintiffs will likely respond to a standing challenge by asserting that their ancestors were insurable property on which insurance companies sold thousands of policies. On this basis, they could argue that they did have a significant interest in the cause of action they have instituted. Alternatively, the plaintiffs could look to the slave policies and interpret their wording to import some significant interest in the contract. Further, they can appeal to the court by arguing that granting a motion to dismiss is simply prematurely testing their substantive rights and is unfairly keeping them out of court. However, standing is not a tool intended to keep

99. Sadloski v. Town of Manchester, 235 Conn. 637, 650, 668 A.2d 1314, 1320 (1995).

100. Farmer-Paellman's suit was filed in United States District Court in the Eastern District of New York, so while her complaint has been mentioned periodically as an example, New York substantive law is beyond the scope of this Comment. *See* Farmer-Paellman Complaint, *supra* note 6.

101. Tomlinson v. Bd. of Educ., 226 Conn. 704, 717, 629 A.2d 333, 341 (1993). *See also* Coburn v. Lenox Homes, Inc., 173 Conn. 567, 570, 378 A.2d 599, 600-01 (1977).

102. *Sadloski*, 235 Conn. at 648-649.

103. Six Carpenters, Inc. v. Beach Carpenters Corp., 172 Conn. 1, 6, 372 A.2d 123, 126 (1976).

aggrieved parties out of court.[104] Rather, standing is meant to ensure that plaintiffs attempting to vindicate nonjusticiable interests do not unduly inconvenience courts and defendants.[105] Further, where the language of a contract is clear and unambiguous, the contract is to be interpreted as written.[106] A court should not "torture words to import ambiguity" where the exact language of the contract does not provide for such interpretation.[107] Any ambiguity in a contract must be found within the contract itself, not "discovered" through the plaintiff's subjective analysis of its terms.[108]

Insurance contracts are typically form policies and the insured parties are clearly named. Slave masters that took out policies on their slaves' lives were the intended beneficiaries of these policies. Under insurance policies, the property being insured is simply that: the property of the policyholder. While the obvious present-day opprobrium attaches when property means slaves, these slaves were legal property at the time when these policies were issued. Therefore, they were insurable property like anything else. Further, slaves had no more legally cognizable interest in insurance contracts than any other similarly insured form of property. Neither the slaves nor their descendants were parties to these insurance contracts; consequently, they do not have standing to sue on these contracts directly and must rely on a court finding that an unjust enrichment claim constitutes enough interest to provide plaintiffs with standing to sue the insurance companies.

2. Standing in Federal Court

The requirements for standing are more stringent in federal court but contain similar language that is open to interpretation, which may help plaintiffs in reparations suits. The standing doctrine is rooted in Article III of the United States Constitution and requires that a litigant must have standing to "invoke the power of a federal court" and have the court decide the merits of the dispute.[109] The standing doctrine is made up of two components.[110] The prudential component encompasses "the general

104. Monroe v. Horwitch, 215 Conn. 469, 472-73, 576 A.2d 1280, 1282 (1990).
105. *Id.*
106. 24 Leggett St. Ltd. P'ship v. Beacon Indus., Inc., 239 Conn. 284, 295, 685 A.2d 305, 311 (1996).
107. *Id.*
108. *Id.*
109. Allen v. Wright, 468 U.S. 737, 750 (1984).
110. *Id.* at 751.

prohibition on a litigant's raising another person's legal rights, the rule barring adjudication of generalized grievances more appropriately addressed in the representative branches, and the requirement that a plaintiff's complaint fall within the zone of interests protected by the law invoked."[111] The constitutional component provides that the injury must be "distinct and palpable," not "'abstract' or 'conjectural.'"[112] Further, "[t]he injury must be 'fairly' traceable to the challenged action, and relief must be 'likely' to follow from a favorable decision."[113] Even where a party does have standing, a federal court can decline to pass on the merits of the case for reasons including that the case presents a political question.[114]

As to the prudential component, Farmer-Paellman and other potential plaintiffs will be raising the rights of those long since dead. Plaintiffs may be able to survive this hurdle if they are representing their ancestors. However, the burden of proving this lineage is substantial. The second standing prohibition may pose the largest problem for reparations plaintiffs. Their grievance can be viewed as generalized because claims against insurance companies can potentially be made by a massive number of slaves' descendants. Further, the injuries that would likely be alleged span hundreds of years and are suffered as the result of a wrong that contemporary American government, citizens and businesses had no role in perpetrating. A judge could find that plaintiffs have no standing and that the legislature is a more appropriate venue for these grievances. While reparations supporters may ultimately prefer legislative reparations, their cause could lose credibility if their suits were dismissed at the outset for lack of standing. Finally, whether the complaint filed by reparations plaintiffs falls within the zone of interest protected by the law of unjust enrichment will likely depend on the previous discussion regarding whether this claim fits into the judicially carved out meaning of this doctrine. Plaintiffs would have to successfully prove that unjust enrichment is an appropriate claim and the most effective means of obtaining a remedy.

With regard to the constitutional component of federal standing, plaintiffs may have a difficult time proving that their alleged injury is not abstract and is traceable to the action they will bring. Chattel slavery inflicted innumerable injuries on enslaved African Americans. Many have argued that slavery's legacy continues to impact African American culture

111. *Id.*

112. *Id. See also* Gladstone Realtors v. Vill. of Bellwood, 441 U.S. 91, 100 (1979); Los Angeles v. Lyons, 461 U.S. 95, 101-02 (1983).

113. *Allen*, 468 U.S. at 751.

114. Flast v. Cohen, 392 U.S. 83, 100 (1968).

in important, though subtle, ways.[115] However, for reparations plaintiffs, proving that this injury is distinct and palpable to these plaintiffs will likely be a tremendous challenge. Essentially, plaintiffs would have to make the case that the dehumanization of their ancestors in the form of being insurable property has injured them in a legally recognizable way today. A judge would have to decide that these plaintiffs have standing to raise the rights of their descendants. Many lineages will likely not be easy to prove. Further, without some definitive theory of continuing discrimination by insurance companies against African Americans that began with slave policies and continues until today, the injury complained of could be found too abstract and more of a political question to be addressed by the legislature.

Whether a lawsuit against an insurance company takes place in federal or state court, potential plaintiffs will face an uphill battle to prove standing. In Connecticut state court, the standard is less detailed and seemingly more lenient. However, in both requirements, the language is general and can be manipulated to go either way depending on judicial preference. Thus, these plaintiffs and potential plaintiffs are on tenuous ground with regard to standing and may face early dismissal, which could undermine the ultimate goal of entering the national discourse and getting the legislative attention they desire.

C. Statute of Limitations and the Theory of Continuing Violation

Slavery was made illegal 138 ago, which makes suing based on any aspect of the peculiar institution extremely untimely. That it took the Civil Rights Movement and years of adjustment to get to a point in American culture where our society could and would contemplate making reparations for slavery is a compelling argument for foregoing the applicable statutes of limitations. Technically, former slaves did have the capacity to sue once they became free. However, former slaves also had the right to vote during the Reconstruction era and it is commonly known that few African Americans were actually permitted to do so. Legalized forms of race-based discrimination characterized the post-Civil War era in the United States,[116]

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115. In Farmer-Paellman's complaint, she alleges that "[a]lthough the institution of slavery was officially outlawed in 1865, it continued, *de facto*, until as recently as the 1950's" and that free African Americans remained in "quasi-servitude due to legal, economic and psychic restraints that effectively blocked their economic, political and social advancement." Farmer-Paellman Complaint, *supra* note 6, at ¶¶ 13, 14.

116. *See generally* CORNEL WEST, RACE MATTERS 6 (1994).

making it impracticable for African Americans to bring suit for the wrongs inflicted during slavery.

Nevertheless, the defendant insurance companies in these suits for reparations may point to statutes of limitations as grounds for dismissal.[117] Both Connecticut state court and federal district court in Connecticut will use the Connecticut statute of limitations.[118] Both express and implied contracts carry with them a six-year window after the right of action accrues within which suits must be brought.[119] Further, should an individual be legally incapable of bringing action when the right accrues, that person may sue within three years after becoming legally capable of bringing the action.[120] Other actions, including those in tort, must also be brought within three years from the date of the act or omission in question.[121] To bring suit for reparations on the theory of unjust enrichment, the slave or former slave would have had to sue within six years of the effective date of the contract.[122] Since slaves could not sue, former slaves had three years under Connecticut law to sue. A court could find the impracticability of bringing suit because of discrimination persuasive and extend the statute of limitations to the three years after African Americans could have legitimately pursued their causes of action. This likely would still prevent any action on the slave policies, because a court would be strained to find that a suit for reparations was impossible to bring at any point prior to 2002.

In response to a statute of limitations challenge, plaintiffs can assert that discriminatory conduct engaged in by insurance companies began with slave policies and continues through the present day, constituting a continuing violation.[123] There are several judicially created tenets of the

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117. Jomo Thomas, one of Farmer-Paellman's lawyers has said that, "we believe the central issue in this case is to beat or get around the notions of statutes of limitations." Kevin Canfield, *A Matter of Justice For Blacks*, HARTFORD COURANT, Apr. 2, 2002, at D1.

118. USCS FED. R. CIV. P. 1, N. 28 (explaining that "[s]tatutes of limitations are to be regarded as substantive law and hence are not affected by the Rules.").

119. CONN. GEN. STAT. § 52-576(a) (2001).

120. CONN. GEN. STAT. § 52-576(b) (2001).

121. CONN. GEN. STAT. § 52-577 (2001).

122. *See* CONN. GEN. STAT. §52-576(a) (2001) (providing that contract actions have a six-year statute of limitations).

123. Farmer-Paellman has pled just such a continuing violation that began with Aetna profiting from selling slave policies and continuing to the present predicament of African Americans, noting that "a 1998 Census report show[ed] that 26 percent of African American people in the United States live in poverty" and that African Americans "lag behind whites according to every social yardstick: literacy, life expectancy, income and education." Farmer-Paellman Complaint, *supra* note 6, at ¶¶ 18, 19. Farmer-Paellman's theory seems to

theory of continuing violation. First, where there is a continuing course of conduct constituting a breach of duty, the statute of limitations does not begin to run until that conduct ends.[124] A court can consider all relevant actions taken in furtherance of a company's discriminatory policy, however these actions must be part of an ongoing practice.[125] The continuing violation exception to the statute of limitations applies only where there is evidence of specific and related instances of discrimination that are permitted for so long that they amount to a discriminatory policy or practice.[126] The exception does not apply where there are only multiple incidents of discrimination, even if they are similar, that are not the result of a continuing policy of discrimination.[127] Finally, a continuing violation does not exist "merely because the claimant continues to feel the effects of a time-barred discriminatory act."[128]

While the theory does not apply neatly to plaintiffs in reparations suits, the attorneys involved may be able to liken the injury alleged to the kinds of ongoing discriminatory practices that have been held to be continuing violations.[129] If plaintiffs can mount enough evidence of discrimination by the defendant insurance companies to prove a pattern of consistent and continued prejudicial practice, they can bring their claims despite a long since expired statute of limitations. However, proving such a long-standing practice will be difficult given the standard. The issuance of slave policies by Aetna and other insurance companies well over one hundred years ago cannot easily be likened to any provable race-based insurance discrimination that has occurred since. The events must be specific and

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be that because Aetna and other corporate entities helped make slavery such a profitable enterprise, they also perpetrated its existence and its resulting ills. She has further claimed that it was not possible to bring such a suit before because descendants of slaves were unable to get records to prove their lineage until recent developments with the internet making the information readily accessible. *Id.* at ¶ 45.

124. City of West Haven v. Commercial Union Ins. Co., 894 F.2d 540, 545 (2d Cir. 1990). *See also* Handler v. Remington Arms Co., 144 Conn. 316, 321, 130 A.2d 793, 795 (1957).

125. Gallo v. Eaton Corp., 122 F.Supp. 2d 293, 302 (D. Conn. 2000) ("In light of this admonishment, courts have consistently found, even at the summary judgment stage, that discrete discriminatory acts, including repeated failures to promote and multiple demotions, do not constitute a continuing violation."), *citing* Van Zant v. KLM Royal Dutch Airlines, 80 F.3d 708, 713 (2d Cir. 1996) (stating that seniority lists and employment tests are examples of ongoing practices).

126. *Id.*

127. Lambert v. Genesee Hosp., 10 F.3d 46, 53 (2d Cir. 1993).

128. Harris v. City of New York, 186 F.3d 243, 250 (2d Cir. 1999).

129. *See Van Zant*, 80 F.3d at 713.

related and a court would have to interpret insurance discrimination and slave policies broadly to meet these requirements. Many have made the argument that the entire plight of African Americans since the end of the Civil War can be traced back to the effects of slavery in some way.[130] Discrimination generally, and in the insurance industry in particular, is an ongoing occurrence, though its frequency and form have changed. With regard to insurance companies, proving a permitted, supported and ongoing policy of discrimination will likely depend on a court's willingness to embrace such a broad interpretation of continuing violation.

D. Class Action: Certification

Another potential hurdle for those who wish to file suit against insurance companies seeking reparations could be class certification. Farmer-Paellman has already filed a class action suit against insurance companies and other corporate defendants and N'COBRA has announced its plans to file a class action against the United States government for reparations.[131] Further, as a result of the statutorily mandated availability of information to descendants of slaves about slave policies, more class actions will likely be brought against insurance companies.[132] The majority of this analysis will focus on class certification in federal court, as its rule is a more detailed and amenable to examination. However, plaintiffs may choose to file a class action in Connecticut state court and to that end, a brief analysis of class certification in Connecticut state court will be provided.

1. State Court Requirements for Class Actions

Class certification in Connecticut state court can likely be obtained. Connecticut law simply provides that "[w]hen the persons who might be made parties are very numerous, so that it would be impracticable or unreasonably expensive to make them all parties, one or more may sue or be sued or may be authorized by the court to defend for the benefit of

130. *See, e.g.*, BAKARI KITTWANA, THE HIP HOP GENERATION: YOUNG BLACKS AND CRISIS IN AFRICAN AMERICAN CULTURE 77-78 (2002). *See also* WEST, *supra* note 116, at 6, 19.

131. Yamamoto, *supra* note 52, at 504. *See also* Farmer-Paellman Complaint, *supra* note 6, at ¶ 33.

132. CAL. INS. CODE § 13810 (2001) (requiring the full disclosure to all descendants of information regarding slave policies issued by all insurance companies).

all."[133] Under this provision, plaintiffs would simply have to plead their numerosity by stating that there are so many descendants of slaves interested in this litigation that litigating separately would be both economically burdensome on both parties and equally burdensome to the judicial system. Insurance companies named as defendants may argue that the number of ancestors who can prove a relationship to a slave insured to his or her master by the defendant company is insufficient to allow a class action to proceed. However, this statute also provides for the court's authorization of a representative to defend for the benefit of all.[134] Allowing a class to proceed is significantly less complicated in Connecticut state court. To be certified as a class in federal court is a far more extensive inquiry into the specific facts surrounding potential class members.

2. Class Certification in Federal Court

Certification of these potential plaintiffs as a class via Rule 23 of the Federal Rules of Civil Procedure may prove yet another substantial hurdle for those in the reparations movement. The first requirement that must be met is that "the class is so numerous that joinder of all members is impracticable . . . ."[135] This requirement is likely the least problematic. There are countless descendants of slaves living in the United States. However, proving their relationship to slaves whose lives were insured to their masters could be both expensive and time consuming. The statutes enacted in California (that will be discussed in Part III) facilitate the discovery of such information. If all insurance companies who issued these policies comply with California's mandate, enough potential plaintiffs could be found to meet the numerosity requirement of class actions.[136]

Next, there must be "questions of law or fact common to the class."[137] The claims made by individual members of this prospective class are likely similar if not identical. Whether or not the theory of the case is unjust enrichment, the claims are rooted in the idea that insurance companies

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133. CONN. GEN. STAT. § 52-105 (2001). *See also* Cutler v. MacDonald, 174 Conn. 606, 608, n. 2, 392 A.2d 476, 478 n. 2 (1978).

134 CONN. GEN. STAT. § 52-105 (2001).

135 FED. R. CIV. P. 23(a)(1).

136. In her complaint, Farmer-Paellman asserts that "[t]he exact number of plaintiff class members is not known. Plaintiffs estimate that the class includes millions of African-American slave descendants . . . [t]he number and identities of the class members can only be ascertained through appropriate investigation and discovery." Farmer-Paellman Complaint, *supra* note 6, at ¶ 34.

137. FED. R. CIV. P. 23(a)(2).

wrongly profited from the business of slavery by selling policies to slave masters.[138] The basic question is whether insurance companies should be held legally accountable for this practice and be forced by a court to make reparations to descendants of the affected slaves.

The third and fourth requirements of Rule 23 are possible bases for failure to be certified as a class. The claims of the representative parties must be "typical of the claims" of the class.[139] Further, the representative parties must "fairly and adequately protect the interests of the class."[140] The requirement of typicality may be difficult to meet if the group serving as class representative is N'COBRA or some other umbrella organization of the reparations movement. These groups have goals and means of achieving them that may sharply differ from those of the individual descendants of slaves who were insured to their masters.[141] Umbrella organizations may bring claims in light of a desire to serve what they believe to be the best interests of all African Americans. Additionally, these groups want to bring the reparations issue into the public arena. The desire to make the issue known and gain increasing support may make these groups inappropriate as representatives of the many descendants involved. Reparations organizations may sacrifice important goals of those they represent in order to achieve more public goals. To that end, they may adjust their claims to the extent that they become substantially different

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138. Farmer-Paellman defines the common questions of fact and law as:

> a. Whether Defendants knowingly, intentionally and systematically benefited from the use of enslaved laborers; b. Whether Defendants wrongly converted to their own use and for their own benefit, the slave labor and services of the Plaintiffs' forebearers, as well as, the products and profits from such slave labor; c. Whether the Defendants knew or should have known that they were assisting and acting as accomplices in immoral and inhuman deprivation of life and liberty; d. Whether Defendants have been unjustly enriched by their wrongful conduct; and e. Whether, as a result of this horrific and wrongful conduct by the Defendants, the Plaintiff class in entitled to restitution or other equitable relief, or to compensatory or punitive damages.

Farmer-Paellman Complaint, *supra* note 6, at ¶ 35.

139. FED. R. CIV. P. 23(a)(3).

140. FED. R. CIV. P. 23(a)(4).

141. Farmer-Paellman claims that the members of Plaintiff class she purports to represent have been similarly affected by the Defendants' course of conduct. Farmer-Paellman Complaint, *supra* note 6, at ¶ 36. Her assertion seems simplistic as she essentially argues that all African Americans whose ancestors were slaves were affected in the same way. Farmer-Paellman's objectives may differ radically from those she professes to represent.

than what individual descendants originally assented to and therefore fail to protect the interests of the proposed class.

To be certified as a class, the group must fit into one of the categories set forth in Rule 23(b).[142] Aetna's formal apology also stated that Aetna would take no further action to make reparations to descendants.[143] Since Aetna has been named as a defendant in Farmer-Paellman's suit, this would satisfy the criteria that the opposing party refused to act on grounds generally applicable to the class for that suit. Another way to satisfy one of the categories would be to argue that a limited fund exists because insurance companies can only pay so much in damages. If individuals sued the insurance companies, whoever sued initially would obtain the largest recovery, leaving less for relative latecomers.[144] However, the argument against allowing a class to be certified can also be made using a money

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142. FED. R. CIV. P. 23(b)(1)-(3) states:

> (1) the prosecution of separate actions by or against individual members of the class would create a risk of
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> (A) inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class, or
>
> (B) adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests; or
>
> (2) the party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; or
>
> (3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include:
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> (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions;
>
> (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class;
>
> (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum;
>
> (D) the difficulties likely to be encountered in the management of a class action.

Id.

143. Aetna's Press Release , *supra* note 62.

144. This argument was recently set forth in Farmer-Paellman's complaint, "Defendants may exhaust their available funds in satisfying the claims of earlier plaintiffs to the detriment of later plaintiffs." Farmer-Paellman Complaint, *supra* note 6, at ¶ 40.

damages rationale. Allowing an umbrella organization to represent the class would most likely result in minimal recovery to individuals. These groups are likely more interested in symbolic recovery and obtaining an apology by using a courtroom as a stage on which to tell their story. Individuals who seek monetary compensation for the wrongs done to their ancestors may be better served by proceeding individually.

A court may be tempted to certify a class represented by one of the reparations organizations but this is likely not in the best interest of the potential class members. Upon closer examination, allowing such a class representative could undermine those descendants actually affected. The case would likely proceed as a form of public litigation with a purpose that, though important, may not adequately protect the interests of potential class members.

III. THE CONNECTION BETWEEN LEGISLATIVE AND JUDICIAL STRATEGY

Given the serious hurdles involved in bringing a lawsuit against insurance companies and the repeated failure of suits against the United States government, an important question presents itself: What is the potential value of bringing more lawsuits?[145] A proper analysis of this question must consist of several parts. First, a closer look at the passage of the California laws mandating the release of information regarding slave insurance policies and the establishment of a commission to study the economic effects of slavery reveal a message that can be construed as encouraging more suits. Second, those in the reparations movement have openly admitted to supporting a strategy of filing lawsuits in order to bring reparations into the public discourse. By doing so, supporters hope to attract the attention of the executive and legislative branches, that can more effectively make proper reparations for slavery. By measuring this strategy

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145. Rhonda Magee, Note, *The Master's Tools, From the Bottom up: Responses to African-American Reparations Theory in Mainstream and Outsider Remedies Discourse*, 79 VA. L. REV. 863, 908 (1993), quoting Derrick A. Bell, Jr.'s observation that:

> [S]hort of a revolution, the likelihood that blacks today will obtain direct payments in compensation for their subjugation as slaves before the Emancipation Proclamation, and their exploitation as quasi-citizens since, is no better than it was in 1866, when Thaddeus Stevens recognized that his bright hope of "Forty Acres and a Mule" for every freedman had vanished "like the baseless fabric of a vision."

Id.

against the public law litigation model proposed by Abram Chayes,[146] a strategy of "quasi-public litigation" will be depicted. This "quasi-public litigation" strategy could utilize the judicial system and the financial vulnerabilities of insurance companies and other corporate entities that profited from slavery to draw attention to the issue and get someone, anyone, to take reparative action.

A. California's Legislative Response to the Reparations Issue

1. Enacting a Statute Mandating an Inquiry Into Companies That Profited From Slavery: Why California?

Former California State Senator Tom Hayden (D-Santa Monica) introduced a bill that required insurance companies to disclose all information related to policies they issued insuring slaves to their masters.[147] A second bill mandated that a commission study the socioeconomic effects of slavery, with specific attention paid to those businesses that profited from slavery.[148] Hayden was prompted to draft both bills in part because of the previously discussed apology issued by Aetna, Inc. due to its role in selling slave policies to slave owners.[149] Hayden was questioned as to why such a bill would be appropriate in California, rather than in one of the former major slaveholding states in the south.[150] Hayden's then chief of staff answered this question by stating, "[t]here are plenty of descendants of slaves from the South living . . . in California."[151]

The bills were met with nearly universal approval. Only a small contingent of the legislature's Republican caucus was unsupportive of the bills.[152] More striking than that, however, is the fact that insurance companies registered no opposition to the final version of the bill and

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146. *See infra* Part III.C.

147. S. Res. 2199 (Ca. 2000), *available at* http://www.leginfo.ca.gov/pub/99-00/bill/sen/sb_2151-2200/sb_2199_bill_2000930_chaptered.html (last visited Nov. 9, 2002).

148. S. Res. 1737 (Ca. 2000) *available at* http://www.leginfo.ca.gov/pub/99-00/bill/sen/sb_1701-1750/sb_1737_bill_20000930_chaptered.html (last visited Nov. 9, 2002).

149. V. Dion Haynes, *California tells Insurers: Open Slave Records*, CHI. TRIB., Oct. 20, 2000, at 4.

150. Michael Falcone, *California State Bills Require Study Into Historical Effects of Slavery*, DAILY BRUIN VIA U-WIRE, Oct. 11, 2000.

151. *Id.*

152. *Id.*

pledged to fully comply.[153] Supporters of the bills believe that informing the public about the slave policies issued by insurance companies will create potential targets of lawsuits, which could embolden other African Americans to file suits against other industries that indirectly profited from slavery.[154] These lawsuits can be seen as part of a larger strategy for obtaining reparations that includes the involvement of insurance companies and could lead to legislative reparations. To fully illuminate this strategy, the requirements of the California statutes must be examined to see the ways in which they could possibly encourage litigation. The potential alternative purpose of filing suit for reparations illuminates a form of "quasi-public litigation" where the courtroom becomes a stage on which to tell the story of slavery to attract national attention and acquire legislative reparations.

2. The Disclosure Statute: Revealing "Slave Policies" to the Public

Beginning on January 1, 2001, the California Insurance Commissioner was authorized by the California Insurance Code to request information from insurance companies doing business in California regarding records of slaveholder insurance policies issued by a predecessor corporation during the slavery era.[155] Accordingly, these insurance companies must also report to the Commissioner concerning their records relating to these policies that provided coverage for "damage to or death of their slaves."[156] Further, the California legislature enacted an additional statutory provision mandating the disclosure of the information possessed by insurance companies about slave policies to descendants of slaves.[157] This

153. Solomon Moore, *Law on "Slave Insurance" to Debut Soon*, L.A. TIMES, Dec. 11, 2000, at B1.

154. *Id.*

155. *See* CAL. INS. CODE § 13810 (2001) ("The commissioner shall request and obtain information from insurers licensed and doing business in this state regarding any records of slaveholder insurance policies issued by any predecessor corporation during the slavery era.").

156. *See* CAL. INS. CODE § 13812 (2001) ("Each insurer licensed and doing business in this state shall research and report to the commissioner with respect to any records within the insurer's possession or knowledge relating to insurance policies issued to slaveholders that provided coverage for damage to or death of their slaves.").

157. *See* CAL. INS. CODE § 13813 (2001) ("Descendants of slaves, whose ancestors were defined as private property, dehumanized, divided from their families, forced to perform labor without appropriate compensation or benefits, and whose ancestors' owners were compensated for damages by insurers, are entitled to full disclosure.").

affirmative duty was imposed by statute on insurance companies doing business in California in order to provide information to the California state government, the descendants of former slaves and to the public.[158] So far, California has compiled a list of at least six-hundred slaves and slaveholders and has received copies of several slave policies.[159] Information concerning these policies and the names of slaves and slaveholders are readily accessible on the California Insurance Commissioner's website.[160] The statutes do not suggest monetary damages, although members of the reparations movement have demanded and will continue to demand, through lawsuits, that these companies pay reparations.[161]

3. The Establishment of a Colloquium to Analyze the Economic Benefits of Slavery

As a further effort to make known the insurance companies who profited from slavery, the state is also requiring University of California officials to assemble a team of scholars to research slavery's history and the ways in which businesses benefited.[162] The expected outcome of this

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158. *See* Green, *supra* note 10, at 86. *See also* CAL. INS. CODE § 13811(2001) ("The commissioner shall obtain the names of any slaveholders or slaves described in those insurance records, and shall make the information available to the public and the Legislature.").

159. Jason B. Johnson, *Recalculating the Price of Human Bondage*, SAN FRAN. CHRON., Apr. 14, 2002, at A4.

160. The Slavery Era Registry Report to the California Legislature including information regarding insurance companies compliance with and response to the new laws and public access to the information, as well as the location of the policies that have been discovered and the names of slaves and slaveholders are all available at http://www.insurance.ca.gov.

161. Green, *supra* note 10, at 86. Just after the California Insurance Commissioner's Report was made public, a second class-action lawsuit was filed in May of 2002 in New Jersey against New York Life Insurance Company and others by Richard E. Barber, who claims he can trace his ancestry back to slavery. Lori Widmer, *A Back Door For Reparations?*, RISK & INS., Aug. 1, 2002, at 1. Also, in August, two elderly brothers from California who were the sons of a slave and a 119-year-old man from New York (who is considered to be the oldest man in the United States) filed a suit against corporate defendants after this information came to light. Eric Bailey, *Slave's sons Seek to Heal Wounds With Reparations*, L.A. TIMES, Sept. 8, 2002, at B1.

162. *See* CAL. ED. CODE § 92615 (2001):

> (a) The Legislature requests that the Regents of the University of California assemble a colloquium of scholars to draft a research proposal to analyze the economic benefits of slavery that accrued to owners and the businesses, including insurance companies and their subsidiaries, that

colloquium will be to draft a research proposal that would allow further studies of the economic benefits of slavery that accrued to businesses.[163] This information could add further incentive to those contemplating suit against insurance companies and other corporate entities as specific details could be uncovered through these studies that insurance companies may not be willing to reveal.

B. The Possible Connection Between the California Legislative Initiatives and Reparations Lawsuits: An Examination of Legislative History

The actions taken by the California legislature, spearheaded by Senator Hayden, mirror those that the reparations movement seeks from the federal government. In the continued, purposeful absence of such action, Deadria Farmer-Paellman has filed a class action suit against corporate defendants including Aetna, Inc. and the Reparations Coordinating Committee anticipates filing suit against the United States, insurance companies, corporations, and individual states in order to bring the accountability of those who benefited financially from slavery into the national discourse.[164]

Whether a lawsuit or action taken by the federal government similar to that already taken by California would be the best way to make African Americans whole while fairly telling slavery's truths is a point of contention within the reparations movement. However, this debate is also the source of overlapping end results that members of the movement seek by bringing their claims to light. Rather than being distinct strategies for

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> received those benefits. The colloquium shall draw on the resources and knowledge of historians and other scholars from across the nation as well as California, and interested parties shall also be invited to participate.
>
> (b) As resources allow, the State Library shall participate in the effort required by this section. The State Library shall examine the economic legacy of slavery in California, including forced slavery, chattel slavery, and indentured servitude.
>
> (c) The Legislature further requests that the Regents of the University of California make recommendations to the Legislature regarding the colloquium's findings on or before January 1, 2002.

Id. *See also* Fletcher, *supra* note 57, at A1.

163. *UCLA Center for African American Studies to Host "Unfair Gains: A Colloquium on the Socioeconomic Legacy of Slavery,"* ASCRIBE NEWSWIRE, Jan. 23, 2002. The colloquium mandated by statute took place Feb. 1 and Feb 2, 2002 at the University of California at Los Angeles and included University history professors, counsel for the California Department of Insurance, and the Chairman of the National Coalition for Black Reparations in Africa. *Id.*

164. Robinson Address, *supra* note 20.

obtaining reparations, pursuing judicial and legislative action are part of a common plan aimed at getting reparations into the national discourse. The passage of the California statutes makes bringing suit against insurance companies in California courts easier, which in turn facilitates federal legislative attention and action.

To fully examine how judicial and legislative strategies constitute a common strategy, it is necessary to look at the legislative history of the California statutes. The bill introduced by Senator Hayden that became California Insurance Code Sections 13810-13813 initially included some more controversial provisions that were later deleted in order the get the bill passed. Originally, Senator Hayden called for "[a] public hearing to determine whether there is a basis to compensate descendants of those slaves under existing law."[165] Further, the bill provided for "legal standing to seek compensation or other remedies . . . ."[166] These provisions were ultimately deleted from the final statutes for several important reasons. First, the California legislature expressed concern that because the slave policies were legal when made, any attempt to modify the legal rights of the parties by legislation would be an "unconstitutional impairment on the obligations of contracts, as well as a deprivation of the person's vested rights."[167] Concerned that the original bill would create unreasonable expectations of recovery, the "legal standing" portion was removed.[168] Instead, the bill was recast as a fact-finding resolution. As the statutes now stand, insurance companies are required to produce information.[169] Though the provisions do not explicitly state that descendants of slaves have standing to sue insurance companies, the statutes do not prohibit these suits either. Further, by requiring the publication of slave policy information, Californians will be more informed about the truths of slavery. When the Senate Judiciary Committee debated the bill, the committee expressed concern that public disclosure of family or company names of those who profited from insuring slaves would cause public humiliation.[170] The passage of those portions of the bill mandating the release of slaveholders

165. S. Res. 2199, *supra* note 147.

166. *Id.*

167. *See id.*

168. S. Res. 2199, Bill Analysis (Ca. 2000), *available at* http://www.leginfo.ca.gov/pub/99-00/bill/sen/sb_2151-2200/sb_2199_cfa_20000510_123210_sen_comm.html (last visited Nov. 9, 2002).

169. CAL. INS. CODE §§ 13810, 13812, 13813.

170. S. Res. 2199, Bill Analysis, *available at* http://www.leginfo.ca.gov/pub/99-00/bill/sen/sb_2151-2200/sb_2199_cfa_20000510_123210_sen_comm.html (last visited Nov. 9, 2002).

described in the insurance records is illustrative of the California Senate's feeling that this risk of public humiliation was not enough to overcome the importance of getting this information to the legislature and the public. In fact, the legislature may have wanted the public humiliation to force those affected to rally behind state and/or federal reparative action. Randall Robinson pointed out that "[p]rivate money plays a disproportionately large role in the making of American public policy. Those who have it can come alone to Congress and get attention . . . . The money has to come from those who expect a return on their investment."[171] If the descendants of former slaveholders and insurance companies have their relationships to the peculiar institution brought to light, they will be more likely to support a legislative form of reparations, rather than having to face judicially imposed liability. California has created a tremendous gateway to pursuing reparations. Descendants of slaves will be more likely to sue insurance companies and descendants of former slaveholders. Rather than having their reputations damaged in the court of public opinion during a lawsuit, these potential defendants will be more likely to lobby state and federal legislatures to enact reparative measures, including increased funding to urban schools and economic relief to disadvantaged African American communities. If insurance companies and descendants of former slaveholders lobby the legislature in addition to reparations supporters,[172] a strong likelihood exists that Congress will find a way to enact some form of reparations in response to both public outcry and monied lobbyists.[173]

C. "Quasi-Public Litigation:" Bringing Suit to Get Legislative Attention

The public law litigation model seeks to vindicate public rights and values through judicial remedies.[174] Parties bring a public action asking the

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171. ROBINSON, *supra* note 12, at 169.

172. In addressing Senate Bill 2199, the California legislature took into consideration the twelve groups that registered their support for the bill and the total absence of groups in opposition. S. Res. 2199, Assemb. Comm. On Ins., Bill Analysis (Ca. 2000), *available at* http://www.leginfo.ca.gov/pub/99-00/bill/sen/sb_2151-2200/sb_2199_cfa_20000627_163645_asm_comm.html (last visited Nov. 9, 2002).

173. Aetna's formal apology for its issuance of slave policies was accompanied by a strong statement that the company would take no further action. Though Aetna will not comment on its legal strategy, the company may support and lobby for legislative reparations in order to avoid the legal and reputational costs of being sued for its involvement in slavery. Aetna's Press Release, *supra* note 62.

174. Harold H. Koh, *Transnational Public Law Litigation*, 100 YALE L.J. 2347, 2347-48 (1991), *construing* Abram Chayes model of public law litigation. *See* Abram Chayes, *The*

court to declare and explicate public norms, often with the goal of bringing about institutional reform.[175] The model of public law litigation proposed by Abram Chayes involves parties who typically are not true adversaries.[176] Rather, they are parties who litigate in order to have a judge interpret policy for them.[177] The judge's role is an active one that shapes the litigation and the remedy is generally forward looking.[178]

Here, the proposed reparations suits do involve a traditional bilateral party structure. The reparations suits will likely be purely adversarial. Unlike the public law litigation model, this fact inquiry will likely be historical not predictive.[179] The suits will be exercises in truth telling about slavery and its ill-gotten gains. Where these suits resemble public law litigation is that potential plaintiffs do seek compensation for a past wrong but they will likely do so by demanding a remedy that is "broadly remedial" as contemplated by the public law litigation model.[180] However, the proposed reparations suits differ from the Chayes' model of public law litigation in a significant way and therefore, this Comment proposes that these proposed suits can be classified as "quasi-public litigation."

Role of the Judge in Public Law Litigation, 89 HARV. L. REV. 1281 (1976). The public law litigation model includes the following:

> (1) The scope of the lawsuit is not exogenously given but is shaped primarily by the court and the parties; (2) The party structure is not rigidly bilateral but sprawling and amorphous; (3) The fact inquiry is not historical and adjudicative but predictive and legislative; (4) Relief is not conceived as compensation for past wrong in a form logically derived from the substantive liability and confined in its impact to the immediate parties; instead, it is forward looking, fashioned ad hoc on flexible and broadly remedial lines, often having important consequences for many persons including absentees; (5) The remedy is not imposed but negotiated; (6) The decree does not terminate judicial involvement in the affair: its administration requires the continuing participation of the court; (7) The judge is not passive, his function limited to analysis and statement of governing legal rules; he is active, with responsibility not only for credible fact evaluation but for organizing and shaping the litigation to ensure a just and viable outcome; and (8) The subject matter of the lawsuit is not a dispute between private individuals about private rights, but a grievance about the operation of public policy.

Id. at 1302.

175. Koh, *supra* note 174, at 2347-48.
176. Chayes, *supra* note 174, at 1302.
177. *Id.*
178. *Id.*
179. *Id.*
180. *Id.*

Instead of a judge taking an active role in shaping the outcome, potential plaintiffs will likely take the active role in telling the ways in which insurance companies profited from the enslavement of African Americans. Plaintiffs can use this truth telling to motivate insurance companies to lobby Congress on their behalf to obtain the legislative reparations sought by the reparations movement. Insurance companies may be persuaded to lobby Congress for reparations because it would cost comparatively less money than a potential judicial judgment ordering them to pay reparations. The litigation can also be used by plaintiffs to attract national attention in the hope that Americans will rally behind the idea of reparations. The goal of attracting such national attention would be that the legislature would enact broad-based measures to compensate as many disadvantaged African Americans as possible.

Reparations seekers admittedly want to bring the issue into the public discourse. Randall Robinson, a prominent figure within the movement, has stated that regardless of winning a lawsuit, anything that provokes a fuller discussion about reparations is a success.[181] Robinson has called for lawsuits to tell the story of slavery in a judicial forum in order to persuade the court of public opinion that America must examine itself and find that reparations is a fair and just concept.[182] Despite the previous analysis of the weaknesses of claims against insurance companies, if reparations supporters can survive a motion to dismiss and fully litigate their claims, they will have won a small victory. Expert witnesses and others can then enlighten the public about the ways in which slavery has affected all aspects of American life.[183] Proponents would get an opportunity to prove that insurance companies owe a part of their wealth to profits gained from insuring one human being to another.[184]

Institutional reform also appears to be the most popular goal among reparations proponents. Though movement leaders will not say so directly,

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181. Robinson Address, *supra* note 20.

182. *Id. But see* Lewis Béale, *Seeking Justice for Slavery's Sins*, L.A. TIMES, Apr. 22, 2002, at E1 (noting that Farmer-Paellman in emphatic that her suit is "not a public relations gesture meant to create some sort of national soul-searching about the slavery issue."). However, Farmer-Paellman was quoted one month earlier, "[t]his lawsuit sets out to educate the world about what slavery really was." *The Osgood File: Class-Action Lawsuit Filed for Black Slavery Reparations: Interview With Deadria Farmer-Paellman* (CBS television broadcast, Mar. 27, 2002) (on file with Burrelle's Information Services, CBS News Transcripts).

183. Robert Joiner, *What's the Interest on Forty Acres and a Mule?*, ST. LOUIS POST-DISPATCH, August 30, 2001, at B7.

184. *Id.*

the solutions they support would be best accomplished via legislative action. Randall Robinson supports money for educational programs and financial support for struggling African American communities.[185] Congress can most effectively institute such programs, as a court can only deal with "the parties before it and those 'similarly situated,' as defined by traditional concepts of judicial jurisdiction; the writs of a legislative body, by contrast, run throughout its kingdom."[186] Simply put, legislators can do more than judges can.[187] Courts, in this instance, can and will be used to interpret and enforce extant rights and legislative laws.[188] By using the courtroom as a stage, the public and particularly the legislature will take notice of the reparations movement thereby placing more pressure on the legislature to enact reparative social programs.[189]

With suits being brought in order to have the legislature take its cue from the judiciary and do the work of making reparations comes the inevitable questions concerning the professional morality involved in using the court system to influence the legislature. A basic principle of the legal profession has been that a lawyer should not argue his or her case outside the courtroom.[190] The temptation is to advocate the client's case in front of the press and the public in order to win in the court of public opinion.[191] The theory is that if the lawyer can persuade the court of public opinion, he or she will be more likely to persuade the judge or jury. To prevent this strategy, trial publicity rules have been incorporated into rules of professional responsibility.[192] However, the current publicity rules likely

185. Robinson Address, *supra* note 20.

186. BITTKER, *supra* note 12, at 84

187. Roy L. Brooks, *The Age of Apology, in* WHEN SORRY ISN'T ENOUGH 6 (Roy L. Brooks ed., 1999). *But see* Adarand Constructors v. Pena, 515 U.S. 200, 227 (1995) (holding that federal programs using racial classifications must meet the strict scrutiny standard announced in *City of Richmond v. J.A. Croson Co.*, 488 U.S. 469 (1989)); *Cf.* Roy L. Brooks, *Not Even an Apology, in* WHEN SORRY ISN'T ENOUGH 314 (Roy L. Brooks ed., 1999) (noting that in *Jacobs v. Barr*, the Supreme Court upheld the constitutionality of monetary reparations for Japanese Americans to the exclusion of German and Italian Americans. This case upheld the constitutionality of race-based measures to redress a public institution's past discrimination).

188. Brooks, *The Age of Apology, supra* note 187, at 6.

189. *Id. See also* BITTKER, *supra* note 12, at 23 (stating that "the fact that segregation by law was regarded as constitutional from 1896 to 1954 is not inconsistent with a Congressional decision to provide compensation for the damages it inflicted on its victims.").

190. Jonathan M. Moses, *Legal Spin Control*, 95 COLUM. L. REV. 1811 (1995).

191. See *id.* at 1822, 1826.

192. *Id.* at 1816-17.

do not apply to public relations work to influence legal actors who are not judges or prosecutors.[193]

Trial publicity rules were designed to guard against the use of publicity to improperly influence the outcome of a trial.[194] For reparations proponents, the trial is the publicity. Supporters will sue in order to tell a story that will be believed by the masses. Judicial safeguards will ensure that this exercise is one characterized by all of slavery's truths. While using the judicial system to obtain legislative attention and action may offend some moral sensibilities, it does not appear to fly in the face of any established professional rules. Therefore, while the reparations suits do not fit into the model of public law litigation where both parties bring an action to obtain institutional reform, the suits do involve one party seeking to correct a continuing injustice via institutional reform. The purpose of the suits will likely be to act as a platform to state what happened; why it was and is still a legal wrong; and why it still deserves compensation. The desired form of compensation will then be pursued in the legislative arena.

CONCLUSION

The path to reparations is a thorny one, replete with legal and social obstacles. The California statutes provide information to potential litigants that will likely be used to sue insurance companies. Suing insurance companies under the theory of unjust enrichment carries with it significant potential pitfalls. However, simply surviving a motion to dismiss would appear to satisfy the major figures within the movement. Fully litigating the various wrongs perpetrated by government, corporations, and individuals during slavery's 246 year existence and subsequent legalized race-based discrimination is the most probable means whereby the legislative and executive branches will pay attention to these continuing wrongs, take steps to admit their existence, and repair them. However, even if the strategy of pursuing lawsuits to attract attention is successful, the legislature must find a legal way of enacting reparative programs aimed at disadvantaged African American communities.

Americans pride themselves on a strong sense of self and knowledge of their history. Yet, Americans do not want to see what slavery has meant to American culture.[195] For the reparations movement to gain acceptance, Americans must look inward. In support of the bill that became the

193. *Id.* at 1839.
194. *Id.* at 1840.
195. ROBINSON, *supra* note 12, at 163.

California statutes mandating the publication of information regarding insurance companies insuring slaves to their masters, the Southern Christian Leadership Conference of Greater Los Angeles submitted the following statement:

> In this state, the political climate in recent years gives the impression that we are not better off speaking about racism and redressing the historic injustices against African Americans. However, healing is not possible without full disclosure of the scope and depth of an illness. The truth that Africans in America were dehumanized to the level of beasts of burden or only useful for the economic benefit of white slaveholders is more than a sad chapter in our national past. It is an awful reality that has shaped the collective life of ancestors of slaves . . . . Your passage of this bill can be the basis for a process that not only discloses the past but also makes healing possible in the future.[196]

All of the efforts made by the reparations movement, from lawsuits to lobbying the legislature to appealing to the American public in editorials, books and speeches, are efforts to make a necessary full disclosure of a fundamental truth in American history.

196. SEN. RULES COMM., BILL ANALYSIS, S. RES. 2199 (Ca. 2000), *available at* http://www.leginfo.ca.gov.ca.gov/pub/99-00/bill/sen/sb_2199_cfa_2000524_185945_sen_floor.html (last visited Nov. 9, 2002).

THE EQUITY IN PRESCRIPTION INSURANCE AND CONTRACEPTIVE COVERAGE ACT: WILL CONGRESS HEED THE WAKE-UP CALL OF *ERICKSON V. BARTELL DRUG COMPANY*?

*Lynda A. Rizzo**

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INTRODUCTION

In *Erickson v. Bartell Drug Co.*[1] ("*Erickson*"), the United States District Court for the Western District of Washington ruled that Bartell's

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* J.D., Spring 2003, University of Connecticut School of Law. The author would like to thank Monica Debiak and Professor Robin Barnes for their support and guidance, the

exclusion of prescription contraception from its prescription drug plan was inconsistent with the requirements of the Pregnancy Discrimination Act[2] (PDA). The court's decision was an important step in the struggle for equal drug coverage for women, yet its limited applicability highlights the need for Congress to pass the Equity in Prescription Insurance and Contraception Coverage Act (EPICC).

While *Erickson*'s ruling applies only to employers pursuant to Title VII of the Civil Rights Act of 1964, EPICC would require that health plans already offering coverage for prescription drugs cover all forms of contraception approved by the Federal Drug Administration (FDA).[3] EPICC would also require coverage for outpatient contraceptive services if the plan already covers other such services.[4] EPICC would extend to self-insured employers that are often able to escape state mandates for prescription contraception coverage. EPICC has been reintroduced each session since 1997, yet has not been passed despite support.[5] The outcome of *Erickson* and the passage of similar legislation in several states, however, seems to reflect a trend supporting the passage of EPICC.[6]

This Note will argue that, in light of *Erickson*, Congress should pass EPICC and finally mandate coverage for prescription contraception, a vital element in maintaining women's health. Part I of this Note will provide a brief history of *Erickson*, while Part II will explain EPICC and the legislative history surrounding the bill. Part III highlights the necessity for

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members and Executive Board of the Connecticut Insurance Law Journal for the efforts they contributed to the publication of this Note, Mark and her family. This Note is dedicated to Marie "Nancy" Rizzo.

1. 141 F. Supp. 2d 1266 (W.D. Wash. 2001).

2. *Id.* at 1271.

3. *Improving Women's Health: Why Contraceptive Insurance Coverage Matters: Hearing on S. 104 Before the Subcomm. on Health, Educ., Labor and Pensions*, 107th Cong. § 1 (2001) [hereinafter *Hearing*] (statement of Sen. Harry Reid), *available at* http://web.lexis-nexis.com/congcomp (last visited Nov. 9, 2002).

4. Planned Parenthood, *Cover My Pills–Fair Access to Contraception, Get the Facts: If it is Passed Into Law, What will EPICC Mean to you?*, *at* http://www.covermypills.com/facts/congress.asp (last visited Nov. 9, 2002) [hereinafter *Facts*].

5. *Hearing*, *supra* note 3. EPICC had forty-two cosponsors in 2001 in the Senate and House of Representatives from both parties and from both sides of the abortion debate. *Id.*

6. *See* Planned Parenthood, Cover My Pills, *Get The Facts: State Laws*, *at* http://www.covermypills.com/facts/ongoing.asp (last visited Nov. 9, 2002) [hereinafter *State*]. Since 1998, twenty states have enacted laws requiring private insurance coverage of contraception. *Id.* These states are: Arizona, California, Connecticut, Delaware, Georgia, Hawaii, Iowa, Maine, Maryland, Massachusetts, Missouri, Nevada, New Hampshire, New Mexico, New York, North Carolina, Rhode Island, Texas, Vermont and Washington. *Id.*

EPICC and will identify the policies and economics in support of the legislation. Part IV concludes that, in light of *Erickson* and the action taken by numerous states, it is clear that there exists a national trend toward coverage for prescription contraception. It is time for Congress to act by mandating coverage for contraception to fulfill the Congressional intent behind the PDA, for the sake of women's health and for the cause of gender equality.

I. *ERICKSON V. BARTELL DRUG CO.*

Jennifer Erickson brought a class action lawsuit against her employer, the Bartell Drug Company, claiming that the company's failure to cover prescription contraception was a violation of Title VII, as amended by the PDA.[7] Erickson served as a plaintiff on behalf of all female employees of Bartell.[8] Bartell's Prescription Benefit Plan extended coverage to prescription drugs and devices, hormone replacement drugs, prenatal vitamins and preventative medicines for a variety of ailments.[9] The plan specifically excluded prescription contraception.[10] Erickson filed a claim with the United States Equal Employment Opportunity Commission (the "EEOC" or "Commission") on December 29, 1999, in which she maintained that "Bartell's failure to provide her with health insurance coverage for prescription contraceptives constitutes unlawful discrimination on the basis of sex," and received a right-to-sue letter from the EEOC on July 10, 2000.[11] She thereafter filed a complaint with the district court alleging that "Bartell singles out female employees for disadvantageous treatment by excluding prescription contraceptives from an employee benefit plan while including benefits for other preventative medical services, including other preventative prescription medications and devices."[12]

The *Erickson* court concluded that Bartell's prescription drug plan discriminated against its female employees "by providing less complete

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7. Am. Compl. ¶ 1. Title VII provides that "[i]t shall be unlawful . . . for an employer . . . to discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual's race, color, religion, sex, or national origin." 42 U.S.C. § 2000e-2(a) (2001).

8. Erickson v. Bartell Drug Co., 141 F. Supp. 2d 1266, 1268 (W.D. Wash. 2001).

9. *Id.* at 1268, n.1.

10. *Id.*

11. Am. Compl. ¶¶ 4-5.

12. *Id.* at ¶ 2.

coverage than that offered to male employees."[13] In reaching his decision, the district judge focused on the legislative history of the PDA. Congress passed the PDA in response to the Supreme Court's ruling in *General Electric Co. v. Gilbert*,[14] in which the Court ruled that "an otherwise comprehensive short-term disability policy that excluded pregnancy-related disabilities from coverage did not discriminate on the basis of sex."[15] By passing the PDA, Congress expressly prohibited discrimination on the basis of "pregnancy, childbirth, or related medical conditions,"[16] making such discrimination analogous to discrimination on the basis of sex.[17]

In ruling that Bartell's selective exclusion of coverage for prescription contraception violated the PDA, the court reasoned that, while the PDA does not expressly reference prescription contraception, Congress adopted the *Gilbert* dissent's "broader interpretation of Title VII."[18] Justices Brennan and Marshall recognized in their dissent to the *Gilbert* decision that employers are required by law to provide benefits that would apply only to women and incur additional costs in order to treat the sexes equally.[19] Reflecting on this, the *Erickson* judge concluded that:

> Male and female employees have different, sex-based disability and healthcare needs, and the law is no longer blind to the fact that only women can get pregnant, bear children, or use prescription contraception. . . . Even if one were to assume that Bartell's prescription plan was not the result of intentional discrimination, the exclusion of women-only benefits from a generally accepted comprehensive plan is sex discrimination under Title VII.[20]

The underlying theme of Bartell's argument was that a woman's ability to control her reproductive choices is distinguishable from other types of

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13. *Erickson*, 141 F. Supp. 2d at 1276-77.
14. 429 U.S. 125 (1976).
15. *Erickson*, 141 F. Supp. 2d at 1269-70.
16. 42 U.S.C. § 2000e(k) (2001). The statute provides that:
> The terms "because of sex" or "on the basis of sex" include, but are not limited to, because of or on the basis of pregnancy, childbirth, or related medical conditions; and women affected by pregnancy, childbirth, or related medical conditions shall be treated the same for all employment-related purposes.

Id.
17. *Erickson*, 141 F. Supp. 2d at 1269.
18. *Id.* at 1270.
19. *Id.*
20. *Id.* at 1271-72 (internal citation omitted).

illnesses or diseases normally treated with prescription drugs.[21] The district judge rejected this argument, reasoning that "the availability of affordable and effective contraceptives is of great importance to the health of women and children because it can help to prevent a litany of physical, emotional, economic, and social consequences."[22] The judge reasoned that unintended pregnancies, which account for half of all pregnancies in the United States, impose costs on the mother, child, and society.[23] In addition, the consequences of unwanted pregnancy inhibit the abilities of women to participate fully in employment opportunities and society.[24] Further, Bartell's plan included coverage for other preventative drugs and, like other preventative treatments, prescription contraception allows women to prevent "unwanted physical changes."[25]

By virtue of its decision, the judge in *Erickson* directed Bartell to include in its plan "each of the available options for prescription contraception to the same extent, and on the same terms, that it covers other drugs, devices, and preventative care for non-union employees."[26] In addition, the court ordered Bartell to cover contraception-related services, including "the initial visit to the prescribing physician, and any follow-up visits or outpatient services."[27]

II. EPICC

A. The Legislation

EPICC was first introduced in 1997.[28] While it received a Senate hearing, it did not enjoy similar success in the House of Representatives.[29] In 1999, the bill did not receive a hearing in either the House or the Senate.[30] EPICC was introduced for the third time in 2001 by Representative Jim Greenwood (R-Pa)[31] and Senator Olympia Snowe (R-

21. *Id.* at 1272.
22. *Id.* at 1273.
23. *Id.*
24. *See id.*
25. *Id.*
26. *Id.* at 1277.
27. *Id.*
28. *Facts*, *supra* note 4.
29. *Id.*
30. *Id.*
31. Equity in Prescription Insurance and Contraceptive Coverage Act of 2001, H.R. 1111, 107th Cong. 1 (2001).

Me).[32] To date, the House bill was referred to the House Committee on Energy and Commerce, while its Senate counterpart was referred to the Senate Committee on Health, Education, Labor and Pensions.[33] No further action has been taken on either the House or Senate versions of EPICC.[34]

EPICC does not require special treatment for prescription contraceptives, but rather requires health plans that provide coverage for prescription drugs to include comparable coverage for all FDA-approved prescription contraceptives.[35] The legislation would also provide coverage for outpatient contraceptive services if the plan covers other outpatient services.[36]

EPICC would be binding upon all group and individual health plans which already cover other prescription drugs and devices.[37] EPICC therefore is the single most effective way of guaranteeing contraception coverage for all women with private insurance.[38] Presently, many employers are exempt from state contraception coverage laws because the Employment Retirement Income Security Act (ERISA) includes a preemption clause that infringes upon the ability of states to mandate specific insurance coverage.[39] While state insurance regulations are exempt from ERISA's preemption clause, employee benefit plans are

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32. Equity in Prescription Insurance and Contraceptive Coverage Act of 2001, S. 104, 107th Cong. (2001).

33. S.104, 107th Cong. 1 (2001); H.R. 1111, 107th Cong. (2001).

34. *Id.*

35. *Hearing*, *supra* note 3 (testimony of Sen. Harry Reid). EPICC states:

> A group health plan, and a health insurance issuer providing health insurance coverage in connection with a group health plan, may not exclude or restrict benefits for prescription contraceptive drugs or devices approved by the Food and Drug Administration, or generic equivalents approved as substitutable by the Food and Drug Administration, if such plan provides benefits for other outpatient prescription drugs or devices.

S. 104, 107th Cong. § 714(a)(1) (2001).

36. *Reid Renews Fight for Women's Contraceptive Equity: Bipartisan Legislation Mandates Insurers Cover Birth Control* (Jan. 23, 2001), *at* http://www.senate.gov/~reid/press/01/01/2001124450.html (last visited Nov. 9, 2002) [hereinafter *Reid*]. EPICC provides that "[a] group health plan, and a health insurer providing health insurance coverage in connection with a group plan may not . . . exclude or restrict benefits for outpatient contraceptive services if such health plan provides benefits for other outpatient services provided by a health care professional. . . ." S. 104, 107th Cong. § 714(a)(2) (2001).

37. *Facts*, *supra* note 4.

38. *Id.*

39. Hazel Glenn Beh, *Sex, Sexual Pleasure, and Reproduction: Health Insurers Don't Want you to do Those Nasty Things*, 13 WIS. WOMEN'S L.J. 119, 139 (1998).

subject to the preemption clause.[40] Thus, ERISA creates a strong incentive for employers to self-insure in order to avoid burdensome state insurance mandates.[41] As self-funded plans become more common, the effectiveness of state mandates will decrease.[42]

Self-insured employee benefit plans, however, are not exempt from federal mandates.[43] Thus, self-insuring employers would be required to provide coverage for prescription contraception if EPICC is passed.[44] This would mean that the more than half of Americans that are insured by health benefit plans governed by ERISA would be guaranteed prescription contraception coverage under EPICC.[45]

Women covered by managed care providers would also reap the benefits of EPICC. Managed care and self-insured employers are emerging trends in health insurance coverage.[46] Managed care plans, unlike self-insured plans, are subject to state insurance mandates.[47] However, only twenty states have enacted laws requiring private insurance coverage of contraception.[48] The effects of EPICC would be striking in that, while ninety-seven percent of private insurance plans cover prescription drugs, half do not cover any method of reversible contraception.[49] EPICC would mandate that these plans extend their prescription drug coverage to include such contraceptives.

In 1998, Congress included a provision in the Federal Employees Health Benefit Program ensuring that all participants in the plan would receive coverage for prescription contraception.[50] The inclusion of this provision has saved female federal employees approximately $350 per year

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40. *Id.*
41. *Id.*
42. *Id.*
43. *Id.*
44. *See id.*
45. *See id. See also* Kathryn Kindell, *Prescription for Fairness: Health Insurance Reimbursement for Viagra and Contraceptives*, 35 TULSA L.J. 399, 401 (2000).
46. *See* Kindell, *supra* note 45, at 402.
47. *See id.* at 401.
48. *State*, *supra* note 6.
49. Cynthia Dailard, *Issues in Brief: U.S. Policy can Reduce Cost Barriers to Contraception,* THE ALAN GUTTMACHER INSTITUTE, *at* http://www.guttmacher.org/pubs/ib_0799.html (last visited Nov. 9, 2002) [hereinafter *AGI*].
50. Center for Reproductive Law and Policy, *Contraceptive Coverage in the Federal Employees Health Benefits Program* (May 2001), *at* http://www.crlp.org/pub_fac_ccfedemploy.html (last visited Nov. 9, 2002) [hereinafter *CRLP*].

at no additional cost the federal government.[51] The proponents of EPICC have attempted to use this victory as a building block in garnering support for the legislation.[52]

B. The U.S. Equal Employment Opportunity Commission

The EEOC handed down an important ruling on December 14, 2000 regarding the issue of contraceptive equity.[53] Two registered nurses filed a claim with the EEOC alleging that their employer's health plan, which excluded coverage for prescription contraception while simultaneously covering various other medical treatments and services, was illegal under Title VII.[54] The EEOC maintained that the exclusion of prescription contraceptives from a health insurance plan that covers prescription drugs is a violation of Title VII, as amended by the PDA.[55]

The EEOC explained that the PDA explicitly prohibits employers from treating women who are pregnant differently from other employees, including the singling out of pregnancy or related medical conditions in benefit plans.[56] "Under the PDA, for example, Respondents could not discharge an employee from her job because she uses contraceptives. So, too, Respondents may not discriminate in their health insurance plan by denying benefits for prescription contraceptives when they provide benefits for comparable drugs and devices."[57] The EEOC explained its conclusion by noting that the statutory language of the PDA covers contraception and that the interpretations of the United States Supreme Court and the intent of Congress accord with its decision.[58]

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51. *Treasury and Government Appropriations Act, 2002,* 107th Cong. 1, S. 9496 (Sept. 19, 2001) (statement of Sen. Olympia Snowe), *available at* http://thomas.loc.gov. Senator Snowe was speaking in support of again including a provision covering prescription contraception in the Treasury and General Government Appropriations Act of 2002 after it was first included in 1998. *Id.* Since 1998, coverage for prescription contraception has not caused the government to incur additional costs in that the provision has had no effect on insurance premiums. *Id.*

52. *Id.*

53. Wendy Netter, *Insurance: Exclusion of Contraception Found Discriminatory by EEOC*, 29 J.L. MED. & ETHICS 104 (Spring 2001).

54. *Id.*

55. *Id.* at 105.

56. EEOC Decision of Dec. 14, 2000, *available at* http://www.eeoc.gov/docs/decision-contraception.html (last visited Nov. 9, 2002) [hereinafter *Decision*].

57. *Id.*

58. *Id.*

While the EEOC decision is not binding on courts or employers, both will likely give deference to the decision.[59] The same is true of the guidelines issued by the Commission. In the December decision, the Commission interpreted its own guidelines to require coverage for prescription contraception if the employer's health plan includes coverage for comparable services.[60] Further, the EEOC stated that the employer must offer this coverage in all health plan options offered to its employees.[61] While not of the same force as court decisions, EEOC rulings are often used as a source of guidance by the courts, and employers look to the Commission's guidelines as a standard for making employee-related decisions.[62]

III. THE NECESSITY OF EPICC IN ACHIEVING CONTRACEPTIVE EQUITY

A. The Ineffectiveness of State Mandates

States have responded to the need for universal coverage of prescription contraception by passing laws ordering insurance providers to cover contraception.[63] While state action is encouraging in that it indicates growing public support for contraceptive equity and reflects a trend toward providing coverage for prescription contraception, it is both a problematic and ineffective approach to the problem. "Not only are these laws limited to state regulated plans, but this piecemeal approach to fairness leaves

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59. Tamar Lewin, *"The Pill" Must Be Part of Insurance*, INTELLIGENCER J., Dec. 15, 2000, at A1 (reporting remarks of Ellen Vargyas, EEOC attorney), *available at* 2000 WL 3828147.

60. Decision, *supra* note 56.

61. *Id.* The EEOC guideline stated in relevant part:

> Disabilities caused or contributed to by pregnancy, childbirth, or related medical conditions, for all job-related purposes, shall be treated the same as disabilities caused or contributed to by other medical conditions, under any health or disability insurance or sick leave plan available in connection with employment. Written or unwritten employment policies and practices involving matters such as the commencement and duration of leave, the availability of extensions, the accrual of seniority and other benefits and privileges, reinstatement, and payment under health or disability insurance or sick leave plan, formal or informal, shall be applied to disability due to pregnancy, childbirth, or related medical conditions as they are applied to other disabilities.

29 C.F.R. § 1604.10(b) (2000).

62. Rebecca Porter, *EEOC Rules Employers Must Cover Contraceptives,* TRIAL, Mar. 2001, at 94.

63. *See State, supra* note 6.

many American women at the mercy of geography when it comes to the coverage they deserve."[64] Surely, such a situation does not impart uniformity in the law.

State contraceptive-equity legislation, often referred to as "pill bills," extends health insurance coverage to eligible women for contraceptives and services comparable to the coverage provided for other medical prescriptions and services.[65] Maryland was the first state to require health insurers to provide comprehensive coverage for all FDA-approved contraceptives.[66] Nineteen additional states have since enacted similar laws demanding private insurance coverage for contraception.[67] Contraceptive equity bills are currently pending in an additional thirteen states.[68] Overall, pill bills have been introduced in thirty-five state legislatures.[69]

Several provisions must be included in contraceptive-equity laws in order to make them effective.[70] The law must provide full coverage for contraceptive needs by including medical appointments and all FDA-approved drugs and devices.[71] The law must not contain loopholes that weaken it and discriminate against women by permitting employers or

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64. *Treasury and Government Appropriations Act, 2002,* S. 9496, 107th Cong. 1 (2001) (statement of Sen. Olympia Snowe), *available at* http://thomas.loc.gov (last visited Nov. 9, 2002).

65. Insure.com, *Pill Bills: States That Mandate Contraceptive Equality, at* http://www.insure.com/health/pillbillstate.html (last visited Nov. 9, 2002) [hereinafter *Pill Bills*].

66. Planned Parenthood, *Fact Sheet: Equity in Prescription Insurance and Contraceptive Coverage, at* http://www.plannedparenthood.org/library/BIRTHCONTROL/EPICC_facts.html (last visited Nov. 9, 2002).

67. Planned Parenthood, *Cover My Pills: Get the Facts—States with Laws Requiring Full Contraceptive Coverage (1998-2002), at* http://www.covermypills.com/facts/states.asp (last visited Nov. 9, 2002). States with pill bills include Arizona, California, Connecticut, Delaware, Georgia, Hawaii, Iowa, Maine, Maryland, Massachusetts, Missouri, New Hampshire, New Mexico, New York, Nevada, North Carolina, Rhode Island, Texas, Vermont and Washington. *Id.*

68. Planned Parenthood, *Cover My Pills: Get the Facts—States with Contraceptive Equity Bills Pending, at* http://www.covermypills.com/facts/states_bill.asp (last visited Nov. 9, 2002). These states include Alaska, Florida, Illinois, Michigan, Nebraska, New Jersey, Ohio, Pennsylvania, South Carolina, Tennessee, Utah and Wisconsin. *Id.*

69. Shellie Ellis, *Contraception Equity on the State Level,* THE NETWORK NEWS, July 1999, at 3.

70. Center for Reproductive Law and Policy, *Contraceptive Equity Bills Gain Momentum in State Legislatures, at* http://www.crlp.org/pub_fac_epicchart.html (last visited Nov. 9, 2002) [hereinafter *Momentum*].

71. *Id.*

insurers to opt out of coverage by claiming a religious exemption.[72] Lastly, the law must include all insurance plans, from employers to health insurance policies.[73]

Three arguments have been successful in thwarting state efforts to craft laws that would meet the above criteria. First, opponents argue that state insurance mandates are an "overly intrusive government action."[74] Second, opponents maintain that mandates will pose a financial burden on small business.[75] Lastly, those against state pill bills reason that mandatory contraception coverage would "impinge upon the religious freedom of those morally opposed to medical contraception."[76]

The laws that have been passed by states reflect the influence of these arguments, demonstrating that even if all fifty states adopted contraceptive equity bills, it is unlikely that these statutes would provide uniform coverage for women.[77] As one commentator observed in studying North Carolina's pill bill, "[c]ertain features of the . . . statute, however, limit its effective breath . . . it specifically excludes certain types of more limited plans. The . . . law also does not state explicitly that 'any' or 'all' FDA-approved contraceptive methods must be covered."[78]

Loopholes in state laws weaken their effectiveness.[79] Ten out of twenty state pill bills include religious exemptions.[80] These exemptions allow religious employers or, in some cases, certain insurance companies owned or operated by religious organizations, to request an exemption if the required coverage conflicts with the employers' religious beliefs.[81] Further, as mentioned above, employers who provide insurance coverage through self-insured plans are exempted from state mandates under ERISA.[82] State mandates may also be self-defeating in that if states begin

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72. *Id.*

73. *Pill Bills, supra* note 65.

74. Lisa Hayden, *Gender Discrimination Within the Reproductive Health Care System: Viagra v. Birth Control*, 13 J.L. & HEALTH 171, 189 (1999).

75. *Id.* at 189-90.

76. *Id.* at 190.

77. *Pill Bills, supra* note 65.

78. *See* Sarah E. Bycott, *Controversy Aroused: North Carolina Mandates Insurance Coverage of Contraceptives in the Wake of Viagra*, 79 N.C. L. REV. 779, 810 (2001).

79. *See Pill Bills, supra* note 65.

80. *See supra* note 68. These state statutes include California, Connecticut, Delaware, Hawaii, Maine, Maryland, Missouri, New York, Nevada and North Carolina. *Id.*

81. *See Pill Bills, supra* note 66.

82. *Beh, supra* note 39, at 139.

to require coverage for prescription contraception, self-insured plans may become more attractive and thus increasingly common.[83]

EPICC would address these problems by serving as an aggressive and comprehensive tool for achieving universal contraceptive coverage for women. The law meets the three criteria by providing coverage for all FDA-approved drugs, devices and medical appointments and it does not contain loopholes such as the religious exemption.[84] In addition, the bill necessarily binds all employers and insurance companies because it serves as a direct amendment to ERISA.[85] Lastly, because it is a federal bill, it will provide uniform coverage for women across the nation, no longer leaving the fate of women in the hands of geography and individual state legislatures.[86]

B. Religious Opposition to EPICC

In addition to the insurance industry, religious groups are an obvious and influential source of opposition to EPICC. "The Judeo-Christian tradition has long disapproved of nonprocreative sexual activity."[87] Throughout history, the medical profession has also sporadically attempted to discourage the public from engaging in such sexual activity.[88] Negativity toward non-procreative sex continued into the twentieth century, and "[e]ven today, physicians often endorse sexual abstinence over sexual activity."[89] The push for Americans to forsake their sexual identities was

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83. *Id.*
84. *Momentum*, *supra* note 70; *Pill Bills*, *supra* note 65; *see supra* notes 32-33.
85. EPICC states that:

> Subpart B of part 7 of subtitle B of title I of the Employment Retirement Income Security Act of 1974 (29 U.S.C. 1185 et seq.) is amended by adding at the end the following . . . A group health plan, and a health insurance issuer providing health insurance coverage in connection with a group health plan may not—(1) exclude or restrict benefits for prescription contraceptive drugs or devices approved by the Food and Drug Administration, or generic equivalents approved as substitutable by the Food and Drug Administration, if such plan provides benefits for other outpatient prescription drugs or devices; or (2) exclude or restrict benefits for outpatient contraceptive services provided by a health care professional (referred to in this section as "outpatient health care services").

S. 104, 107th Cong. §§ 3(a), 714(a)(1)-(2) (2001).
86. *See Hayden*, *supra* note 74, at 189.
87. *Beh*, *supra* note 39, at 123.
88. *Id.*
89. *Id.* at 124-25.

felt most strongly by women, who "had to be especially careful not to enjoy sex, because they were maternal, rather than sexual creatures."[90] Senator Dick Clark, in commenting on the PDA, observed that "[t]he significance of this legislation is that it deals with one of the most important causes of employment discrimination against women: [namely,] the age-old belief that [a] woman's primary role is to give birth and [to] care for [the] children."[91]

Insurance companies have embraced the moral repugnance of non-procreative sexual activity by the medical profession and religion to deny coverage for services related to sexual functions.[92] The insurance industry has adopted the term "moral hazard" to reflect its reluctance to cover sexual health.[93] According to the moral hazard rationale, insurers refuse to cover sexual matters because of the belief that the voluntary nature of sexual activity makes insurers vulnerable to excessive claims and, therefore, coverage for sexual and reproductive health is "unusual" and "inappropriate."[94] Insurers use the moral hazard argument to maintain that many of the risks associated with sexual health are outside of the "usual hazards" covered by insurance.[95] Using the moral hazard rationale, "[i]nsurers have been reluctant to acknowledge that insureds are sexually active and require medical care to preserve their sexual health."[96]

Opponents to contraceptive coverage maintain that it would violate the religious freedom of those who believe that contraception is immoral."[97] Such opposition has considerably hindered meaningful improvement of contraceptive coverage for women across the country.[98] The most prominent way in which religious groups have impeded women from receiving insurance coverage for prescription contraception is the inclusion of religious exemption clauses in state pill bills.[99] Ten out of twenty states

90. *Id.* at 123.

91. *Testimony on S. 995–Pregnancy Disability Benefits Before the Senate Subcommittee on Labor*, 95th Cong. § 1 (1977) [hereinafter *Discrimination*] (statements of Sen. Dick Clark).

92. *See generally Beh, supra* note 39.

93. *Id.* at 125.

94. *Id.*

95. *Id.* at 126.

96. *Id.* at 125.

97. Sylvia Law, *Sex Discrimination and Insurance for Contraception*, 73 WASH. L. REV. 363, 395 (1998).

98. *Hayden, supra* note 74, at 190.

99. *See infra,* discussion Part III-A.

include religious exemptions in their pill bills.[100] As mentioned above, these exemptions allow religious employers and, in some situations, insurance companies owned or operated by religious organizations, to request exemption if the coverage conflicts with the employer's religious beliefs.[101] In fact, "[i]nsurance companies rarely oppose state contraceptive coverage laws because the scope of those laws is minimal."[102]

It is curious that religious groups do not support EPICC and that the insurance companies have seemed to embrace this religious opposition as fuel for its fight against EPICC. The religious opposition seems to ignore the fact that Viagra, a drug that may clearly be used only for the enhancement of sexual enjoyment, is covered by over half of insurance plans.[103] More importantly, religious groups overlook the fact that many insurance plans cover abortion,[104] a right that religious groups have so vehemently opposed. In addition, most insurance plans cover sterilization, a form of permanent birth control that allows couples to freely engage in non-procreative sexual activity.[105] It seems clear, therefore, that the positions and motivations of the religious political front and the insurance industry are inapposite to rather than compatible with each other.

Admittedly, Title VII does include a religious exemption.[106] However, "courts have interpreted these exemptions narrowly to prohibit invidious discrimination on the basis of gender."[107] More on point to the present discussion, however, is the Ninth Circuit's recent holding that the religious exemption of Title VII applies only to hiring and firing, not to benefit determinations.[108] In any case, however, most hospitals and employers in the United States do not share such religious beliefs and, due to the reasons articulated above, religious employers who do consider contraceptive use

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100. *See supra* note 80 and accompanying text.

101. *Id.*

102. Megan Colleen Roth, *Rocking the Cradle With Erickson v. Bartell Drug Co.: Contraceptive Insurance Coverage Takes a Step Forward*, 70 U. MO. KAN. CITY L. REV. 781, 792 (2002).

103. *Id.* at 788. "Within two months after the drug's introduction to the market in 1998, more than half of the Viagra prescriptions filled received some level of insurance coverage." *Id.*

104. *Beh, supra* note 39, at 170. Two-thirds of insurance plans cover induced abortions, twenty percent of plans partially cover abortions and only ten percent of plans do not cover abortion at all. *Id.*

105. *Id.* at 167.

106. Law, *supra* note 97, at 384.

107. *Id.*

108. *Id.* at 385 (discussing EEOC v. Freemont Christian Sch., 781 F.2d 1362 (9th Cir. 1986)).

morally repugnant cannot legally defend discriminatorily denying women contraceptive coverage because of these beliefs.[109] As one commentator has observed, "the religious beliefs of employers are unrelated to the insurance coverage which is purchased by their workers and cannot be imposed upon employees."[110]

Lastly, EPICC would serve to actually bridge the gap between the pro-life and pro-choice political camps. Proponents of the legislation contend that EPICC offers an innovative solution to finding a middle ground in the abortion debate.[111] Individuals on both sides of the abortion issue agree that that the number of abortions must be reduced, and EPICC provides a mechanism whereby this goal, as well as ensuring fairness for American women, can be achieved.[112]

C. The Ineffectiveness of Title VII

Court cases such as *Erickson* have limited applicability because their rulings are binding only upon the employer involved in the case at bar.[113] The same is true of EEOC rulings.[114] While court cases and EEOC decisions alert employers to a possible legal obligation to provide coverage for prescription contraception, these court rulings and EEOC guidelines are neither binding nor obligatory.[115] Further, rulings made in favor of contraceptive coverage under Title VII cover only a limited class of women in that only women who receive insurance coverage directly from their employers would be covered.[116] As a result, the vast majority of American women who receive coverage from providers not bound by Title VII would not be affected by favorable Title VII court rulings.[117]

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109. *Id.* at 395.

110. *Insurance Coverage of Contraceptives: Hearing Before the S. Comm. on Labor*, 105th Cong. (1998), *available at* 1998 WL 409185 (F.D.C.H.) (statement of Sharon Grosfeld, Delegate, Maryland State Legislature).

111. Press Release, Federal Document Clearing House, Inc., Snowe: Contraceptive Coverage "Fundamental" in Resolving Health Care Inequities (July 21, 1998), *available at* 1998 WL 7325655.

112. *Id. See also Hearing, supra* note 3 (statement of Sen. Harry Reid).

113. *Contraceptive Coverage: Hearing Before the S. Comm. on Health, Labor and Pensions*, 107th Cong. § 1 (2001) (statement of Jennifer Erickson), *available at* http://web.lexis-nexis.com/congcomp (last visited Nov. 9, 2002).

114. *Id.* (statement of Marcia D. Greenberger, Co-President National Women's Law Center).

115. *Id.*

116. *Id.*

117. *See id.*

Most workers receive coverage through private insurance plans sponsored by their employers but not offered directly from their employers. "[One hundred sixty-five] million [Americans] finance health care costs by participating in employer-sponsored group health plans,"[118] making group-based coverage the dominating healthcare financing option.[119] "Employer-sponsored . . . [plans] take a variety of forms, the most prevalent being the managed care health plan."[120] Managed care organizations coordinate approximately fifty percent of employer-sponsored plans, embracing eighty-five percent of workers and seventy-three percent of commercially insured persons.[121] Title VII, which applies only to employers of fifteen or more employees, does not touch these providers.[122] Seventy-five percent of women of childbearing age in the United States depend upon private insurance to cover their medical costs.[123] Thus, the vast majority of the female work force would not benefit from a Title VII obligation to cover contraception. In addition, women are over-represented in the classes of workers unprotected by Title VII.[124]

This conclusion is despairing when one considers the lack of contraceptive coverage private plans provide. A measly fifteen percent of large group plans extend coverage to each of the most popular forms of contraception.[125] "Half of indemnity plans and Preferred Provider Organizations (PPOs), twenty percent of Point of Service (POS) networks, and seven percent of Health Maintenance Organizations (HMOs) cover no

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118. Kathleen A. Bergin, *Contraceptive Coverage Under Student Health Insurance Plans: Title IX as a Remedy for sex Discrimination*, 54 U. MIAMI. L. REV. 157, 163 (2000).

119. *Id.* at 163-64.

120. *Id.* at 164. Managed care enterprises include Preferred Provider Organizations (PPO) and Health Management Organizations (HMO).

121. *Id.*

122. Title VII states: "The term 'employer' means a person engaged in an industry affecting commerce who has fifteen or more employees . . . ." 42 U.S.C. § 2000e(b) (2000).

123. Center for Reproductive Law and Policy, *Contraceptive Coverage for All: EPICC Act is Prescription for Women's Equality, at* http://www.crlp.org/pub_fac_epicc.html (last visited Nov. 9, 2002) [hereinafter *EPICC Facts*].

124. *See Contraceptive Coverage: Hearing Before the S. Comm. on Health, Labor and Pensions, supra* note 113 (statement of Marcia D. Greenberger). These classes include self-employed, temporary, part-time, contract workers, those employed by employers that do not offer health insurance, retirees too young for Medicare coverage, and disabled workers not eligible for public assistance. *Id.*

125. *EPICC Facts, supra* note 123.

reversible contraception."[126] Forty-nine percent of large group plans do not routinely cover any contraceptive method.[127]

Even plans that do provide some coverage do not afford women a choice among the available forms of contraception.[128] "Only fifteen percent of large group health insurance plans cover all five of the most common methods of reversible contraception: oral contraceptives, diaphragms, Depo Provera, IUD's, and Norplant."[129] In contrast, eighty-six percent cover tubal ligation, between ninety-seven and ninety-eight cover maternity care, and sixty-six percent cover medically necessary abortions.[130] Most pertinent is the fact that while "ninety-seven percent of large group plans cover prescription drugs, a mere thirty-three percent cover oral contraceptives—the most popular method of reversible birth control among American women."[131] Clearly, the lack of adequate coverage under both traditional indemnity and managed care plans renders health care reform necessary.[132]

In contrast to the number of insurance providers that do not cover contraceptives, the number of women that employ prescription contraceptives is staggering. Ninety-three percent of the 55.1 million American women of childbearing age use some form of contraception.[133] According to the National Center for Health Statistics and Center for Disease Control, over half of married women in all age groups surveyed utilize contraception.[134]

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126. Planned Parenthood, *The Equity in Prescription Insurance and Contraceptive Coverage Act, at* http://www.plannedparenthood.org/library/BIRTHCONTROL/equity.html (last visited Nov. 9, 2002) [hereinafter *Planned Parenthood*]. The most commonly used methods are oral contraceptives (the pill), Norplant, intrauterine devices, Depo-Provera, and the diaphragm. *Id.*

127. *EPICC Facts, supra* note 123.

128. *See Planned Parenthood, supra* note 126.

129. *EPICC Facts, supra* note 123.

130. *Id.*

131. *Id.*

132. *Beh, supra* note 39, at 159. Thirty-nine percent of HMO's cover all five forms of contraception. *AGI, supra* note 49.

133. Henry J. Kaiser Family Foundation, *Women's Health Policy Facts: Coverage of Gynecological Care and Contraceptives, available at* http://www.kff.org/content/2000/1557b/covgnserfs.pdf (last visited Nov. 9, 2002).

134. U.S. Bureau of Census, *World Population Profile: 1998: Percent of Currently Married Women Using Contraception by age: All Available Years, available at* http://web.lexis-nexis.com/statuniv (last visited Nov. 9, 2002). Of married women aged 15-19 years, 55.6 percent used contraception. This figure changes to 60.5 percent for women 20-24 years; 64.4 percent for women aged 25-29 years; 70.2 percent for women aged 30-34

While less costly methods of contraception are available to women, the most effective methods must be obtained through a prescription.[135] The most popular form of reversible contraception is the birth control pill, which is employed by twenty-seven percent of American women who use contraception.[136] Oral contraceptives are ninety-seven percent effective when used properly.[137] Barrier methods such as intrauterine devices and diaphragm are used by approximately twenty percent.[138] One million women used Norplant in 1995.[139] A final alternative for women is the Depo-Provera shot, which is the most recent forms of contraception approved by the FDA.[140] Without effective contraception, the average American women would experience between fifteen and twenty-four pregnancies during her childbearing years.[141]

The clear health benefits afforded by prescription contraception easily refute the position of insurance providers that contraceptives are merely "elective" or "lifestyle" drugs and are therefore not "medically necessary."[142] "Health care systems prefer to classify contraceptives as

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years; 77.9 percent for women aged 35-39 years; and 75.5 percent for women aged 40-44 years. *Id.*

135. *Hayden, supra* note 74, at 178-80. Forms of birth control available without a prescription include condoms, foams, spermicidal jellies, and the "rhythm method." *Id.* However, these methods are less effective than prescription contraceptives. *Id.* For example, the rhythm method is sixty-eight percent effective and condoms eighty-four percent effective. *Id.*

136. *Law, supra* note 97, at 369. Two-thirds of private insurance plans do not cover oral contraceptives. *Id.* at 370.

137. *Hayden, supra* note 74, at 178.

138. *Law, supra* note 97, at 370. The diagram is a rubber membrane placed over the opening to the uterus in the vagina. *Id.* It is inserted prior to intercourse and must be fitted by a physician. *Id.* The IUD is implanted in the woman's uterus by a doctor and remains in place until removed or expelled. *Id.* While the IUD is more effective than the diaphragm, it is largely unavailable in the United States. *Id.* Except for HMO's, three-quarters of private plans exclude coverage for the female diaphragm. *Id. See also Hayden, supra* note 74, at 179-80.

139. *Law, supra* note 97, at 371. Norplant consists of six small capsules that are implanted in the skin and contain the hormone progestin. *Id.* It was approved by the FDA in 1991. *Id.* Norplant has an effectiveness rate of ninety-nine percent, equal to sterilization. *Id.* It remains effective for many years and is proven to be safe, but it is expensive in that the entire cost must be paid up front. *Id.* Seventy-five percent of private plans exclude coverage for Norplant. *Id. See also Hayden, supra* note 74, at 179.

140. *Hayden, supra* note 74, at 179. "Depo-Provera is ninety-nine percent effective in preventing pregnancy . . . equivalent to surgical sterilization." The shots are administered by a physician every three months. *Id.*

141. *Id.* at 177.

142. *Id.* at 183.

'preventative' or 'elective' options in order to justify exclusion of coverage."[143] However, when considered in light of their medical benefits, contraceptives are comparable to other medical prescriptions.[144] For instance, common blood pressure medications routinely covered by health plans serve a purely preventative purpose in that they do not cure the condition but help control blood pressure in order to *prevent* future problems.[145] Allergy medications and immunization shots are other common examples of preventative medicines that are covered by health plans.[146]

Contraception is a basic health care need for women. "[Sixty] million women in the U.S. are currently in their childbearing years, age 15 to 44 on average."[147] Forty-two million of these women engage in sexual activity yet do not desire pregnancy.[148] However, due to a lack of effective contraception, fifty percent, or three million, of women who become pregnant do in fact experience an unwanted or unplanned pregnancy.[149] "Unplanned pregnancies lead to 1.4 million abortions and another 1.2 million births every year . . . ."[150] In contrast, only eight in one-hundred women using the birth control pill become unintentionally pregnant.[151]

In addition to preventing unplanned pregnancy, "[r]eady access to contraceptive services increases the likelihood that the estimated twelve million Americans contracting sexually transmitted infections each year will be diagnosed and treated."[152] The likelihood of general health problems also increases when another pregnancy occurs soon after a birth or involve teenagers or women past their childbearing prime.[153] "For some

143. *Id.* at 183-84.
144. *Id.* at 184.
145. *Id.*
146. *Id.* Ninety-seven percent of private health insurance providers cover prescription drugs. *EPICC Facts*, *supra* note 123.
147. Planned Parenthood, *Cover My Pills–Fair Access to Contraception: Get the Facts*, *at* http://www.covermypills.com/facts/factsheet.asp (last visited Nov. 9, 2002) [hereinafter *Get the Facts*].
148. *Id.*
149. *Id.*
150. *Id.*
151. *AGI*, *supra* note 49.
152. *Planned Parenthood*, *supra* note 126.
153. *AGI*, *supra* note 49.

women with serious medical conditions, controlling their fertility is a matter of life or death."[154]

The failure of insurance companies to cover all methods of prescription contraception further impacts women's health in that women are often unable to utilize the form of contraception most appropriate for their individual needs.[155] Three out of every four women say that cost is an important consideration in determining whether to employ a contraceptive method that is covered by insurance and one that is not.[156] "Even when a plan covers contraception, the types of contraceptives covered are often limited."[157]

> From the perspective of women's health physicians, a one-size-fits-all mentality . . . is unacceptable. [Contraceptive decisions must be made according to the woman's] personal and family history, age, lifestyle, health status, cultural beliefs, and economic circumstances, all of which can change for an individual over time.[158]

Thus, the fact that women are denied a true opportunity to choose a contraceptive method provides an additional obstacle to contraceptive use.[159]

Contraception is also pertinent to improving children's health.[160] "The National Commission to Prevent Infant Mortality estimated that ten percent of infant deaths could be prevented if all pregnancies were planned . . . ."[161] For example, 4,000 infant deaths could have been prevented in 1989.[162] This holds true in part because women who endure unplanned pregnancies "are less likely than other women to receive adequate prenatal care."[163]

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154. *Insurance Coverage of Contraceptives: Hearing on S. 776 Before the Subcomm. on Labor and Human Resources*, 105th Cong. (1998) *available at* 1998 WL 407267 (F.D.C.H.) [hereinafter *Schwarz*] (statement of Richard H. Schwarz, M.D.).

155. *Contraceptive Coverage Hearing, supra* note 113 (statement of Marcia D. Greenberger).

156. *EPICC Facts*, *supra* note 123.

157. *Schwarz*, *supra* note 154.

158. *Id.*

159. *Id.*

160. *Get the Facts*, *supra* note 147.

161. *Planned Parenthood*, *supra* note 126.

162. *Id.*

163. *Get the Facts*, *supra* note 147. This was the outcome of a study of 45,000 women. *Planned Parenthood*, *supra* note 126.

Unintended pregnancies are also linked with higher abortion rates and increased occurrences of low birth weight and maternal morbidity.[164]

D. The PDA Compels That EPICC be Enacted

1. The PDA

While EPICC provides an aggressive remedy that would reach entities untouched by Title VII, the legislative intent behind the PDA also offers support for the enactment of EPICC. The PDA prohibits discrimination "on the basis of pregnancy, childbirth, or related medical conditions."[165] As the *Bartell* court and the EEOC[166] argued above, women's reproductive health as maintained by prescription contraception may certainly fall within the scope of the PDA. However, the legislative intent of the PDA can be extended further to explain the necessity of EPICC, namely that EPICC can do what the PDA cannot: universally eliminate the discriminatory practice of denying contraceptive coverage, the impact of which falls solely on the shoulders of women.

In passing the PDA, Congress expressly overruled the Supreme Court's decision in *Gilbert v. Gen'l Electric Co.* that "an otherwise comprehensive short-term disability policy that excluded pregnancy-related disabilities from coverage did not discriminate on the basis of sex."[167] The Court reasoned that "pregnancy discrimination does not adversely impact all women and therefore is not the same thing as gender discrimination and disability insurance which covers the same illnesses and conditions for both men and women is equal coverage."[168] "To the *Gilbert* majority, the fact that pregnancy-related disabilities were an uncovered risk unique to women did not destroy the facial parity of the coverage."[169]

Congress expressly disagreed with this conclusion by enacting the PDA as an amendment to Title VII. Congress provided that "women effected by pregnancy, childbirth, or related medical conditions shall be treated the same for all employment-related purposes, including receipt of

164. *Hayden, supra* note 74 at 177.

165. *See* 42 U.S.C. § 2000e(k) (2001).

166. *See supra* discussion Parts I and II.B.

167. Erickson v. Bartell Drug Co., 141 F. Supp. 2d 1266, 1270 (W.D. Wash. 2001) (citing General Elec. v. Gilbert, 429 U.S. 125 (1976)).

168. *Id.* at 1270

169. *Id.*

benefits."[170] The legislative history reflects Congressional intent for the language of the PDA to be interpreted broadly, a stark contrast to the position of the *Gilbert* majority. "We all know that this legislation [the PDA] was made necessary by . . . *Gilbert*. . . . This decision came as a critical blow to working women across the country. It constitutes a major setback in the battle for women's rights."[171]

Congress endorsed the *Gilbert* dissent as the accurate interpretation of Title VII.[172] The dissent emphasized that, when evaluating a claim of discrimination by an insurance plan, the appropriate classification is "between persons who face a risk of pregnancy and those who do not."[173]

In referring specifically to medical benefits, the legislative history states that "[d]iscrimination against female employees in medical plans by excluding pregnancy coverage has . . . the same impact as discrimination in disability plans; a woman who is obliged to apply her own income to doctor and hospital bills although male employees are not is obviously earning less for the same work."[174] The history goes on to express that "[p]regnancy is gender related, and the failure of companies which routinely pay benefits for a wide range of both voluntary and involuntary disabilities to pay them [women] for pregnancy is clearly discriminatory."[175]

The Court has endorsed a broad reading of the PDA in subsequent rulings. In *Newport News Shipbuilding & Dry Dock Co. v. EEOC*,[176] the Court held that the PDA served broad remedial purposes.[177] "In short, the

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170. 42 U.S.C. § 2000e(k).

171. *Discrimination*, *supra* note 91 (statement of Sen. Harrison A. Williams, Jr., Chairman, S. Subcomm. on Labor).

172. S. REP. NO. 95-331, at 2-3 (1977). The Report states:

> In the committee's view, the following passages from the two dissenting opinions in the case correctly express both the principle and the meaning of title VII. As Mr. Justice Brennan stated: "Surely it offends commonsense to suggest . . . that a classification revolving around pregnancy is not, at the minimum, strongly 'sex related.'" Likewise, Mr. Justice Stevens stated that "[b]y definition, such a rule discriminates on account of sex; for it is the capacity to become pregnant which primarily differentiates the female from the male.

Id. (alteration in original).

173. *Law*, *supra* note 97 at 379.

174. S. REP. NO. 95-331 at 5.

175. *Discrimination*, *supra* note 91 (statement of Sen. Wendell R. Anderson) (emphasis in original).

176. 462 U.S. 669 (1983).

177. *Law*, *supra* note 97, at 378.

PDA broadly requires employers to treat equally pregnancy and pregnancy-related conditions for which benefits are provided to an employee or his or her otherwise qualified dependents."[178] The Court has also ruled that the PDA's protections extend to women who are not pregnant.[179] The Court summarized the intended effect of the PDA in stating that "[t]he legislative history confirms what the language of the PDA compels . . . that this statutory standard was chosen to protect female workers from being treated differently from other employees simply because of their *capacity* to bear children."[180]

2. The PDA as a Predecessor of EPICC

The legislative history of PDA reveals many of the same concerns and features as the history of EPICC, almost foreshadowing the current legislation. The PDA codified a series of rulings and guidelines promulgated by the EEOC that reflected the Commission's belief that "the wide range of employment policies directed at pregnant women—or at all women because they might become pregnant—constitutes one of the most significant hindrances to women's equal participation in the labor market."[181] EPICC attempts to do the same by transforming the EEOC's progressive stance on contraceptive equity into law.[182]

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178. *Id.*

179. *Id.*

180. *Automobile Works v. Johnson Controls, Inc.*, 449 U.S. 187, 205 (1991) (emphasis added).

181. *Discrimination, supra* note 91, at 32 (statement of Ethel Bent Walsh, Vice Chairman, U.S. Equal Employment Opportunity Commission). In 1969, the EEOC ruled that a company's decision to fire an employee due to her pregnancy and refusal to rehire her were actions prohibited by Title VII. *Id.* Following that decision, the Commission decided that a policy under which maternity leave was granted depending upon individual circumstances was unlawful. *Id.* In 1970, the Commission found that a difference in the availability of insurance coverage to male and female employees constituted sex discrimination. *Id.* This series of decisions led to the issuance of guidelines in 1972 that "explicitly state that exclusion from initial hiring, complete or partial denial of fringe benefits, and discharge because of pregnancy violated title VII." *Id.*

182. *See Decision, supra* note 56. The EEOC rendered a decision on December 14, 2000 in which it interpreted both the PDA and its own guidelines to mean that an employer's "coverage must extend to the full range of prescription contraceptive choices." *Id.* Moreover, Respondents must include such coverage in each of the health plan choices that it offers to its employees." *Id.* The Commission ruled in this manner concerning both Title VII and its own regulations, which state "any health insurance provided must cover expenses for pregnancy-related conditions on the same basis as expense for other medical conditions." Guidelines on Discrimination Because of Sex, 29 C.F.R. § 1604 Appendix (2000).

EPICC also attempts to eliminate the paternalistic nature of insurance plans that exclude coverage for contraceptives much in the same manner that the PDA recognized the paternalistic motivations of policies that excluded pregnancy benefits. "[T]he significance of this legislation is that it deals with one of the most important causes of employment discrimination against women; namely, the age-old belief that a woman's primary role is to give birth and to care for children."[183] Over twenty years later, women are still battling this stereotype. Four thousand one hundred and sixty complaints under the PDA were filed with the EEOC in 2000.[184]

The proponents of the PDA recognized that the classification of pregnancy as an elective condition is inappropriate both in that employers provide benefits for conditions that are also brought upon by voluntary action and that pregnancy is sometimes involuntary.[185] EPICC's supporters have likewise emphasized that "EPICC is about equality for women . . . . You can be sure, if men had to pay for contraceptive drugs and devices, the insurance industry would cover them."[186] In making judgments about the role of women in relation to pregnancy, insurers deny coverage upon the often mistaken belief that pregnancy is generally desired by women and that women can control whether or not they become pregnant; thus, insurers conclude that pregnancy is undeserving of coverage.[187]

The PDA and EPICC both address employment opportunities and the economic plight of women. The PDA recognized that the failure to classify pregnancy discrimination as sex discrimination "constitutes one of the most significant hindrances to women's equal participation in the labor market."[188] The Court has echoed this sentiment, stating that "[t]he ability of women to participate equally in the economic and social life of the

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183. *Discrimination, supra* note 91, at 393 (statement of Sen. Dick Clark).

184. U.S. Equal Employment Opportunity Commission, *Pregnancy Discrimination Charges EEOC & FEPAs Combined: FY 1992–FY 2000, available at* http://www.eeoc.gov/stats/pregnanc.html (last visited Nov. 9, 2002). Figure reflects the number of charges filed with the EEOC and state and local Fair Employment Practices Agencies that have a work sharing relationship with the EEOC.

185. *Discrimination, supra* note 91, at 26 (statement of Sen. Edward M. Kennedy).

186. *Reid, supra* note 36.

187. *Beh, supra* note 39, at 129.

188. *Discrimination, supra* note 91, at 32 (statement of Ethel Bent Walsh).

> Too often, women were totally excluded from employment because they might become or were pregnant. Even if hired a double standard prevailed—most particularly in the area of fringe benefits. Often, women were fired as soon as they became pregnant and were not rehired or, if rehired, not given credit for their past years of work.

Id.

Nation has been facilitated by their ability to control their reproductive lives."[189]

Accordingly, proponents of EPICC point to the economic hardships inflicted upon women by inadequate coverage for contraception.[190] The most effective forms of birth control are often the most expensive, posing a major barrier to contraceptive access for women.[191] Yet, many women *do* utilize some form of birth control, and therefore spend sixty-eight percent more in out-of-pocket health care costs than men, with the majority of these expenses attributed to reproductive health-related needs.[192] These costs amount to $7000–$10,000 over a woman's reproductive lifetime.[193] This is especially significant in light of the gender gap that already burdens women in terms of yearly income.[194]

When women fail to use effective contraception, they disproportionately "bear the risk of unwanted pregnancy . . . the attendant physical burdens and medical risks . . . the health care costs of pregnancy and childbirth . . . [and] barriers to employment and educational opportunities."[195] The financial responsibility of raising children is also onerous, for the cost of raising one child can range between $161,620 to $314,550, depending on one's economic class.[196] Unintended pregnancy resulting from the lack of effective birth control jeopardizes a woman's ability to complete her education and participate in the workforce, thereby threatening her ability to support herself and her family.[197] Unintended pregnancy sentences women to years of professional and personal disadvantage.[198]

While the argument for contraceptive coverage under Title VII is strong, the argument has major flaws. A requirement to cover

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189. Planned Parenthood v. Casey, 505 U.S. 833, 856 (1992).

190. *See Hearing supra* note 3. *See also supra* note 110 (statement of Sharon Grosfeld) and *surpa* note 113 (statement of Marcia D. Greenberger).

191. *AGI, supra* note 49.

192. *Planned Parenthood, supra* note 126.

193. *Kindell, supra* note 45, at 415.

194. *Id.* A twenty-nine year old woman with a college education earns an average annual salary of $34,000 while a man with the same education earns $44,350. *Id.* This amounts to a lifetime difference of $990,000. *Id.*

195. *See Contraceptive Coverage: Hearing Before the S. Comm. on Health, Labor and Pensions, supra* note 113 (statement of Marcia D. Greenberger).

196. *Kindell, supra* note 45, at 415.

197. *See Contraceptive Coverage: Hearing Before the S. Comm. on Health, Labor and Pensions, supra* note 113 (statement of Marcia D. Greenberger).

198. *See Kindell, supra* note 45, at 415.

contraception pursuant to the PDA would affect very few women because Title VII extends only to employers.[199] In addition, court decisions are an unpredictable and piecemeal approach to achieving contraceptive equity. While the *Erickson* court was receptive of such a claim, one cannot predict how other courts, including the Supreme Court, would handle such a case. Further, the experience with maternity coverage after the passage of the PDA reveals the need to guarantee coverage for women who do not receive health insurance from their employers. While employers included maternity coverage after the PDA was enacted, insurers continued in some situations to exclude such benefits in plans provided to non-employer customers simply because they were not legally bound to include them.[200] "There is every reason to believe that insurers will respond in a similar way to contraceptive coverage, thereby underscoring the need for EPICC."[201]

The PDA may simply be too weak in the area of contraceptive equity to accomplish its own goals. Worldwide, contraception is employed mainly by women.[202] Therefore, it cannot reasonably be disputed that it is a gender issue. As one commentator has noted, "the PDA's application to insurance coverage for contraception has been widely ignored; an additional federal law clarifying that excluding contraception from insurance coverage may be salutatory. It is not uncommon for Congress to adopt 'redundant' legislation."[203]

E. Public Policy Supports the Enactment of EPICC

1. Public Support for Contraceptive Equity

Americans support mandated coverage for prescription contraception. "Seven out of ten privately insured adults believe that health insurers should be required to cover the full range of contraceptives."[204] Eight out of ten Americans maintained their support for full contraceptive coverage in their health insurance plans even if it would increase their monthly costs.[205] "[Ninety] percent of all voters support access to family planning;

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199. *See infra* notes 123-24 and accompanying text.

200. *See Contraceptive Coverage: Hearing Before the S. Comm. on Health, Labor and Pensions, supra* note 113 (statement of Marcia D. Greenberger).

201. *Id.*

202. Dr. Sheldon Segal, *Contraceptive Update*, 23 N.Y.U. REV. L. & SOC. CHANGE 457 (1997).

203. *Law, supra* note 97, at 401.

204. *CRLP, supra* note 50. (Survey respondents include both men and women.).

205. *Id.*

seventy-five percent support contraceptive coverage."[206] Prominent medical organizations also support contraceptive equity as a part of "basic health care."[207] Lastly, the growing number of states that have either enacted or introduced contraceptive equity legislation reflects a national trend in favor of legislation such as EPICC.[208] EPICC would therefore satisfy the national sentiment in favor of contraceptive coverage in a timely and aggressive manner unobtainable through individual state mandates.

EPICC is a positive law for the nation because it is a positive step for women. Women's reproductive health is a public health issue that has ramifications for society as a whole. Unintended pregnancy due to the unavailability of contraception hinders women's employment and educational opportunities.[209] It follows that women are afforded a fair chance at equal participation in the labor market when they are given access to effective contraception. In addition, the number of both unintended pregnancies and abortions would be significantly reduced.[210] In this way, EPICC is a bill that can and does boast support from both sides of the abortion debate.[211] "Our bill gives Americans on both sides of the abortion debate the opportunity to join together in the common goal of preventing unintended pregnancies."[212] In fact, "[o]ne recent poll . . . found that 77% of Americans support laws requiring health insurance plans to cover prescription contraception."[213]

EPICC is also a positive piece of legislation in that it generally raises awareness of women's health and the lack of research conducted on topics concerning women's health. "I have said time and time again that if men

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206. *Equity in Prescription Insurance and Contraceptive Coverage Act of 1997: Hearing on S. 766 Before the Senate Committee on Labor,* 104th Cong. § 1 (1998) (statement of Gloria Feldt, President, Planned Parenthood Federation of America), *available at* 1998 WL 407259 (F.D.C.H.).

207. *CRLP, supra* note 50. These medical organizations include the American Medical Association, the American College of Obstetricians and Gynecologists, the American Medical Women's Association, the American Society for Reproductive Medicine, and the Society for Adolescent Medicine. *Id.*

208. *See infra* notes 67-68 and accompanying text.

209. *See supra* note 113 (statement of Marcia D. Greenberger).

210. *Planned Parenthood, supra* note 126. In any single year, eighty-five percent of sexually active women not using contraception became pregnant. *Id.* In contrast, only three to six percent of women using oral contraceptives became pregnant. *Id.* Half of all unintended pregnancies (3 million per year) end in abortion. *Id.*

211. *See infra* note 5 and accompanying text.

212. *Reid, supra* note 36.

213. *See Contraceptive Coverage: Hearing Before the S. Comm. on Health, Labor and Pensions, supra* note 113.

suffered from the same illnesses as women, the medical research community would be much closer to eliminating diseases that strike women."[214] Legislation such as EPICC, as well as administrative and court rulings in favor of contraceptive equity, urge that women's health needs be equivalent to those of men as a matter of women's rights.[215]

2. Cost Analysis: Contraceptive Equity is Financially Wise

Insurers often explain their failure to cover prescription contraception by insisting that such coverage would be too costly.[216] The expense of covering contraception, however, is far outweighed by the relative costs avoided.[217] Insurance companies unwisely and routinely cover more expensive procedures yet fail to cover contraceptives that are less costly and would decrease the need for these expensive procedures.[218]

The costs associated with insurance coverage for the full range of prescription contraception are minimal. Insurers would incur additional costs of only $21.40 per employee per year.[219] This translates into an additional cost of $1.43 per month for employers currently offering no contraceptive coverage[220] and $16 per enrollee per year for the insurer.[221] These figures are in stark contrast to the $14,000–$30,000 cost for the hospitalization of low birth weight babies and the $5000 expended for each normal childbirth.[222] In addition, since forty-four percent of unintended pregnancies end in abortion, insurers would also be avoiding the significant costs associated with abortion services.[223]

In addition to the fact that coverage is relatively inexpensive, contraceptive coverage would easily "pay for itself" by preventing insurers from financing the more costly care associated with unintended pregnancies.[224] A meager "fifteen percent increase in the number of women using oral contraceptives would produce enough savings in pregnancy costs to provide full contraceptive coverage to all health plan

214. *Reid*, *supra* note 36.
215. *See Lewin*, *supra* note 59 (reporting remarks of Marcia Greenberger, co-president of the National Women's Law Center on the December 2000 EEOC decision).
216. *See Hayden*, *supra* note 74, at 186.
217. *See Hayden*, *supra* note 74, at 186.
218. *EPICC Facts*, *supra* note 123.
219. *Kindell*, *supra* note 45, at 416.
220. *Id.*
221. *Hayden*, *supra* note 74, at 186.
222. *Id.* at 187.
223. *Id.*
224. *Id.* at 188.

members."[225] While less expensive methods of birth control are available to women, these methods are less effective and therefore carry with them the hidden costs associated with unintended pregnancy.[226] While most insurers fail to cover contraception, plans routinely cover tubal ligation, maternity care, and medically necessary or appropriate abortion services.[227] Relevantly, EPICC does not require special treatment for prescription contraceptives but simply mandates equitable treatment.[228]

The experience of the federal government lends further support to the cost effectiveness of contraceptive coverage. Every tax dollar spent for contraceptive coverage by the government saves an average of "three dollars in Medicaid costs for pregnancy-related health care and medical care for newborns."[229] Federal and state Medicare costs would increase by $1.2 billion each year without funding for contraceptive services.[230] Public funding for contraception has proven to be effective in improving maternal health and avoiding unintended pregnancies that would result in abortions, low birth weight babies, and infant death.[231] Lastly, the federal government has not incurred any additional costs in association with the Federal Employees Health Benefits Program, which was amended in 1998 to include coverage for contraceptive services for federal workers.[232]

CONCLUSION

The outcome of the *Erickson* case, the support of the EEOC and the increased commonality of state mandates for contraceptive coverage are

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225. *Id.* (Study conducted by the American Journal of Public Health in 1995.).

226. *Id.* at 187.

227. *EPICC Facts*, *supra* note 123. Eighty-six percent pay for tubal ligation. *Id.* Between ninety-seven and ninety-eight percent cover maternity care. *Id.* Sixty-six percent cover abortion services. *Id.*

228. *See id.*

229. *AGI*, *supra* note 49.

230. *Id.*

231. *Id.* A 1992 North Carolina study indicated that women who used publicly funded family planning services were more likely to seek early prenatal care and employ that care throughout their pregnancy. *Id.* "[P]ublicly funded contraceptive services prevented 20,000 instances of low birth weight, 6,500 infant deaths and 5,500 neo-natal deaths between 1982 and 1988." *Id.* In addition, funded services prevented 1.3 million unintended pregnancies, which would have resulted in 534,000 births, 632,000 abortions, and 165,000 miscarriages. *Id.*

232. *See Contraceptive Coverage: Hearing Before the S. Comm. on Health, Labor and Pensions*, *supra* note 113 (statement of Marcia D. Greenberger). The Office of Personnel Management reported no cost increase due to contraceptive coverage in 2000. *See also infra* note 51 and accompanying text.

encouraging victories in the battle for contraceptive equity. Such victories indicate that the nation supports coverage for prescription contraception and is growing impatient with Congressional inaction. As this Note has argued, however, approaches to contraceptive equity that focus on state action or court claims are inherently flawed. Loopholes, exemptions, and incomplete coverage weaken state mandates, while court rulings are unpredictable and affect a limited segment of the American workforce.

It is time for Congress to provide universal coverage for prescription contraceptives. Women find in EPICC a law that is both universal in its reach and free of loopholes in its application. EPICC assures that women would no longer be at the mercy of state legislatures, the courts, their employers, or the insurance industry in gaining access to effective contraception, a key element to maintaining women's health. Congress must enact EPICC in order to fulfill the legislative intent behind the PDA, for the sake of women's health, and for the cause of gender equality.

INSURERS JUMP ON TRAIN FOR FEDERAL INSURANCE REGULATION: IS IT REALLY WHAT THEY WANT OR NEED?

*Danielle F. Waterfield**

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INTRODUCTION

Within the last few years there has been a dramatic shift in the U.S. insurance industry regarding the issue of insurance regulation. Historically, the insurance industry jealously defended the prerogative of state regulation of insurance.[1] Insurance was viewed as a local business with an inherent need for a local regulator.[2] The industry argued as a whole that consumers

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1. John Davidson, *Dingell Act: Failed Promises or Failed Premises*, 1 INT'L. INS. L.R. 12, 13 (1993).

2. *Insurance Regulation and Competition for the 21st Century: Series 3: Hearing before the House Financial Services Subcomm. on Capital Markets, Insurance and Government Sponsored Enterprises,* 107th Cong. 34, at 3 (2002) [hereinafter *Series 3 Hearing*] (statement of Tom Ahart on behalf of the Independent Insurance Agents &

did not want a federal insurance regulator and would inevitably suffer if control over regulation of insurance shifted to Washington.[3] Even as little as five years ago, one would be hard pressed to find any public statements in support of federal regulation of insurance from within the U.S. insurance industry.[4]

Following enactment of financial services modernization legislation in 1999,[5] however, the insurance industry has changed its tune somewhat and now admits numerous inadequacies in the state-based insurance regulatory system. Following the lead of insurance representatives within the banking industry, several public proposals have surfaced authored by representatives of the insurance industry itself arguing the need for some form of federal regulation of insurance.[6] Even the most ardent opponents of federal involvement in insurance regulation–primarily insurance agents, small insurers and state legislatures–now publicly acknowledge that some limited form of federal involvement may be needed to guarantee reform of the current regulatory system.[7] This begs the questions, what has changed and what federal role does the insurance industry really want or need?

This Comment will review the factors that have contributed to the changing insurance market and proposed solutions to the admitted inefficiencies of the current insurance regulatory system. Part I will review the history of insurance regulation in the United States leading up to the

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Brokers of America (IIABA)) (citing *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533, 540 (1944), and *German Alliance Ins. Co. v. Lewis*, 233 U.S. 389, 415 (1914)).

3. *Series 3 Hearing, supra* note 2, at 1-2 (statement of Scott A. Gilliam, Director of Government Relations, The Cincinnati Insurance Companies).

4. Dean Anason, *In Focus: Strange Bedfellows: Bankers, Insurers Pushing for Federal Insurance Charter*, AM. BANKER, June 7, 1999, at 1.

5. Gramm-Leach-Bliley Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) [hereinafter GLBA].

6. The three major industry trade associations disclosing some form of optional federal chartering proposal include the American Insurance Association (AIA), the American Council of Life Insurers (ACLI), and the American Bankers Insurance Association (ABIA). The ACLI proposal was unveiled in April 2001 and is available on the ACLI website at http://www.acli.com (last updated Feb. 12, 2002). A new redrafted proposal from the ABIA was unveiled in May 2001 and is available on the ABIA website at http://www.aba.com/aba/ABIA/FcoI053101b.pdf. The AIA proposal was unveiled in July 2001, and is on file at the AIA in Washington D.C.

7. *See Series 3 Hearing, supra* note 2, at 1 (submitted statement of the National Association of Insurance and Financial Advisors). *See also* Press Release, NAIC, NAIC Adopts Producer Licensing Model Act (Jan. 27, 2000) (quoting George Nichols, III, NAIC President as saying the members of the NAIC "recognize a need for greater standardization and uniformity in insurance regulation . . . .").

root of the current regulatory system, enactment of the *McCarran-Ferguson Act*. Part II will explore the factors that have contributed to the policy shift within the insurance industry. Part III will analyze the optional federal insurance charter and national standards alternatives that are being proposed to increase efficiency and uniformity in insurance regulation. Finally, Part IV will propose a third solution that this author believes is a better alternative to achieve needed regulatory reforms.

I. REGULATORY HISTORY OF THE INSURANCE INDUSTRY

For nearly two decades, regulation of the "business of insurance" in the United States historically has been the province of the individual states.[8] Yet, the history of insurance regulation is marked by federal-state tensions and periodic proposals for federal intervention.[9] While the American system of federalism denotes that the federal government regulate interstate business, the business of insurance is not subject to a federal regulatory framework as are others in the financial services industry. The formation of this reverse approach to regulation in the United States is the result of an interesting blend of practical politics verses political theory.[10]

A. Early History

The states' ability to charter organizations facilitated early state regulation of the business of insurance.[11] States established the first insurance regulatory agencies in the 1850s designed to register insurers conducting business within their respective state borders.[12] While first intended primarily to tax insurance premiums and insurance stock, the reach of these agencies quickly expanded along with the complexity of

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8. *H.R. 10 Financial Services Competitiveness Act of 1997, Session 2: Hearing before the House Commerce Subcommittee on Finance and Hazardous Materials*, 105th Cong. 3, at 12 (1997) (statement of Ann M. Kappler on behalf of the Independent Insurance Agents of America (IIAA), the National Association of Life Underwriters (NALU) now known as NAIFA, and the National Association of Professional Insurance Agents (PIA)), *available at* http://www.com-notes.house.gov/cchear/Hearings.nsf.

9. Susan Randall, *Insurance Regulation in the United States: Regulatory Federalism and the National Association of Insurance Commissioners*, 26 FLA. ST. U. L. REV. 625, 626 (1999).

10. Kevin Hennosy, *Spread The Risk, at* http://www.spreadtherisk.org/government.htm (last visited Nov. 9, 2002) [hereinafter *Spread the Risk*].

11. David G. Stebing, *Insurance Regulation in Alaska: Healthy Exercise of a State Prerogative*, 10 ALASKA L. REV. 279, 285 (1993).

12. *Spread the Risk, supra* note 10.

regulation.[13] As insurance companies grew in size and their business extended across state lines, these large companies sought federal regulation to avoid cumbersome multiple state regulation.

In an effort to supplant state regulation, the New York Underwriters Agency, a group of New York-based fire insurance companies, set out to challenge state insurance authority on constitutional grounds.[14] The companies hired Samuel Paul to represent them as an agent in Virginia but refused to comply with Virginia's licensing laws.[15] He was denied a license to sell insurance and ultimately convicted of violating Virginia statute.[16] On appeal, Paul argued that Virginia's laws violated the Commerce Clause and the Privileges and Immunities Clause of the United States Constitution.[17]

The United States Supreme Court disagreed. In 1868, the Court ruled in *Paul v. Virginia*,[18] that state insurance regulation did not violate the Commerce Clause because insurance policies were "simple contracts of indemnity" which "are not articles of commerce in any proper meaning of the word."[19] The Court further held that corporations were not "citizens" within the meaning of the Privileges and Immunities Clause and that "issuing a policy of insurance was not a transaction of commerce."[20] It followed that the insurance industry was not subject to regulation by the federal government, but only by individual states. Surviving numerous legal challenges, the rule established in *Paul v. Virginia* governed insurance law for the next seventy years.[21]

Not dissuaded, however, since insurers were denied the opportunity for federal regulation by the Supreme Court's decision in *Paul v. Virginia*, they set out to achieve uniformity through a coalition of state insurance commissioners.[22] In 1871, New York Superintendent of Insurance George W. Miller hosted a meeting involving nineteen state insurance regulators sympathetic of the companies' concerns to discuss national issues related to

13. Stebing, *supra* note 11, at 285.
14. *Spread the Risk*, *supra* note 10.
15. Randall, *supra* note 9, at 630.
16. *Id.*
17. *Id.* at 631.
18. Paul v. Virginia, 75 U.S. 168 (1868).
19. *Id.* at 183.
20. *Id.*
21. *Spread the Risk*, *supra* note 10.
22. *Id.*

insurance regulation.[23] The respective individual state insurance commissioners wanted a system of insurance law that was "the same in all states—not reciprocal, but identical; not retaliatory, but uniform."[24] The result was the formation of the National Convention of Insurance Commissioners, which ultimately became known in 1936 as the National Association of Insurance Commissioners (NAIC).[25] For almost seventy-five years, the states relied on the NAIC's efforts and continued their regulatory practices without interference from the federal government.[26]

While during this time the *Paul* decision had become a canon of law within the insurance industry, it was inevitable that the increasing size and role of the federal government following the Roosevelt New Deal would once again bring new questions over the role of insurance regulation. By the 1940s, state insurance regulation was fairly comprehensive except for the issue of rate regulation.[27] Nonetheless, President Theodore Roosevelt was building his resources to strengthen the federal government's power over corporate America, which included efforts to reinvigorate the nation's antitrust laws.[28] In addition, while supportive of NAIC efforts to establish uniformity, proponents of federal insurance regulation continued to use the courts and political means to overturn *Paul v. Virginia* and establish national regulation.[29] These efforts culminated with the dismissal of the 1942 indictment of South-Eastern Underwriters Association (SEUA)[30] and its 198 member companies for violations of the Sherman Act by the

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23. Kevin Hennosy, *The 140-Years War: The NAIC Has a History of Trying to Restore Peace as Battles Wage*, 3-4 (Jan. 30, 2002) (unpublished article, on file with the author) [hereinafter Hennosy, 140-Years War].

24. FOUNDATION FOR AGENCY MANAGEMENT EXCELLENCE, COSTS AND BENEFITS OF FUTURE REGULATORY OPTIONS FOR THE U.S. INSURANCE INDUSTRY (1871) (quoting George W. Miller, the New York Insurance Commissioner at the close of the inaugural meeting of the National Association of Insurance Commissioners) (on file with the Counsel of Insurance Agents and Brokers in Washington D.C.) [hereinafter COSTS & BENEFITS].

25. Stebing, *supra* note 11, at 288.

26. *Id.* at 289.

27. Randall, *supra* note 9, at 632.

28. Telephone interview with Kevin Hennosy, Founder of *Spread the Risk* and Former NAIC Employee (Jan. 25, 2002) [hereinafter Hennosy Telephone Interview].

29. Hennosy, 140-Years War, *supra* note 23, at 5.

30. The SEUA was a group of nearly 200 private stock fire insurance companies doing business in the southeastern part of the country, and twenty-seven individuals. *See* United States v. South-Eastern Underwriters Ass'n, 322 U.S. 533, 534 (1994).

District Court because, pursuant to the *Paul* decision, "the indictment d[id] not charge Federal offenses . . . ."[31]

In an aggressive move to expand the scope of federal antitrust laws into the insurance industry, the government appealed the *South-Eastern* decision directly to the United States Supreme Court. The government believed that the Court would have a more expansive theory of antitrust law along lines similar to that of the Roosevelt Administration.[32] The government was right. In 1944, the Supreme Court reversed its earlier position by a four-to-three decision, and ruled in *United States v. South-Eastern Underwriters Ass'n*[33] that the business of insurance falls within the scope of the Commerce Clause and federal regulation because it constitutes interstate business.[34]

The *South-Eastern Underwriters* decision changed the political and legal landscape surrounding insurance regulation and raised serious doubts about the states' ability to regulate insurance. In an effort to maintain the states' primary insurance regulator function, the NAIC, state officials and the insurance industry joined forces to negotiate a legislative solution.[35] With the goal of protecting state jurisdiction and the ability to tax insurance premiums, the NAIC proposed a bill that was introduced by Senators Pat McCarran (D-Nev.) and Warren Ferguson (R-Mich.).[36] Faced with tremendous political pressure from the states, Congress swiftly passed the *McCarran-Ferguson Act*[37] in 1945, which ceded the field to the states with only a few exceptions.[38] The Act included a general exemption for "the business of insurance" in order to ensure the continuation of state regulation in the aftermath of the Supreme Court's determination that insurance was commerce and as such, subject to the restrictions of the Commerce Clause.[39]

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31. United States v. South-Eastern Underwriters Ass'n, 51 F. Supp. 712, 715 (N.D. Ga. 1943).

32. *See id.*

33. 322 U.S. at 533.

34. *Id.* at 550.

35. Stebing, *supra* note 11, at 289.

36. See *id.*

37. 15 U.S.C. §§ 1011-1014 (2000).

38. Mary Cannon Veed, *The Re-Engineering of the U.S. Commercial Insurance Market: Open Doors or Open Season?* 798 PLI/COMM 129, 133 (1999).

39. Jonathan R. Macey & Geoffrey P. Miller, *McCarran-Ferguson Act of 1945: Reconceiving the Federal Role in Insurance Regulation*, 68 N.Y.U. L. REV. 13, 25 (1993). The general exemptions in the *McCarran-Ferguson Act* for the "business of insurance" are those related to the states' taxation and regulatory powers. *Id.*

B. McCarran-Ferguson Act

The current regulatory structure for the insurance industry is rooted in the *McCarran-Ferguson Act* of 1945.[40] In what is often called "reverse preemption," the Act provides that "[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance."[41] However, the Act provides that the Sherman, Clayton, and Federal Trade Commission Acts "shall be applicable to the business of insurance to the extent that such business in not regulated by State Law."[42] The implication of this language was that: (1) states would continue to have primary authority for insurance regulation, but Congress could enact legislation in this field if it found it to be deficient; and (2) many insurance activities would not be subject to federal antitrust law, provided they were regulated by the states.[43] These exemptions in particular would become a prized benefit providing fuel for the insurance industry's adamant defense of state regulation over the next six decades.[44]

Despite the freedom that the *McCarran-Ferguson Act* gives the states, Congress articulated a number of limits on states' regulatory power over the business of insurance. For example, if Congress clearly indicates an intent to preserve federal law notwithstanding the *McCarran-Ferguson Act*, federal law will still apply regardless of state action.[45] Congress may also adopt legislation at any time regulating any portion of the business of insurance.[46] Congress has rarely done this, but instead has in the past often

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40. *Id.* at 46. The most pertinent part of the Act provides that "[t]he business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business." 15 U.S.C. § 1012(a) (2000).

41. 15 U.S.C. § 1012(b) (2000). The Act also declares that continued regulation by the states of the business of insurance is in the "public interest," and that "silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States." *Id.* § 1011.

42. *Id.* § 1012(b).

43. Scott E. Harrington, *The History of Federal Involvement in Insurance Regulation*, *in* OPTIONAL FEDERAL CHARTERING AND REGULATION OF INSURANCE COMPANIES 25 (Peter J. Wallison ed., 2000).

44. Hennosy Telephone Interview, *supra* note 28.

45. *See* 15 U.S.C. § 1014 (2000).

46. The phrase "business of insurance" is subject to varying interpretations, thus raising questions as to the scope of legislation that Congress may adopt regulating the insurance industry. *See* Macey & Miller, *supra* note 39, at 21. The courts have not yet

gone in the other direction by expressly stating that the new legislation is not intended to apply to the business of insurance.[47] Nevertheless, the last few years have given rise to a number of occasions where Congress showed its williness to partially extend its power into small areas of the insurance industry.[48]

II. CHANGING DEVELOPMENTS BEHIND PUSH FOR REFORM

One does not need to be a financial services scholar to realize that something has changed over the last few years causing the insurance industry's reversal of position on insurance regulation. The leading factor is obviously the historic modernization of financial services regulation in the United States in the late 1990s.[49] However, there are also other significant factors that have led to the industry's public acknowledgment that the current state-based insurance regulatory system is broke and needs to be fixed. The following section explores these factors in further detail with the goal of explaining how the insurance industry may have gotten to this point.

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provided a conclusive answer as to whether the term should be narrowly defined to include only actual contracts of insurance or more broadly defined to include all activities generally and traditionally engaged in by insurance companies, or somewhere in between these two extremes. *Id.* The Supreme Court noted in *United States Dep't of Treasury v. Fabe*, 508 U.S. 491, 505 (1993), that "the broad category of laws enacted 'for the purpose of regulating the business of insurance' consist of laws that possess the 'end, intention or aim' of 'adjusting, managing, or controlling the business of insurance' including the actual performance of an insurance contract . . . ." (quoting BLACK'S LAW DICTIONARY 1236, 1286 (6th ed. 1990)).

47. *See* Employment Retirement Income Security Act, 29 U.S.C. § 1144(b)(2)(a) (2000). *See also* GLBA, Pub. L. No. 106-102, 113 Stat. 1338 (1999), in which Congress specifically stated that these Acts would not apply to the business of insurance.

48. The GLBA enacted in 1999 was the first major indication of congressional intent to begin specifically preempting certain state regulatory powers over the business of insurance. GLBA, Pub. L. No. 106-102, 113 Stat. 1338 (1999). The law purports to reserve most regulatory powers to the states while at the same time includes significant preemption provisions relating to the sale of insurance by banks. *See* 15 U.S.C. §§ 6701, 6711-6714 (2000); P.L. 106-299, § 102, 114 Stat. 467 (2000). Subsequently, on June 30, 2000, the president signed into law the *Electronic Signatures in Global and National Commerce Act*, which gave an electronic signature the same legal authority as a handwritten signature. In order to bring the insurance industry out from under the protective shield of McCarran-Ferguson, Congress unambiguously stated that the "business of insurance" was included under the Act. *Id.*; 15 USC § 7002 (2000).

49. *See generally*, Dawn Kopecki, *US Bankers Begin Push for Federal Insurance Regulator*, WALL ST. J., Feb. 22, 2000, at 27A.

A. Gramm-Leach-Bliley Act: Bank Entry

The United States modernized regulation of the financial services industry on the eve of the new century allowing commercial banks to engage in insurance underwriting. Following years of debate and setbacks, Congress passed historic legislation in 1999, known as the *Gramm-Leach-Bliley Act* (GLBA),[50] which removed the legal barriers between the insurance, securities, and banking industries that separated them for the previous six decades.[51] The law's intended modernization objectives were accomplished by repealing the anti-affiliation provisions of the 1933 *Glass-Steagall Act,*[52] which imposed barriers between the insurance and securities industries, and the 1982 amendments of the *Bank Holding Act of 1956,*[53] which erected barriers between the banking and insurance industries.[54] As a result, GLBA opened the doors between these financial services industries allowing them to offer insurance, banking, and securities products all under one roof.[55]

In the post-GLBA environment, insurers are facing more direct competition with other financial services industries. Insurance companies and banks, in particular, are offering similar products and engaging in national marketing to the same customers.[56] The convergence of these products is placing an emphasis on product development and the ability to get new products out into the marketplace in a timely manner.[57] It is also highlighting the competitive disadvantages that insurers face when dealing with the state regulatory process. Many insurance groups believe that

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50. GLBA, Pub. L. No. 106-102, 113 Stat. 1338 (1999).

51. The GLBA was signed into law on Nov. 12, 1999.

52. 12 U.S.C. § 377 (2000).

53. 12 U.S.C. § 1843 (2000). The *Bank Holding Company Act* of 1956 prohibited banks from controlling a non-bank company unless the Federal Reserve Board determined that the non-bank company activities were "so closely related to banking or managing or controlling banks as to be a proper incident thereto." In 1982, Congress amended the *Bank Holding Company Act* to forbid banks with limited exceptions from conducting general insurance underwriting or agency activities. 12 U.S.C. §§ 78, 377 (2000).

54. Scott A. Sinder, *The Gramm-Leach-Bliley Act and State Regulation of the Business of Insurance—Past, Present and . . . Future?*, 5 N.C. BANKING INST. 49 (2001).

55. *Id.* Companies can now engage in all three of these activities either through financial holding companies or through financial subsidiaries.

56. Peter J. Wallison, *Optional Federal Chartering for Life Insurance Companies, in* OPTIONAL FEDERAL CHARTERING AND REGULATION OF INSURANCE COMPANIES 53 (Peter J. Wallison ed., 2000).

57. *Id.*

insurers should have the same advantage of a single supervisory body as their competitors have.[58]

1. Bank Insurance Powers Expand

Historically, the insurance industry and the banking industry have engaged in a turf battle over the ability of banks to sell insurance.[59] In contrast to sole state regulation as is the case with the insurance industry, the United States has a dual banking system in which banks may choose either federal or state regulation.[60] However, before enactment of *McCarran-Ferguson*, while banks could choose national status under federal regulation, they remained subjected to state laws that completely prohibited bank insurance sales.[61] Nevertheless, numerous subsequent court battles and legislative and regulatory developments over the years have rendered this separation basically ineffective.[62] As such, national banks regulated by the federal government are able to engage in certain insurance activities free of state regulation. In these particular areas, insurers believe they are at a competitive disadvantage because their bank counterparts do not face the same inefficient multi-state regulatory hurdles.[63]

In the mid-1980s, the United States Supreme Court substantially altered the landscape of state regulation of bank insurance sales. Two major unanimous Court decisions made within one year of each other—

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58. *See* Steven Brostoff, *ACLI Endorses Optional Federal Chartering*, NAT'L UNDERWRITER, Nov. 19, 2001, at 34 (quoting Joe Gasper, president and DOO of Nationwide Financial Services, Inc.) ("[I]n today's rapidly evolving financial services marketplace, life insurers no longer compete only with one another, but with banks and securities firms as well."). The American Council of Life Insurers (ACLI) now classifies regulatory reform as a "survival issue" for life insurers. *Id.*

59. Karol K. Sparks, *Bank Insurance Sales: A Compliance Guide*, SG023 ALI-ABA 451 (2001).

60. *See generally*, AMERICAN BANKERS INSURANCE ASSOCIATION (ABIA), THE BENEFITS OF CHARTER CHOICE, THE DUAL BANKING SYSTEM AS A CASE STUDY (2001), *available at* http://www.aba.com/ABIA/ABIA_issues.htm [hereinafter BENEFITS OF CHARTER CHOICE].

61. Sinder, *supra* note 54, at 57-58.

62. *See generally*, WILLIAM R. ANDERSON, THE ASSOCIATION OF LIFE INSURANCE COUNSEL, MERCHANTS NATIONAL TO BARNETT: A DECADE OF BANKING AND INSURANCE LITIGATION 13-19 (1996).

63. *See generally, Insurance Regulation and Competition for the 21st Century: Series 2: Hearing before the House Financial Services Subcomm. on Capital Markets, Insurance and Government Sponsored Enterprises,* 107th Cong. 3 (2002) [hereinafter *Series 2 Hearing*] (statement of Joseph J. Gasper, Chairman, ACLI, President of & COO Nationwide Financial Services, Inc.).

NationsBank of N.C., N.A. v. Variable Annuity Life Ins. Co.[64] and *Barnett Bank of Marion County, N.A. v. Nelson*[65]—resulted in expanded powers of national banks to sell insurance and sufficient obfuscation of state insurance regulation of national bank insurance sales activities.[66] The decisions created considerable confusion regarding the nature of state regulation of national bank insurance activity and created a flurry of activity by the states to reaffirm their regulatory prerogative.[67]

The *Barnett* decision radically altered the landscape of state regulation of bank insurance sales. In a unanimous decision, the Court held that federal banking law preempted a Florida statute prohibiting banks from selling insurance.[68] The federal law authorized national banks in towns with populations not exceeding 5000 to sell insurance.[69] The Court ruled that states may continue to regulate national banks' insurance sales only as long as the states do not significantly interfere with the national banks' powers.[70] The decision also made clear that small town national banks may act as insurance agents "under such rules and regulations as may be prescribed by the Comptroller of the Currency" (OCC).[71] This opened up a wave of controversy as to the scope of national banks' insurance authority.[72]

While states rushed to protect their prerogative of state insurance regulation, the federal government moved in to expand bank insurance powers. In response to the Court's decision in *Barnett*, the NAIC adopted a resolution supporting the states' authority to regulate bank insurance

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64. 513 U.S. 251 (1995).

65. 517 U.S. 25 (1996).

66. WILLIAM R. ANDERSON, ABA COMM. ON LIFE, HEALTH, PUBLIC REGULATION OF INSURANCE & COMM. ON EMPLOYEE BENEFITS LAW TORT AND INSURANCE PRACTICE SESSION, NATIONSBANK AND BARNETT: A SCYLLA AND CHARYBDIS FOR STATE REGULATION OF INSURANCE (1997).

67. *Id.* at 1.

68. *Barnett*, 517 U.S. at 37.

69. The federal law at issue is commonly known as "Section 92." *See* 12 U.S.C. § 92 (2000).

70. *Barnett*, 517 U.S. at 42. It is important to note, however, that the decision did not address the extent to which banks located in small towns could sell insurance in places with a population greater than 5000, or the extent to which state insurance regulators could regulate the sale of insurance products by national banks.

71. Sinder, *supra* note 54, at 58. *See Barnett*, 517 U.S. at 28 (quoting Act of Sept. 7, 1916, 39 Stat. 753, codified as amended at 12 U.S.C. § 92).

72. Anderson, *supra* note 66, at 1.

activities and appointed a special committee to monitor the issue.[73] At the same time, the OCC issued numerous rulings and interpretive letters attempting to expand the scope of national banks' insurance authority.[74] The OCC used its powers to enable small town banks to sell insurance to customers located anywhere regardless of population, so long as they were managed from the small town office.[75] The OCC also used the "incidental powers" clause of the *National Banking Act* (Section 24) to successfully expand to banks insurance powers such as to debt cancellation insurance and the sale of annuities.[76] Many in the banking community took these developments as an indication that *McCarran-Ferguson* did not apply to the banking industry.[77] The OCC even went so far as to publicly announce that national banks did not have to comply with state insurance agent licensing requirements at all.[78]

2. New Competitive Realities

The new and expanded presence of banks in the insurance industry has completely changed the competitive paradigm of the insurance industry. When Congress enacted GLBA, it incorporated the legal standard of

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73. The National Association of Life Underwriters (NALU), Independent Insurance Agents of America (IIAA), & Professional Insurance Agents (PIA), BANKS AND INSURANCE: THE AFTERMATH OF BARNETT, A BLUEPRINT FOR THE STATES.

74. Sinder, *supra* note 54, at 60.

75. *Id.* (citing NBD Bank, N.A. v. Bennett, 67 F.3d 629 (7th Cir. 1995); and *Banks Cleared to Sell Insurance Annuities*, [1996-1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶¶ 81-107 (OCC Interpretative Letter No. 753, Nov. 4, 1996)). *See also*, Indep. Ins. Agents of America, Inc. v. Ludwig, 997 F.2d 958 (D.C. Cir. 1993). As a result of the OCC's authority over small town banks, in effect national banks with a single small town office could engage in insurance sales activities from anywhere to anywhere.

76. *See* First Nat'l Bank v. Taylor, 907 F.2d 775, 778 (8th Cir. 1990), *cert. denied*, 498 U.S. 972 (1990) (holding that debt cancellation contracts are directly connected to the bank's lending activities and the OCC's authorization of this activity was reasonable and within the incidental powers granted by the National Bank Act); NationsBank of N.C., N.A. v. Variable Annuity Life Ins. Co., 513 U.S. 251 (1995).

77. Sinder, *supra* note 54, at 63.

78. *Id.* (citing 12 C.F.R. pt. 5 (1999)); Memorandum from Julie L. Williams, Chief Counsel to Eugene A. Ludwig Comptroller of the Currency (re: Legal Authority for Revised Operating Subsidiary Regulation) (Nov. 18, 1996), *reprinted* at [1996-1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶¶ 90-464; *Review of the OCC's New Regulation Permitting Operating Subsidiaries of Banks to Engage in Activities That are not Explicitly Permissible for National Banks and for Other Purposes: Hearing Before the Subcomm. on Financial Institutions and Regulatory Relief of the Senate Banking, Housing and Urban Affairs Comm.*, 105th Cong. (1997) (testimony of Eugene A. Ludgwig, Comptroller of the Currency).

Barnett by recognizing the right of banks to engage in insurance sales, solicitation and cross-marketing activities.[79] Insurers must now compete directly with commercial banks, mutual funds, and brokerages. At the same time, however, Congress recognized the continued role of the states as functional regulators of the insurance industry.[80] This left insurers under a state-based regulatory environment while their new competitors could enjoy the benefits of a single regulatory body.

The OCC's aggressive expansion of authorized national bank insurance activities enabled national banks to thwart state insurance regulation in several sectors of the field. This expansion resulted in certain exceptions where banks can sell traditional insurance products while remaining solely under OCC jurisdiction because the products are technically classified as banking products. As the primary regulator of national banks, the OCC opinions regulating these bank activities for the most part have survived numerous court challenges by insurance agents, companies, and state departments of insurance.[81] This practice has given national banks a competitive advantage over insurers who face multi-state regulation for essentially the same products that national banks sell.

a. Competing Similar Products

A good example of the regulatory advantages enjoyed by national banks can be found in credit insurance. Credit insurance is used as a debt management tool and is traditionally sold by insurance agents regulated by the states.[82] The market for credit insurance has expanded with the growth

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79. GLBA, Pub. L. No. 106-102, 113 Stat. 1338 (1999), §104(d)(2)(A). The section codified the holding in *Barnett Bank* discussed previously in this chapter. The GLBA states that under this section "no state may . . . prevent or significantly interfere with the ability of a depository institution, or an affiliate thereof, to engage, directly or indirectly, either by itself or in conjunction with an affiliate or any other person, in any insurance sales, solicitation, or cross marketing activity." *Id. See Barnett*, 517 U.S. at 25.

80. Neal R. Pandozzi, *Beware of Banks Bearing Gifts: Gramm-Leach-Bliley and the Constitutionality of Federal Financial Privacy Legislation*, 55 U. MIAMI L. REV. 163, 178 (2001).

81. Anderson, supra note 66, at 13-19 (citing Saxon v. Georgia Ass'n of Indep. Ins. Agents, 399 F.2d 1010 (5th Cir. 1968)); Independent Ins. Agents of America, Inc. v. Ludwig, 955 F.2d 731 (D.C. Cir. 1992); American Ins. Ass'n v. Clarke, 865 F. 2d 278 (D.C. Cir. 1988); First Nat'l Bank v. Taylor, 907 F.2d 775 (8th Cir. 1990), *cert. denied*, 498 U.S. 972 (1990).

82. *See* Anthony Rollo, *A Primer on Consumer Credit Insurance*, 54 CONSUMER FIN. L.Q. Rep 52, 56 (2000). Consumer credit insurance ("credit insurance") is offered in connection with a loan or credit agreement where the policy terms and benefits are related to the specific consumer credit contract or obligation, and the insurance proceeds are used to

of consumer credit and involves two primary categories consisting of: (1) insurance relating to installment credit or closed-end credit; and (2) insurance relating to credit card debt or open-end credit.[83] Most states have separate chapters in their insurance code relating to credit insurance primarily directed at regulating credit insurers as opposed to creditors.[84] The majority of states also have separate statutory or regulatory provisions governing rate structure and restrictions on credit insurance coverage and necessary disclosures.[85]

The sale of credit insurance, however, is slowly being replaced with a virtually identical banking product. The courts over the years have upheld several OCC rulings enabling national banks to offer debt cancellation/suspension products, which are essentially the same products as credit insurance.[86] The purpose of debt cancellation products is to protect the lender from loan loss risks when the contingency covered by the contract occurs.[87] This practice is very similar to the underwriting of credit insurance. However, because these contracts are classified as banking products, they are subject to OCC jurisdiction.[88] As such, while insurance companies and agents selling these identical products must deal with the inefficiencies of state insurance regulation, national banks have the convenience of one-stop-shop regulator.

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repay the debt upon occurrence of an insured event. *Id.* at 52. It is "generally offered based on the prospect that the borrower can pay the debt from future income, with earning power in part serving as security for the credit." *Id.* "Credit insurers market their products to the producers who sell the insurance, as opposed to the ultimate consumers." *Id.* Agents or intermediaries involved in the sale of the credit insurer's product to the borrower typically include automobile dealerships, banks, credit unions, department stores, jewelry stores, furniture and appliance stores, and finance companies. *Id.*

83. *Id.* at 52.

84. *Id.* at 56.

85. *Id.*

86. *Taylor*, 907 F.2d at 780 (affirming the OCC's authorization of debt cancellation contract sales because debt cancellation contracts are not insurance); Indep. Bankers Ass'n of America v. Heimann, 613 F.2d 1164, 1170 (D.C. Cir. 1979), *cert. denied*, 449 U.S. 823 (1980) (affirming the OCC's authorization to sell credit insurance products because "credit life insurance is a limited special type of coverage written to protect loans").

87. The lender would charge a fee when the loan is made, which is then used as a reserve under the contract against the possibility of later loan loss. *See* Rollo, *supra* note 82, at 66.

88. *Taylor*, 907 F.2d at 780 (affirming the OCC's authorization of debt cancellation contract sales because debt cancellation contracts are not insurance).

b. Bank Competition Highlights Flaws in Insurance Regulation

As more and more banks begin selling insurance products, the flaws in the insurance regulatory system are more clearly emerging. Prior to GLBA, competition existed solely from those within the insurance industry, all of whom experienced the same negative effects on their bottom lines from state regulatory inefficiencies.[89] As American Council of Life Insurers (ACLI) senior Vice President Gary Hughes aptly noted, "[s]ince it affected everybody, it wasn't that significant of an issue."[90] However, now that insurers are facing cross-sector competition, regulatory costs are putting the squeeze on insurers, to the point that insurers can no longer avoid the issue.[91]

Both property/casualty insurers and life/health insurers are complaining that they are at a "severe competitive disadvantage" to other financial services industries now that these providers have entered the insurance market.[92] These new competitors face a less cumbersome regulatory system and a "vastly shorter timetable" for getting new product approvals, on average only thirty to ninety days.[93] Insurers on the other hand face inconsistent and often much more lengthy processes among the states.[94]

Large groups within the insurance industry, particularly the companies, believe it is no longer realistic to expect the NAIC to implement needed reforms.[95] The NAIC is working aggressively to reformat the state

89. E.E. Mazier, *Federal Charter Backers Cite Benefits for Insurers*, NAT'L UNDERWRITER, Jan. 28, 2002, at 10.

90. *Id.* (quoting Gary Hughes, ACLI Senior Vice President and General Council).

91. Lynna Gach, *Staying the Course: As Insurers Navigate the Changing Regulatory Environment, They Have set Their Sights on Speed-To-Market Rules*, BEST'S REVIEW, Feb. 1, 2002, at 43 (quoting Bruce Ferguson, ACLI Deputy Director).

92. Christian Bruce, *AIA Sees Multi-Year Coordinated Effort to Clear Federal Insurance Charter Bill*, BNA'S BANKING REPT. NEWS, July 30, 2001, at 43.

93. Gach, *supra* note 91, at 43.

94. For example, the departments of insurance in Illinois, North Carolina, and Montana currently require a final dated copy of the policy and fund prospectuses approved by the SEC before they will accept a variable annuity product for review. Concurrent review of the product by the SEC and the respective insurance department is not allowed. Connecticut, New York, New Jersey, Oregon and Washington all frequently require more than four months to approve a filing. *See* Memorandum by Kevin McKechnie, ABIA Report on Speed to Market Issues (June 15, 2001) (on file with ABIA in Washington, D.C.).

95. Nicole Duran, *Insurers Demand Simpler Rules but not Federal Charter*, AM. BANKER, June 22, 2001, at 3 (quoting James A. Blum, Chairman and President of

regulatory process to show that the existing system works. However, many have lost faith in the state legislatures' ability or desire to reform the current system.[96] While state insurance regulators may recognize the increased competition from banks, unless state legislators are willing to take action and modify their state's laws, it will be very difficult for regulators to make necessary reforms to equal the playing field without federal intervention.[97] Thus, insurers have begun looking to the federal government for help, a notion once thought highly unlikely and undesirable by the insurance industry.

B. State Streamlining Efforts Produce Little Results

Changes in the market and technology have led to an almost unanimous conclusion that, at the very least, state-based insurance regulation would benefit from modernization and reform. Both industry and regulatory officials alike are championing the need for a more streamlined regulatory system.[98] Many argue this is because the varying regulatory constraints and disparities among the fifty states puts the insurance industry at a significant disadvantage compared with other financial services industries.[99] In order for the insurance business to remain viable, these groups argue that the system of insurance regulation must become far more streamlined and efficient even if that requires federal involvement to achieve this goal.[100] This common notion is producing an industry-wide push for more uniformity unlike that seen ever before.

Brotherhood Mutual Insurance Co., on behalf of the National Association of Mutual Insurance Companies (NAMIC)).

96. Jim Connolly, *Commissioners Plan to Huddle and Strategize for the Coming Year*, NAT'L UNDERWRITER, Jan. 29, 2001, at 27.

97. Mazier, *supra* note 89, at 11 (quoting Gary Hughes, ACLI Senior Vice President and General Council).

98. *See, e.g.*, FINANCIAL SERVICES COORDINATING COUNSEL (FSCC), PRINCIPLES FOR FEDERAL INSURANCE REGULATION STATEMENT ON FEDERAL INSURANCE REGULATION (2002) (representing the joint views of the American Bankers Association, the American Counsel of Life Insurers, the American Insurance Association, and the Securities Industry Association), *available at* http://www.aba.com/ABIA/ABIA_issues.htm (last visited Nov. 9, 2002) [hereinafter PRINCIPLES FOR FEDERAL REGULATION].

99. *See Insurance Product Approval: The Need for Modernization: Hearing Before the Subcomm. on Capital Markets, Insurance and Government Sponsored Enterprises of the House Financial Services Comm.*, 102nd Cong. (2001) [hereinafter *Insurance Product Approval hearing*] (statement of the Counsel of Insurance Agents and Brokers).

100. *Improving Insurance for Consumers: Increasing Uniformity and Efficiency in Insurance Regulation: Hearing before the Subcomm. on Finance and Hazardous Materials of the House Commerce Comm.*, 101st Cong. (2000) [hereinafter *Improving Insurance*

1. Early Efforts: Dingell's Solvency Concerns

The need for a more streamlined regulatory system grew out of public concern over insurer insolvencies occurring over ten years ago.[101] In the early 1990s, Representative John Dingell (D-MI), then the Chairman of the House Commerce Committee,[102] held a series of hearings on the issue of insurance insolvency culminating with his introduction of the *Federal Insurance Solvency Act of 1993* (H.R. 1290).[103] A rash of insurance insolvencies, involving both domestic and off-shore insurance companies led him to believe that state regulators had failed to adequately perform their jobs and thus failed to protect the public from the harmful consequences of such insolvencies.[104] Representative Dingell believed that the state-based system was fraught with disparities and inefficiencies to the point that a federal role was needed to "assure that the insurance regulatory system . . . [wa]s functioning properly to protect the public."[105]

Dingell's solution was to substitute federal oversight of the industry for the existing state-based system, which he believed had failed miserably. H.R. 1290 would have established a new federal agency, the Federal Insurance Solvency Commission (FISC) which would develop nationally uniform solvency standards applied to both federally regulated companies and state regulated companies.[106] H.R. 1290 would have given insurance companies the option of being regulated for solvency by either a state insurance department or by the FISC.[107] The bill was strongly opposed by state insurance regulators and the insurance industry, however, and failed to muster enough support to make it to the House floor for a vote.[108]

Hearing] (statement of Drayton Nabers, Jr. on behalf of the American Council of Life Insurers).

101. *See, e.g.*, Press Conference, Public Citizen, Insurance: The Next Industry in Crisis? (Oct. 15, 1990) (statement by Joan Claybrook, President, Public Citizen).

102. Representative Dingell is currently the most senior Democratic member of the House Oversight and Investigation Subcommittee of the House Commerce Committee. When Representative Dingell presided as Chairman, the full House Committee's name was the House Commerce Committee. Since then, the name of the Committee has changed to the House Energy and Commerce Committee.

103. H.R. 1290, 103rd Cong. (1993); H.R.1257, 103rd Cong. (1993).

104. *See Insurance Company Failures: Hearing Before the House Subcomm. on Oversight and Investigation of the Energy and Commerce Comm.*, 101st Cong. (1990) (opening comments of Rep. John Dingell).

105. *Id.*

106. Davidson, *supra* note 1, at 418.

107. *See* H.R. 1290.

108. H.R. REP. No. 103-302 (1993).

2. Inefficiencies Spur Complaints From Insurers

While H.R. 1290 ultimately ended in defeat, the streamlining effort had just begun. In the early 1990s, insurance companies started joining together arguing that the current system of regulation was handcuffing them.[109] Insurance companies started pressing state regulators for reform, expanding the push into other areas of regulation such as licensing and product approval.[110] The NAIC quickly responded once it determined that it had to make it easier to do business if the insurance industry was to remain viable.[111] The NAIC also recognized the increasing pressure on Congress to intervene and create a more uniform regulatory process in line with that of other financial services industries. Former NAIC President George Nichols noted that "[i]f the NAIC and its members are not champions for the total insurance market, the federal government will become more of an option."[112]

State efforts to implement reform, however, never seem to produce lasting results. The NAIC has always had good intentions in its desire for a uniform insurance regulatory system.[113] Nevertheless, in its 130 years of existence, the NAIC has yet to achieve this goal.[114] When control of Congress switched following the 1994 elections, the entire political atmosphere changed along with it, giving the states yet another reason to stall their streamlining efforts.[115] The new Republican majority wanted to decrease the size and power of the federal government, not expand it.[116] As

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109. Interview with Nicole L. Allen, Director of State Affairs, Council of Insurance Agents and Brokers in Washington, D.C. (Jan. 25, 2002) [hereinafter Allen Interview].

110. *Id.*

111. *See* George Nichols III, NAIC Vice President, *Message From the Officers*, NAIC NEWS, Feb. 1999.

112. *Id.* Former NAIC President George Nichols publicly stated that the NAIC "must find ways to streamline and make rules uniform across state boundaries . . . [and] create the next generation of regulation that enhances market competition and regulates services and products, not simply an industry." *Id.*

113. George W. Miller, founder of the NAIC, expressed this very intent at the first meeting of the NAIC in 1871. *See* History discussion *infra* Part I.

114. *NARAB & Beyond: Achieving Nationwide Uniformity in Agent Licensing: Hearing Before the Subcomm. on Capital Markets, Insurance and Government Enterprises of the House Comm. on Financial Services*, 107th Cong. (2001) [hereinafter *NARAB & Beyond*] (statement of Rep. Sue Kelly, R-NY).

115. Allen Interview, supra note 110.

116. On the first day of the 104th Congress, the new Republican majority set out to immediately pass major reforms it claimed would restore the faith and trust of the American people in their government. This was known as the Republican "Contract with America." Included in these reforms was the goal of reducing the overall size of government through

such, the idea of creating a federal regulator for insurance did not garner significant enthusiasm from the new committee chairmen.[117] No longer at the helm of the Commerce committee, Representative Dingell was not as much of a threat to state regulators. The incentive for states to reform the system themselves diminished, as there was no real apparent federal threat of intervention by Congress.[118]

3. Renewed Federal Threat of Preemption

Nevertheless, state streamlining efforts gained steam again with the renewed threat of federal preemption included in the GLBA.[119] In enacting the GLBA, Congress gave states a strong incentive to jump-start the streamlining process or face federal statutory consequences.[120] Dealing solely with the issue of insurance producer (agent and broker) licensing, Congress included a provision in the GLBA designed to alleviate duplicative and onerous burdens associated with the multi-state licensing of these insurance producers.[121] If within three years of enactment of GLBA at least twenty-nine states did not implement reciprocal or uniform agent/broker licensing standards, Congress would establish the National Association of Registered Agents and Brokers (NARAB) to do it for them.[122] This real threat of federal preemption sparked a renewed interest among the states in creating more uniformity within the state regulatory

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cutbacks and reorganization. More information on the Contract with America can be found at http://newt.org/index.php?src=gendocs&id=52 (last visited Nov. 9, 2002).

117. NAIC, FOURTH QUARTER 1994 PROCEEDINGS OF THE NATIONAL ASSOCIATION OF INSURERS COMMITTEE, OPENING SESSION COMMENTS 8 (1994).

118. Allen Interview, *supra* note 110.

119. COSTS & BENEFITS, *supra* note 24, at 5.

120. *See* Eileen Canning, *Insurance Commissioners Adopt Model Act to Promote Uniformity Required by New Law*, BNA DAILY REPT. FOR EXECUTIVES, Feb. 2, 2000, at A37 (quoting NAIC President and KY Insurance Commissioner George Nichols III as stating, "With the passage of S. 900 [the Gramm-Leach-Bliley Act], the financial marketplace will change dramatically and we, as regulators, must adapt to that change so we can continue to serve the nation's consumers."). *Id.*

121. GLBA, Pub. L. No. 106-102, 113 Stat. §§ 321-336; 15 U.S.C. §§ 6751-6766.

122. The GLBA provided that NARAB would go into effect three years from the date of enactment of GLBA, which was November 12, 1999. *See* GLBA, Pub. L. No. 106-102, 113 Stat. § 321(d)(1). Therefore, November 12, 2002 was set as the deadline for the states to enact the required reforms. *See NARAB & Beyond, supra* note 115 (opening statement of Ranking Member, Rep. Paul E. Kanjorski). NARAB would be a "semi-autonomous body managed and supervised by state insurance commissioners with the power to set and, [more importantly], preempt certain state standards in order to create a national licensing standard for insurance." *Id.*

system.[123] It also indicated a new sentiment in Congress representing a threat the states had thought was gone, or at least greatly diminished, after the 1994 elections.[124]

4. Consumer Protection

A renewed focus on consumer protection has also added fuel to state streamlining efforts. Shortly after enactment of GLBA, upon request from none other than Rep. John Dingell, the General Accounting Office (GAO) conducted a study on state regulatory oversight which indicated that lax state oversight was a key component in the success of a notorious $200 million insurance embezzlement scam in the late 1990s.[125] The report concluded that "[r]egulators in Tennessee, Mississippi, Missouri, Oklahoma, and Arkansas had the opportunity to discover the alleged scheme at various points in the cycle, but consistently failed to do so . . . ."[126] This information raised new questions over whether state regulators can adequately handle the job of regulating insurance business and protecting the public interest.[127]

Federal efforts to streamline insurance and other financial services anti-fraud efforts are also gaining momentum on Capitol Hill. Currently,

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123. *See generally* Canning, *supra* note 121 (quoting NAIC President George Nichols III as stating, "[a]doption of this [Producer Licensing] model act [to promote uniformity] takes on particular significance in light of the NARAB provision.").

124. Allen Interview, *supra* note 110.

125. *Insurance Regulation: Scandal Highlights Need for States to Strengthen Regulatory Oversight,* GAO REPORT (Sept. 19, 2000). At the request of House Commerce Committee Ranking Member John Dingell (D-MI), the GAO conducted a study on the insurance regulatory oversight and information-sharing involved in the matter of a highly publicized insurance investment scam exposed in May 1999. "[U]nder indictment for embezzling more than $200 million in insurance company assets over a nearly eight year period," Martin Frankel was accused of having stolen money from the seven insurance companies that he was said to have secretly controlled through a Tennessee investment company. *Id.* at 1. Although a former securities broker who was barred from that industry in 1992, Frankel migrated to the insurance industry and continued to operate as a rogue by engaging in illegal activity. The GAO report concluded that he was aided by lax state oversight. *Id.* at 2.

126. Eileen Canning & Rob Garver, *Testimony for National Insurance Charter*, AM. BANKER, Sept. 20, 2000, at 1.

127. *See, e.g.,* Jackie Spinner, *Insurer's CEO Charged With Fraud*, WASH. POST, Jan. 30, 2002, at E1. It is important to note, however, that while these questions are reemerging, they are not new. Public interest groups raised the concern of state regulatory mismanagement as early as 1990 arguing that state regulators were "overburdened and underfunded" and failed to stop excessive risk taking and fraud because the regulation was "sporadic and uneven." *See* Joan Claybrook, President, *Public Citizen*, Address at the National Press Club, Washington, D.C. (Oct. 15, 1990).

supporters are pushing for enactment of a bill to create a network linking financial fraud databases around the country in an effort to assist regulators and law enforcement officials in pinning down elusive perpetrators of fraud.[128] The proposed bill does not go so far as to create a federal anti-fraud system, but links the existing state fraud networks together for all state regulators and enforcement officials to use.[129] While Congress is for the time being willing to defer to the states to resolve the problems surrounding consumer fraud, the introduction of this bill, as with NARAB, indicates Congress' willingness and intent to intervene in insurance regulation if the states do not implement sufficient reforms.

C. Globalization of the Insurance Market

Globalization of the insurance and financial services market has changed the business of insurance from that dominated by local insurers in a state market to a multinational corporate business full of conglomerates with international status. Advances in technology and other innovations are contributing to the blurring of distinctions between national and global insurance markets.[130] The insurance industry is no longer able to ignore the realities of today's marketplace. As a result, insurers are looking to new progressive, market-based regulatory models that will level the playing field for insurers at home and abroad.[131]

Competitive opportunity between domestic and foreign insurance companies has become an unavoidable subject of debate between the United States and foreign nations. Representatives from European insurance trade associations are urging U.S. "state lawmakers to become more active in [the] international forums that are setting the ground rules for the new century of trade."[132] Trade policy is playing a growing role in the insurance sector in many countries because of increasing cross-border transactions and foreign direct investment.[133] Yet, international trade discussions on insurance matters with the U.S. Trade Representative are usually futile because the U.S. Trade Representative has no authority on the

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128. *See* H.R. 1408, 107th Cong. (2001).

129. Rachel Witmer McTague, *Bill to Create Anti-Fraud Network Clears House Judiciary Committee*, BNA DAILY REP. FOR EXECUTIVES, Oct. 11, 2001, at A25.

130. COSTS & BENEFITS, *supra* note 24, at 6-8.

131. Phil Zinkewicz, *Associations Debate State/Federal Regulation*, ROUGH NOTES, Nov. 1, 2001, at 64.

132. *NCOIL Struggles for Post-GLB Relevance*, INS. ACCT., Mar. 12, 2001, at 2 [hereinafter *NCOIL Struggles*].

133. *See generally* Veed, *supra* note 38, at 136-38.

matter.[134] This has led to tension over conditional market access and non-national treatment, and forced insurers to question the state regulatory environment.[135]

1. General Agreement on Trade in Services (GATS)

The GATS emerged as part of the Uruguay Round package as the first multilateral trade agreement on services, including insurance.[136] It was a significant step forward in international cooperation and reflected a growing realization of the economic importance of trade in services as well as the need for closer cooperation among nations in a world of growing interdependence. The GATS represents hundreds of commitments among the participating members "to increase market access, transparency, and treatment of foreign insurers the same as local companies."[137]

While the latest GATS agreement was intended to help simplify and harmonize insurance regulation among member states, the United States included a list of numerous exemptions as a precondition to its participation in the agreement.[138] These very broad exemptions relating to market access and national treatment in the insurance sector were meant to uphold the state regulatory structure created by the *McCarran-Ferguson Act*.[139] The United States justified its exemptions on the premise that the "principles of federalism" recognized that insurance had always been regulated at the

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134. *Id.*

135. Letter from CEA, Secretary General, to Sir Leon Brittan, Q.C., Vice President, European Commission (June 17, 1999) (on file with CEA).

136. *See World Trade Organization Seattle Ministerial: Outcomes and Lessons: Hearing Before the U.S. Senate Finance Comm.*, 106th Cong. 2 (2000) (testimony of Susan S. Westin, Associate Director, International Relations and Trade Issues, National Security and International Affairs Division, General Accounting Office). The GATS is a product of the Uruguay Round General Agreement on Tariffs and Trade (GATT) which was signed in April 1994. Since governments were unable to reach full agreement in the GATS negotiations on a package of market opening commitments in financial services at the end of the Uruguay Round in 1993, they extended negotiations in 1995, which resulted in an interim agreement. By September 30, 1999, sixty-one countries including the United States and the EU signed the Fifth Protocol to the GATS. *See* World Trade Organization (WTO), Fifth Protocol to The General Agreement on Trade Series (on file with WTO and *available at* http://www.wto.org/ (last visited Nov. 9, 2002)).

137. AMERICAN COUNCIL OF LIFE INSURERS, INSURANCE TRADE AGREEMENT COMPLIANCE MONITORING TASK FORCE STATUS REPORT at 5 (1999).

138. *See* United States of America Schedule of Specific Commitments, Feb. 26, 1998, GATS B.I.S.D. (3rd Supp.) (1999) [hereinafter *GATS Schedule*].

139. *Id.*

state government level.[140] Thus, although the GATS agreement sought to promote global markets, it also preserved regulatory obstacles to full market globalization.

2. Increasing Demands of the Global Market

The inefficiency and cumbersome nature of the current state regulatory system is recognized internationally and is a major factor in the push for some form of federal solution to fix the problem. The increasing number of international insurance companies and large domestic insurers offering products nationally makes the current state-based system out of step with the times.[141] Passage of GLBA only accentuates this problem, as foreign financial services industries are now entering the U.S. insurance market through subsidiaries. U.S. insurers wishing to operate on the world stage do not want to be hampered by restrictive regulation that their foreign competitors do not face.[142] As a representative of the London market of reinsurers noted, the current U.S. state regulatory system cannot "adequately respond to the changing commercial and legal landscape of the global insurance industry."[143]

The NAIC's commercial lines deregulation efforts also exemplify a realization among many within the U.S. insurance industry that regulation in the United States must adapt to the demands of the global market.[144] State regulators are now opening markets for insurance of commercial risks

140. Additional Commitments Paper I, Attachment to the United States Schedule, Feb. 26, 1998, GATS B.I.S.D. (3d Supp.) (1999).

141. Statement of Maurice Greenberg, American International Group (AIG) Chairman, LLOYD'S LIST INT'L (Mar. 7, 2001).

142. Robert E. Vagley, *Regulation out of Step With Industry*, BUS. INS., Feb. 19, 2001, at 7.

143. *NCOIL Struggles*, *supra* note 133 at 3 (quoting Stephen Cane, Alea London, Ltd, Chairman).

144. The NAIC adopted a few years ago its "White Paper on Regulatory Re-Engineering of Commercial Lines Insurance" in an attempt to shift the allocation of regulatory resources to where they are most needed. *See* Regulatory Re-engineering of Commercial Lines Insurance, White Paper (1998), available at NAIC (Kansas City, MO). The NAIC realized that in order for regulators to balance their responsibility between protecting consumers with the industry's need and desire to have a less restrictive regulatory environment, commercial line insurers should be free from regulatory rate and form-filing requirements. *See Commercial-Lines Deregulation Gains Momentum Nationwide,* Special Report, BESTWEEK, (March 29, 1999).

because they are beginning to recognize the different needs and benefits of commercial line insurance regulation.[145]

III. PROPOSED SOLUTIONS FOR IMPLEMENTING DESIRED REFORM

While the insurance industry as a whole agrees that the inefficiencies in the current insurance regulatory system need to be rectified,[146] the industry is not completely unified whether, or to what degree, the federal government should play a role in the reform.[147] Large domestic and international insurance companies—representing both property/casualty and life/health insurers—seem to be taking the lead in advocating a complete overhaul of state regulation by establishing an optional federal insurance charter for insurers to be able to choose either state regulation or federal regulation.[148] These proposals are modeled in part after the current dual-regulatory banking system.[149] Insurance agents and smaller more local insurance companies support the state regulatory system and believe that the states have and can continue to implement needed reforms when given a little incentive by the federal government through the use of national insurance standards.[150] This Section analyzes these two separate and very different theories.

A. Optional Federal Charter Solution

The concept of an optional federal insurance charter has become the model which proponents of federal regulation of insurance are pursuing to achieve their goal. Many now argue the previously mentioned factors dictate that the current regulatory system is inadequate and must be reformed in order for insurers to gain an equal footing with other financial

145. Letter from Anne B. Allen, Director, NAIC, to Glenn Pomeroy, Commissioner, *NAIC* (Feb. 24, 1998) (on file with the NAIC).

146. *See generally Series 3 Hearing*, *supra* note 2 (statement of Terri Vaughan, NAIC President).

147. COSTS & BENEFITS, *supra* note 24, at 21-23.

148. *See generally Series 2 Hearing*, *supra* note 63 (statement of Joseph Gasper, Chairman, American Counsel of Life Insurers).

149. *Id.* at 9.

150. *See generally Insurance Regulation and Competition for the 21st Century: Series 1: Hearing before the House Financial Services Subcomm. on Capital Markets, Insurance, and Government Sponsored Enterprises*, 107th Cong. (2002) [hereinafter *Series 1 Hearing*] (statement of Ann Spragens, Vice President and General Counsel, Alliance of American Insurers); *Series 3 Hearing*, *supra* note 2 (statement of the National Association of Insurance and Financial Advisors).

services industries.[151] The key word in the chartering proposal is the word "optional."[152] In fact, as the President and CEO of New York Life stated, "[w]hile there is strong interest in the concept of federal chartering within the industry, there is no interest in establishing exclusive or mandatory federal regulation for life insurers."[153]

The idea behind the optional chartering proposal is that it would give insurance companies, agents and brokers the choice of a regulator and supervisory system, either with the state or with a newly developed federal regulator.[154] The new federal regulatory system would not replace the state system but would supplement it.[155] The argument in support of such an approach is that it would provide a more uniform, consistent and comprehensive regulatory system for insurers and insurance agencies.[156] The idea seems to make logical sense when comparing it to the banking industry, which has successfully operated under such a dual-chartering system.[157] However, there are fundamental differences between banking and insurance, and the problems that consumers face in the property/casualty area and in health/life insurance are different than the problems consumers face in banking.[158] The optional federal insurance charter may be the most direct manner in which to increase efficiency and uniformity, but it is neither a simple solution nor a costless solution for the industry and consumers.

1. Comparison With Banking Industry

The logic behind the duel-chartering proposal for insurance rests on its comparison with the regulatory system behind the banking industry that has

151. Mazier, *supra* note 89, at 10.

152. Press Release, ACLI, ACLI Board Authorizes Pursuit of Optional Federal Charter Bill, Reaffirms Commitment to Improving State Regulation, (Nov. 12, 2001) (on file with the author) [hereinafter ACLI Press Release].

153. *Id.* (quoting ACLI's outgoing Board Chairman, Sy Sternberg, President, chairman and CEO of New York Life).

154. Symposium, *The Future of Law and Financial Services: Panel III: The New Policy Agenda for Financial Services*, 6 FORDHAM J. CORP. & FIN. L. 113, 137 (2001) (statement of Beth Climo, Managing Director of the American Bankers Assn. Securities Assn. and the American Bankers Assn. Insurance Assn. (ABAIA)).

155. *Id.*

156. *Improving Insurance Hearing, supra* note 100 (statement of Glen J. Milesko, Chairman and C.E.O. of Banc One Insurance Group on behalf of ABIA).

157. *See* BENEFITS OF CHARTER CHOICE, *supra* note 60 at 1.

158. *Iowa Commissioner Stresses Modernization*, BEST'S REV., Feb. 1, 2001, at 16-17 (written interview with Therese Vaughan, former NAIC President and Iowa Insurance Commissioner) [hereinafter *Iowa Commissioner*].

been in place for 140 years. Since 1732, states have chartered and regulated banks.[159] Nevertheless, without replacing the state system, in 1863 the federal government offered banks a second alternative when Congress passed the National Bank Act,[160] in which it offered to charter and regulate banks. The dual chartering system for banks has been a "resounding success" and is a model for efficiency within the financial services industry.[161] A fan of the dual banking system, former FDIC chairman William M. Isaac, once said that a dual regulatory system

> embodies a system of checks and balances between two levels of government and helps to ensure the decentralization of decision-making power. It serves as a safety valve against concentration of power in the hands of a few decision makers, who can become imperceptive or complacent, and against the potential for abusive or simply unwise actions.[162]

Proponents of an optional federal insurance charter believe that such a system would benefit the industry and consumers, lead to better regulation, and bolster the economy.[163] The idea behind the insurance system would be to create an office served by a single federal insurance commissioner who possesses the power to charter, regulate, and supervise federally chartered insurance firms, and the authority to establish supervisory and consumer standards.[164] All federally chartered associations and agencies would be allowed to engage in "incidental" activities, which is similar to the authority granted to banks and would allow the insurance industry to evolve into new and emerging business activities.[165] The federally-chartered insurance firms, however, would still have to comply with state law, unless those laws interfered with the legitimate insurance activities of the firm.[166]

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159. BENEFITS OF CHARTER CHOICE, *supra* note 60.

160. 12 U.S.C. § 21 (2000).

161. Timothy J. King, *Insurers Should get Dual Chartering System Like Banks*, AM. BANKER, Vol. 165, No. 80, Apr. 28, 2000 at 10.

162. *Id.*

163. *See generally Series 3 Hearing*, *supra* note 2 (statement of Glen J. Milesko, Chairman of Banc One Insurance Group on behalf of ABIA); *Series 2 Hearing*, *supra* note 63 (statement of Joseph Gasper, Chairman, ACLI).

164. Series 3 Hearing, *supra* note 2 (statement of Milesko) at 4.

165. Larry LaRocco, former Managing Director, ABIA, Address at an American Enterprise Institute Conference (June 3, 1999) (on file with ABIA and with the author).

166. *Id.*

2. Recent Activity

The current push for federal insurance regulation differs from past attempts and poses a real possibility that the federal government will in some form or manner become involved in insurance regulation in the near future. In the past, almost every serious review of the state-based system of insurance regulation was initiated by Congress and sprang from perceived or actual failure of some kind.[167] In contrast, however, the impetus this time for looking into the concept of federal chartering is coming from the industry itself.[168] This is a key distinction. The issue now is "regulatory efficiency, not the venue of regulation."[169]

The difference today is that companies no longer believe they can wait around "while incremental improvements are debated and slowly implemented on a state-by-state basis."[170] Insurance companies are competing with banks and securities firms and have come to the realization that they need a more centralized streamlined regulatory process to effectively compete with the new firms entering the market.[171] As a spokesperson for the American Insurance Association (AIA) appropriately stated, "while the NAIC recognizes the need for reform, recommendations from the NAIC are not the same as actually enacting changes in fifty states."[172] The current state-based regulatory system is not moving fast enough to address the changing need of the industry, so the industry is looking to the federal government for help.[173] Since enactment of GLBA, numerous insurance groups representing a vast majority of insurance companies have either proposed their own optional federal chartering plan or come out in support of an existing plan.[174] While originally these proposals differed greatly, in June 2002, four major financial services trade associations, representing the insurance, banking, and securities industries, together released a joint statement of principles for federal insurance

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167. Wallison, *supra* note 56, at 51.

168. *Id.*

169. Steven Brostoff, *What's Next for Federal Charter Proposal?*, NAT'L UNDERWRITER, July 30, 2001 at 6 (quoting Robert E. Vagley, AIA President).

170. R. Christian Bruce, *Insurance: Witnesses at House Insurance Hearing Debate Merits of Federal, State Charters*, 75 BNA BANKING REP. 392 at 12 (Sept. 25, 2000) (quoting testimony of Drayton Nabers on behalf of the ACLI).

171. Adam Wasch, *Insurance: Major Insurance Association Begins Lobbying for Optional Federal Charter*, 77 BNA BANKING REP. 509 at 1 (Nov. 19, 2001).

172. Brostoff, *supra* note 170, at 6 (quoting Debra Ballen, Senior Vice President of AIA).

173. ACLI Press Release, *supra* note 153.

174. *See* ACLI, ABIA, AIA websites, *supra* note 6.

regulation.[175] Their goal is to further develop a common plan from these principles to implement an optional federal insurance charter and present it to Congress for enactment.[176] Both Senator Charles Schumer (D-N.Y.) and Representative John LaFalce (D-N.Y.) have introduced legislation in Congress comprising pieces of these proposals.[177]

a. National Insurance Chartering and Supervision Act (Schumer)[178]

The *National Insurance Chartering and Supervision Act* (the "Schumer bill") would enable establishment of national insurance companies and national insurance agencies to be chartered, supervised and regulated by the federal government.[179] It is a hybrid bill that represents the interests of both the banking and insurance industries.[180] However, some say the impetus for the bill came from the banking industry.[181] Major industry players in both the banking and insurance industries believe this bill is an important first step that will address significant deficiencies in the state regulatory system.[182] Nevertheless, reaction from industry groups is wide-

175. PRINCIPLES FOR FEDERAL REGULATION, *supra* note 98.

176. *See Series 3 Hearing*, *supra* note 2 (statement of Glen J. Milesko, Chairman of Banc One Insurance Group on behalf of ABIA); *Series 2 Hearing*, *supra* note 63 (statement of Joseph Gasper, Chairman, ACLI).

177. On December 20, 2001, Senator Charles Schumer introduced the *National Insurance Chartering and Supervision Act*. *See* ABIA Press Release, *Statement from ABIA on the Introduction of Optional Federal Chartering Legislation* (Dec. 21, 2001) [hereinafter ABIA Press Release] (on file with the author). On February 14, 2002, Rep. John LaFalce introduced the *Insurance Industry Modernization and Consumer Protection Act* (H.R. 3766). *See* 148 Cong. Rec. H523 (daily ed. Feb. 14, 2002).

178. The *National Insurance Chartering and Supervision Act* (Schumer bill) was unofficially introduced in the Senate on December 20, 2001. However, the bill did not yet receive an official committee referral due to committee jurisdictional questions, and therefore was not given an official bill number. A copy of the bill is publicly available on the ABIA's website *at* http://www.aba.com/ABIA/ABIA_issues.htm (last visited Nov. 9, 2002).

179. *See* ABIA, *ABIA Summary of the National Insurance Chartering and Supervision Act*, *at* http://www.aba.com/ABIA/ABIA_issues.htm (last visited on Nov. 9, 2002) [hereinafter ABIA Schumer Summary].

180. Steven Brostoff, *Senate Gets Optional Federal Charter Bill*, NAT'L UNDERWRITER, Dec. 27, 2001, *available at* http://www.nunews.com/lifeandhealth/hotnews/viewLH.asp?article=12_27_01_11_3666.xml (last visited Nov. 9, 2002).

181. *See* Statement of Mike Pickens, NAIC Vice President and Arkansas Insurance Commissioner (on file with the NAIC in Kansas City, MO.).

182. Brostoff, *supra* note 181.

ranged with some groups arguing that the bill moves in the wrong direction for improving insurance regulation.[183]

b. The Insurance Industry Modernization and Consumer Protection Act (LaFalce)[184]

The *Insurance Industry Modernization and Consumer Protection Act* (the "LaFalce bill") would provide for the issuance of optional federal charters for carrying out the underwriting and sale of insurance or any other insurance operations.[185] While containing similarly related provisions to those of the Schumer bill, the LaFalce bill places more of an emphasis on consumer protections.[186] Industry officials have reservedly come forward to support LaFalce's goals for the legislation, but have clearly indicated skepticism as to whether the LaFalce plan could really work.[187] In addition, insurance agent groups see the LaFalce bill and its federal charter provision as an inappropriate means to achieve state regulatory reform.[188]

3. Framework of Optional Federal Charter Proposal

While differing in some technical aspects, the optional federal charter proposals as introduced in Congress contain similar approaches for reform. Those interested in the optional federal charter continue working to develop a single common administrative construct.[189] However, some of

183. *PIA Reaffirms Position on Regulation, Opposes Schumer Proposal*, PR NEWSWIRE, Feb. 1, 2002 (quoting Patricia A. Borowski, PIA Senior Vice President of Government Affairs) [hereinafter *PIA Reaffirms Position*].

184. *The Insurance Industry Modernization Act* (H.R. 3766) was introduced by Rep. John LaFalce (D-NY) on February 14, 2002. *See* the Honorable John J. LaFalce (D-NY) Statement on the introduction of the *Insurance Industry Modernization and Consumer Protection Act* (Feb. 14, 2002), *at* http://www.house.gov/banking_democrats/pr_020214.htm. [hereinafter LaFalce Statement]. Rep. LaFalce is currently the most senior Democrat on the House Financial Services Committee, which has jurisdiction over insurance regulation. *See* House Financial Services Committee Democrats *at* http://www.house.gov/banking_democrats/ (last visited Nov. 9, 2002).

185. *See* LaFalce Statement, *supra* note 185.

186. Adam Wasch, *LaFalce Offers Bill Establishing Optional Federal Insurance Charter*, BNA DAILY REP. FOR EXECUTIVES, Feb. 15, 2002, at A-17.

187. Dennis Kelly, *LaFalce Introduces Bill for Federal Regulation of Insurance*, BEST'S INS. NEWS, Feb. 15, 2002 (citing AIA spokesman Gary Karr).

188. Press Release, Independent Insurance Agents of America, IIAA Opposing LaFalce Regulation Plan (Feb. 20, 2002).

189. *See generally Series 3 Hearing*, *supra* note 2 (statement of Glen J. Milesko, Chairman of Banc One Insurance Group on behalf of ABIA); *Series 2 Hearing*, *supra* note 63 (statement of Joseph Gasper, Chairman, ACLI).

the major concepts of the optional federal chartering proposals aimed at increasing efficiency and uniformity are encapsulated in the Schumer and Lafalce legislation.

a. Applicable Law and Preemption

As a general matter, the optional federal chartering proposals view preemption of state insurance law as the most rational means of improving efficiency and implementing uniformity among the states.[190] Although the proposals would recognize the continuation of state regulation over a few areas of insurance, national insurance companies, agencies and federally-licensed insurance producers as defined in both the Schumer and LaFalce bills would not be subject to state insurance law.[191] However, the legislation would specifically require federal companies to comply with certain state laws, such as state residual insurance programs, state tax requirements including state premium taxes, and state workers' compensation laws.[192] Additionally, the legislation would alter some fundamental concepts in the *McCarran-Ferguson Act* by making federal anti-trust laws applicable in most situations.[193]

b. National Regulator Provisions

The optional charter proposals would create a new agency within the Treasury Department to charter, regulate and supervise federal insurance companies.[194] This agency, patterned after the Office of the Comptroller of Currency (OCC) and the Office of Thrift Supervision (OTS),[195] would be

190. BENEFITS OF CHARTER CHOICE, *supra* note 60.

191. *See* National Insurance Chartering and Supervision Act (Schumer bill), tit. [hereinafter Schumer bill] VIII, *available at* http://www.aba.com/ABIA/ABIA_issues.htm (last visited Nov. 9, 2002); H.R. 3766, 107th Cong. Tit. VII (2002).

192. *See* Schumer bill, *supra* note 192, § 801(F); H.R. 3766 §§ 706, 801.

193. The Schumer bill would make antitrust laws applicable to national insurers except in the areas of policy forms and participation in state residual insurance programs. *See* Schumer bill, *supra* note 192, § 802. The LaFalce bill takes a different approach to antitrust exemptions in that it repeals all insurance antitrust provisions except: (1) the sharing of historical loss data among insurers (but not trending data); (2) the activities of insurers required to participate in State mandatory residual market mechanisms designed to make insurance available to those unable to obtain insurance in the voluntary market; and (3) the activities of insurers required to participate in a worker's compensation administration mechanism. *See* H.R. 3766 § 501.

194. The establishment and powers of the National Insurance Commissioner are set forth in Title I of the Schumer bill and Title II of H.R. 3766.

195. *See* ABIA Schumer Summary, *supra* note 180. The OCC charters and supervises national banks, and the OTS charters and supervises federal thrifts. *See* OCC website, *at*

headed by the National Insurance Commissioner appointed by the President.[196] The powers of the Commissioner would cover both life and property casualty insurance.[197] Start-up costs for the agency would be provided by a loan from the Treasury Department, and payment of the loan and on-going costs of the agency would be paid by assessments and fees imposed on federally-chartered insurance companies, not taxpayers.[198]

c. National Insurer Provisions

The optional chartering proposals would authorize federal chartering of new national insurance companies or national insurers, including the conversion of state-insurers into national companies.[199] These companies would be required to obtain a license from the Commissioner prior to engaging in underwriting activities, which would specify the line or lines of insurance a company could underwrite.[200] There still remains a question as to how to approach companies wishing to underwrite both property/casualty insurance and life/health insurance, however, this disparity does not appear to be significant enough to derail the chartering concept.[201] National insurers would be permitted to establish subsidiaries, although the proposed rules governing these subsidiaries differ slightly.[202]

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http:www.occ.treas.gov (last visited Nov. 9, 2002); OTS website, *at* http://www.ots.treas.gov (last visited Nov. 9, 2002).

196. *See* Schumer bill, *supra* note 192, §§ 102-103. The reference to being appointed by the President is made in the LaFalce bill in Section 201(d)(1). Instead of the term "Commissioner," the LaFalce bill would title the head of the agency as the National Insurance Director. *See* H.R. 3766 §201. The position is essentially the same. As such, the remainder of this Comment will refer to the head of the agency as "Commissioner."

197. Brostoff, *supra* note 170.

198. *See* Schumer bill, supra note 192, § 110; H.R. 3766 § 204(k).

199. *See* ABIA Schumer Summary, *supra* note 180. The provisions for chartering a national insurance company are contained in Title II of the Schumer bill. Similar provisions in the LaFalce bill for "national insurers" are contained in Title III of H.R. 3766. The difference between the two is minimal. In H.R. 3766, the Director would have the power to charter and supervise federally chartered underwriters called "national insurers." However, the bill does not provide for licensing of federal producers (agents), whereas the Schumer bill would also authorize chartering of national insurance agencies.

200. *See* Schumer bill, *supra* note 192, § 208; H.R. 3766 §§ 303, 306.

201. The Schumer bill would provide that no company would be allowed to obtain a license to underwrite both life/health insurance and property/casualty insurance. *See* Schumer bill, *supra* note 192, § 208. However, nothing in the bill would prevent a holding company from owning a national insurance company that is licensed to underwrite life/health insurance and a second national insurance company that is licensed to underwrite property and casualty insurance. *See* Schumer bill, *supra* note 192, § 210. The LaFalce bill would provide that a national insurer could underwrite all forms of insurance other than

Federal charters would be granted based upon a set criteria determined by the Commissioner. Some of these criteria include the character and competency of parties seeking the charter and the financial resources and future prospects of the insurer.[203] National insurers would be subject to NAIC model regulations on risk-based capital, reserve requirements and accounting standards for a set amount of years, after which regulations adopted by the Commissioner would apply to these matters.[204] The legislation would also require national insurers to have annual independent audits and annual actuarial analyses, and also direct each company to establish an independent audit committee of its board.[205]

d. Insurance Agencies/Agents

One primary difference in the optional federal chartering proposals circulating in Congress concerns the issue of producer licensing. As a general matter, the LaFalce bill creates only limited federal regulatory and enforcement authority over state-licensed agents and brokers to the extent that they are acting with regard to a policy or product of a national insurer.[206] The Schumer bill, on the other hand, would provide for the chartering and regulation of national insurance agencies and the licensing of federal insurance producers.[207] All national insurance agencies would be required to obtain a federal producers license, which would automatically

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health insurance. It would then require the Director to report to Congress three years after enactment on whether national insurers should be authorized to underwrite health insurance. *See* H.R. 3766 § 391.

202. The Schumer bill provides that if a company establishes any subsidiaries, it would be prohibited from investing more than fifteen percent of its assets in any subsidiary, or thirty percent of two or more subsidiaries, that engages in activities that the company may not engage in directly. *See* Schumer bill, *supra* note 192, § 303. The LaFalce bill would allow a subsidiary of a national insurer to engage in any business that is lawful in the state in which the subsidiary is organized. *See* H.R. 3766 § 303(e).

203. In granting a charter to a national insurer, the Commissioner must consider the character and competency of the parties seeking the charter and the financial resources and future prospects of the proposed insurer. *See* Schumer bill, *supra* note 192, § 204(b); H.R. 3766 § 301(b). The LaFalce bill would also require that the Commissioner consider whether chartering would be hazardous to the insurance-buying public. *See* H.R. 3766 § 301(b).

204. *See* Schumer bill, *supra* note 192, tit. IV; H.R. 3766 tit. III, Subtitle C.

205. *See* Schumer bill, *supra* note 192, §§ 406-407.

206. *See* H.R. 3766 § 707. The Act defines "state licensed insurance producer" to include state licensed agents and brokers to the extent that they are selling, soliciting and negotiating products or policies issued by a national insurer. Thus, when acting as agents or brokers of a national insurer, they are potentially subject to the Act's requirements.

207. *See* Schumer bill, *supra* note 192, tit. VII.

be granted when it receives its federal charter.[208] State licensed producers may sell policies issued by a national insurance company if they hold a federal producer license or operate in a state that has licensing qualifications comparable to federal standards.[209] National producers would be able to sell policies underwritten by state insurers, however, state-licensed producers would be prohibited from selling a policy underwritten by a national insurance company without first obtaining a federal license, or unless the Commissioner determines the applicable state licensing standards are substantially equivalent to those applicable to federal producers.[210]

e. Consumer Protection Regulations

In addition to economic efficiency concerns, some proponents of the federal charter option believe that the current state regulatory system allows for unacceptable leniency in state consumer protection laws.[211] Sponsors of federal chartering proposals want to ensure that any legislation on the matter would prohibit any person from engaging in unfair or deceptive practices in the underwriting or sale of insurance.[212] These practices include misrepresentations and false advertising of policy terms and advertisements, defamation of a company, or boycott, coercion or intimidation.[213] Some proponents also suggest the imposition of community reinvestment requirements on federally-chartered insurers, as those currently applicable to the banking industry, thus requiring insurance companies to invest a portion of their assets in certain designated areas.[214]

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208. *Id.* § 721(b)(2).

209. *Id.* § 721.

210. *Id.* § 721(b)(3).

211. *See Generally* Statement of Milesko, *supra* note 164, at 5-14.

212. The Schumer bill includes consumer protection provisions patterned after NAIC model laws and New York law. Something not specifically addressed in other proposals, the Schumer bill would also prevent discrimination based upon a person's status as a victim of domestic violence, and requires a person's written consent for an HIV test. *See* Schumer bill, *supra* note 192, §§ 422, 427. The LaFalce bill would authorize the Commissioner to promulgate regulations governing unfair/deceptive practices. State licensed insurance producers also would be required to comply with several of these regulations to the extent that they are selling, soliciting, or negotiating insurance products or policies of national insurers. Therefore, the application of such regulations would not be limited to national insurers. H.R. 3766, 107th Cong. § 372 (2002).

213. *See* Schumer bill, *supra* note 192, § 422; H.R. 3766 tit. III, Subtitle F.

214. These community reinvestment requirements (CRA), similar to those set forth in the Federal Deposit Insurance Act, are addressed in the LaFalce bill only. *See* H.R. 3766 tit. III, § 372(c)(4). The inclusion of a CRA requirement in an optional federal chartering

B. National Standards Alternative

Although the need for greater uniformity and efficiency is clear, many argue that the idea of an optional federal charter would be the equivalent of throwing the baby out with the bath water.[215] Led by insurance agents and small insurers, some in the insurance industry are advocating pursuit of a national alternative to the chartering option as a more pragmatic approach to foster uniformity.[216] While such an approach is constitutional if laid out correctly, it is fraught with difficulties that may be hard to overcome. However, the idea of proposing small changes to Congress in baby steps may have some merit and be more politically feasible than a complete overhaul and substitution of the current state system. Furthermore, the real threat of preemption by imposing standards may in itself be enough to get the states to enact uniform standards themselves.

1. Theoretical Background

The national standards idea stems from the notion that Congress should intervene only to overcome structural impediments to insurance regulatory reform at the state level. The belief is that attempts to improve rather than replace the current state regulatory system could promote a more efficient and effective state regulatory framework.[217] The argument follows that using federal legislative tools on an issue-by-issue basis instead of a one-size-fits-all approach could achieve the same level of overall reform as the creation a federal regulator.[218]

The professed advantage to the national standard approach is that it could promote the establishment of more uniform standards and

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proposal is not universally supported. In fact, life insurers have stated that the CRA is not even applicable to them "because [they] are not chartered to work in specific communities." *See NARAB & Beyond*, *supra* note 115 (quoting ACLI spokesman Jack Dolan).

215. Press Release, Thomas B. Ahart, President of the Independent Insurance Agents of America (IIAA), IIAA Adopts New Policy Position on Insurance Regulation Reform (Jan. 23, 2002) [herinafter Ahart].

216. *See generally Series 3 Hearing*, *supra* note 2, (statement of Tom Ahart on behalf of the Independent Insurance Agents & Brokers of America (IIABA) and statement of the National Association of Insurance and Financial Advisors (NAIFA)); *Series 1 Hearing*, *supra* note 151 (statement of Ann Spragens, Senior Vice President and General Counsel, Alliance of American Insurers).

217. *See generally Series 3 Hearing*, *supra* note 2 (statement of the National Association of Insurance and Financial Advisors (NAIFA)).

218. Adam Wasch, *Insurance: Optional Federal Charter Plan Faces Uncertain Support, Benefits, Experts Say*, BNA DAILY REP. FOR EXECUTIVES, Jan. 21, 2002 (quoting Robert Rusbuldt, CEO of the IIAA).

streamlined procedures among the states without abandoning the state-based system that has worked for over 130 years.[219] Since 1989, the NAIC has worked to improve the regulatory system by promulgating minimum national standards for insurance regulators.[220] However, unlike Congress or the individual state legislatures, the NAIC is "institutionally incapable of achieving these kinds of reforms because the regulators lack the necessary enforcement authority."[221] In light of this reality, some argue that minimal federal standards established by Congress could expedite sluggish state reform efforts.[222] Rather than creating a single federal regulator, Congress could use a variety of legislative tools or "minimum standards" on an issue-by-issue basis to achieve the same level of reform.[223] This approach would build upon rather than dismantle the state-based system. Those pursuing this approach primarily include the individual state legislatures and insurance agent groups.[224]

2. Constitutionality of National Standards Theory

One strong point of opposition to the notion of national insurance standards is that such a concept is unconstitutional.[225] However, if such a system is set up correctly, it can clearly pass constitutional muster. The key to devising the plan is to ensure that whatever standards Congress enacts are not forced upon the states to implement themselves. Federalism principles indoctrinated within the United States Constitution maintain that

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219. Press Release, NAIC, NAIC Statement Regarding AIA Draft Proposal for Optional Federal Chartering; NAIC President Emphasizes Progress on State-Based Reforms and Commitment to Statement of Intent Initiatives (July 18, 2001).

220. Francine L. Semaya et al., *Public Regulation of Insurance Law: Recent Developments*, 29 TORT & INS. L.J. 371, 373 (1994).

221. Mazier, *supra* note 89 at 10 (quoting Leigh Ann Pusey, Senior Vice President of Federal Affairs, AIA).

222. Nicole Duran, *Independent Insurers 2-Way Regulatory Plan Criticized*, AM. BANKER, Jan. 29, 2002, at 4 (quoting Robert A. Rusbuldt, CEO of the IIAA).

223. Ahart, *supra* note 216.

224. Insurance agent groups that have gone on record supporting a national standards approach include the National Association of Professional Insurance Agents (PIA) and the Independent Insurance Agents of America (IIAA). *See PIA Reaffirms Position, supra* note 184. The National Association of Insurance and Financial Advisors (NAIFA) recently adopted a position that supports the underlying principles of state regulation of insurance but also congressional action to "improve and augment the regulation of insurance." *See* Steven Brostoff, NAIFA Backs Congressional Action on Insurance Regulation, NAT'L UNDERWRITER (October 7, 2002).

225. Interview with J. Kevin A. McKechnie, Associate Director at American Bankers Insurance Association (ABIA), in Washington, D.C. (Oct. 16, 2001) [hereinafter McKechnie Interview].

while Congress may enact laws applicable to the individual states, it is prohibited from forcing states to use their own resources to enforce those laws.[226] However, Congress may use its constitutional powers to "encourage" states to act in a manner consistent with federal standards.[227] Therefore, Congress may use its commerce powers to regulate interstate business and pass certain minimum standards for state insurance regulators to follow as long as it does not force the states to enforce those standards.

The constitutionality of the national standards approach for insurance depends upon the manner in which Congress adopts the plan. The Supreme Court held in *New York v. United States,* that Congress may use federal legislation to encourage states to adopt state legislation regulating an industry or practice in compliance with federal standards.[228] In doing so, the Court established two guidelines for Congress when it is trying to encourage states to act in a certain manner.[229] Congress may either use its spending powers to condition states' receipt of federal funds on meeting federal goals, or it may regulate private activity under its commerce power.[230] The only limitation on Congress is that the encouragement stops short of outright coercion.[231]

While dangling federal money in front of the states may entice some to adopt minimum federal insurance standards, it is more plausible that Congress' use of its commerce powers would have more of an impact. Under the Commerce Clause, if Congress chooses to regulate private

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226. *See* New York v. United States, 505 U.S. 144 (1992).

227. *See* Candice Hoke, *Constitutional Impediments to National Health Reform: Tenth Amendment and Spending Clause Hurdles*, 21 HASTINGS CONST. L.Q. 489, 538 (1994).

228. *New York*, 505 U.S. at 166-67. The *New York* case dealt with regulation of radioactive waste. In its attempt to regulate disposal of this waste, Congress enacted the *Low Level Radioactive Waste Policy Act Amendments* of 1985. 42 U.S.C. §§ 2021(b)–2021(e) (1994). The law declared: (1) that states were primarily responsible for disposing of waste within their borders; and (2) authorized states to enter into regional compacts restricting their disposal facilities' use to states that were members of the compact. *See* 42 U.S.C. §§ 2021(c)(2), (d)(2). Upon the state's challenge, two of the mechanisms given to states to comply with the law were affirmed by the Supreme Court, but the third was ruled unconstitutional. The first two were mechanisms that included: (1) using Congress' spending power; and (2) its commerce power to encourage the state to regulate in a certain way. The third mechanism was a "take title provision" which required the states to adopt laws in accordance with the federal standards on disposal or require the state to take ownership, possession and potential liability for the waste. *See New York*, 505 U.S. at 171-77.

229. *New York*, 505 U.S. at 166-67.

230. *Id.*

231. Pandozzi, *supra* note 80, at 224.

activity, it may offer states one of two choices: (1) regulating the activity according to federal standards; or (2) having federal regulation preempt state law.[232] Historically, since the time insurance was deemed part of interstate commerce, states have feared the threat of preemption the most.[233] If Congress indicates that it will preempt any state law not in conformance with a national insurance regulation standard, states will have a strong incentive to follow the national standards and will likely choose to adopt and enforce them of their own free will.[234] As long as states are not compelled to adopt the standards, a national standard approach to insure regulation will most likely pass constitutional muster.

3. Issues Ripe for National Standards

The requirements and focus for a national standards approach differs greatly from the optional federal charter. Concerns over efficiency and greater uniformity are addressed on an issue-by-issue basis instead of a comprehensive overhaul of the old system. A successful and effective national standards approach to insurance regulation, however, needs to address the priority issues for both insurance companies and agents. These issues primarily include producer licensing, rate and form filing otherwise known as speed-to-market issues, and other company issues such as company licensing, transaction review, corporate governance, solvency standards, financial audits, and market conduct examinations.[235] The NAIC and individual state legislatures have already taken action on many of these issues with the goal of achieving greater efficiency and uniformity of regulation.[236] National standards in these areas, along with continued improvements in state regulation, may very well obviate much of the interest in a federal optional insurance charter.

a. Producer Licensing

Producer licensing has drawn considerable attention in the last few years as an area of insurance regulation wrought with inefficiency and in desperate need of substantial reform. All agents and brokers (producers) must be licensed in every state in which they conduct business and must

232. *New York*, 505 U.S. at 173-74 (citing Hodel v. Va. Surface Mining & Reclamation Ass'n, Inc., 452 U. S. 264, 288 (1981).

233. Hennosy Telephone Interview, *supra* note 28.

234. *Id.*

235. Wasch, *supra* note 172.

236. Kathleen Sebelius, NAIC President, *Managing the Winds of Change: Issues Facing the NAIC in 2001*, J. INS. REG., Apr. 1, 2001.

comply with different and often inconsistent standards and duplicative licensing processes.[237] This is deemed very cumbersome and inefficient and is seen within the insurance industry as anti-competitive.[238]

The issue has garnered so much attention that Congress included a provision in the GLBA requiring a majority of states to streamline producer licensing standards.[239] Congress will establish the National Association of Registered Agents and Brokers (NARAB) to enact reciprocal or uniform agent/broker licensing standards if the states do not accomplish this on their own within the specified time frame.[240] NARAB would be a semi-autonomous body managed and supervised by state insurance commissioners with the power to set and, more importantly, preempt certain state standards in order to create a national licensing standard for insurance.[241] If the required number of states are unable to comply by the set deadline, NARAB will set out to overhaul the nation's licensing system with authority to set and preempt certain state insurance standards for agency licensing.[242]

The issue of producer licensing is ripe for national standards. Almost all the parties involved in this regulation agree that the duplicative regulatory requirements impose an unnecessary cost on commercial insurers and consumers with multi-state insurable risks.[243] While the NAIC predicts that NARAB will be prevented because the states have met the required threshold, a universal uniform licensing standard remains elusive as a number of large states have not adopted the NAIC standards.[244] As such, to adequately address the issues surrounding producer licensing, Congress may need to intervene again and adopt a uniform minimum federal licensing standard that would be effective in all fifty states.

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237. Joel Wood, Council of Insurance Agents and Brokers, *Broker Organizations*, *in* OPTIONAL FED. CHARTERING AND REGULATION OF INS. COMPANIES 168 (Peter J. Wallison ed., 2000).

238. *Id.*

239. *See generally* GLBA, *supra* note 5, §§ 321-336; 15 U.S.C. §§ 6751-6766.

240. Wood, *supra* note 238, at 169.

241. Sinder, *supra* note 54, at 80.

242. GLBA, *supra* note 5, §§ 321-336; 15 U.S.C. §§ 6751-6766.

243. Wood, *supra* note 238, at 168.

244. *See* NAIC website, *at* http://www.naic.org/GLBA/narab_wg/PLMA.htm (last visited Nov. 9, 2002). As of August 20, 2002, the NAIC reports that forty-seven states have enacted legislation or adopted regulations seeking to satisfy the reciprocity requirements set forth in GLBA. New York, Pennsylvania and New Mexico are among the larger states that have not yet adopted reciprocal producer licensing laws or regulations. *Id.*

b. Rate and Form Filing—Speed-to-Market

Another area ripe for some form of national standard involves the speed-to-market problem. One of the most predominate complaints about the current regulatory system is that the slow and often burdensome and duplicative system for getting new products to market is anti-competitive and places U.S. insurers at a considerable disadvantage.[245] Most states require insurers to file new rates and forms with the state insurance commissioner and obtain formal regulatory approval before introducing them in the marketplace.[246] Accordingly, an insurer wishing to introduce a new product nationally may be forced to seek approval in up to fifty-five different jurisdictions.[247] Needless to say, this process can be intensive, time-consuming and create unnecessary costs and delays that inevitably slow the speed at which an insurer is able to get a new product into the market—hence the "speed-to-market" title.

Like the issue of producer licensing, the emergence of speed-to-market regulation was propelled in part by enactment of the GLBA and the resulting increasing competition from bank entry into the insurance market.[248] A recent ACLI survey of life insurance company chief executive officers identified speed-to-market issues as the "most-needed reform."[249] Some liken the speed-to-market problem as the primary threat to the viability of the United States insurance market.[250] The delay from rate and form approvals that are not required of other federally-regulated financial services industries places a daunting challenge on insurers to remain competitive.[251] Insurers argue that these speed-to-market issues, including current price and product controls among the fifty states, discourage product innovation and competition.[252]

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245. *Improving Insurance Hearing, supra* note 100 (testimony of Robert Mendelsohn, Group Chief Executive of Royal & Sun Alliance on behalf of the American Insurance Association (AIA)).

246. *See* Macey, *supra* note 39, at 80-83.

247. An insurer seeking to sell a product in all fifty states and five U.S. territories would have to file separate applications and seek approval from every state/territory respectively. *See* Davidson, *supra* note 1.

248. Gach, *supra* note 91.

249. *Id.*

250. *Improving Insurance Hearing, supra* note 100, at 1 (statement of Drayton Nabers, Jr., on behalf of the American Council of Life Insurers).

251. *Improving Insurance Hearing, supra* note 100, at 2 (testimony of Robert Mendelsohn, Group Chief Executive of Royal & SunAlliance on behalf of the American Insurance Association (AIA)).

252. *Id.*

The national standard solution for speed-to-market issues must strike a balance between timely and quality reviews and appropriate consumer protections. Making the system more market-oriented, faster, and creating greater accountability would enable insurers to gain an equal footing with their competitors in other financial services industries. This could be accomplished through state cooperation or national standards dictating the maximum time state regulators may take before approving/rejecting new insurance products.[253] The NAIC is currently working on how to integrate multi-state regulatory processes with individual state regulatory requirements.[254] Negotiations are also underway to create an NAIC-endorsed interstate compact that would facilitate the approval of insurance products by a single entity for use in all insurance jurisdictions.[255] The interstate compact would be a voluntary agreement among states to address issues of mutual interest affecting all participants.[256] Opponents of the optional federal charter believe the compact initiative would allow insurers to obtain speed-to-market without sacrificing the established state-based regulatory framework.[257]

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253. *See generally Series 1 Hearing, supra* note 151, at 46 (statement of Ann Spragens, Vice President and General Counsel, Alliance of American Insurers).

254. Sebelius, *supra* note 237, at 396-401. In order to meet the challenges of direct competition with other financial services industries, the NAIC has developed two distinct plans. It has developed for life and health insurance products initially, the Coordinated Advertising, Rate and Form Review Authority (CARFA) to create a single point of filing and review, national standards for insurance products, and an efficient state-based procedure for processing the filing. *See* NAIC CARFRA website, *at* http://www.carfra.org (last visited Nov. 9, 2002). The NAIC hopes to expand the program to certain property and casualty products in the future. As of June 2002, there are currently only twenty-two states participating in CARFA. *See* NAIC CARFRA website, *at* http://www.carfra.org/participating_states.htm (last visited Nov. 9, 2002).

The other plan was developed by the NAIC Improvements to State-Based Systems Subgroup of the NAIC Speed to Market Working Group. It is to address product filings that will remain subject to state-based filing and review by developing a set of recommendations for operational efficiencies and regulatory efficiencies. *See* Sebelius, *supra* note 237, at 396-401.

255. *See Series 1 Hearing, supra* note 151, at 2 (statement of Wayne F. White, President & Chairman of Home Mutual Fire Insurance Company on behalf of the National Association of Mutual Insurance Companies (NAMIC)).

256. Bill Anderson, Vice President and Association General Counsel, and Michael Gerber, Association General Counsel, National Association of Insurance and Financial Advisors (NAIFA), *Speed to Market: NAIC Proposes an Interstate Agreement to Streamline Approval of Insurance Products*, NAIFA ADVISOR TODAY, July 2002, at 69.

257. *Id.*

A major problem with relying solely on state cooperation is that compliance with the NAIC-developed programs remains voluntary and the programs are not appropriate for all lines of insurance. As one former insurance commissioner stated, "[i]t's one thing to get fifty different commissioners to agree to one thing in one point in time and another to get 50 different state legislators to agree with 50 different commissioners."[258] In the end, the NAIC may only propose important changes. It is up to the fifty state legislatures, the District of Columbia and the U.S. territories to adopt these recommendations, which has proven almost impossible to achieve.[259] This leaves much to be desired in the search for a solution to the speed-to-market problem.

Given the uncertainty and improbability of complete state cooperation, Congress could intervene and establish minimum federal standards designed to increase the speed in which insurance products get into the marketplace. There may not be much chance to get complete uniformity on speed-to-market issues because the state markets are so different.[260] However, a modest level of rate and form regulation from the federal level may well be perceived as desirable in many states.[261] Given this possibility, the speed-to-market issue is ripe for some federal involvement designed not to upset the current regulatory structure, but to improve its efficiency.

As such, Congress could enact a set of federal standards that would imitate the current rate and form approval process that national banks currently use by limiting the time states have to review and approve rates and forms. This approach would not disrupt the current requirement that forms be filed in every state the product is offered, but would ensure that potential new products are not kept from the market because of never-ending bureaucratic red tape. Congress could also implement standards, like those already developed by the NAIC and in use by an overwhelming majority of states, dictating the use of electronic filing to improve the efficiency of speed-to-market issues.[262] Since much of the motivation

258. Gach, *supra* note 91 (quoting Glenn Pomeroy, former North Dakota Insurance Commissioner and former NAIC President).

259. *Series 1 Hearing*, *supra* note 151, at 5 (statement of Steve Bartlett, CEO, The Financial Services Roundtable).

260. Miram Eljas, *Insurance Products: Vaughan-States Need Regulatory Consistency*, AM. BANKER, Oct. 16, 2001, at 17A.

261. *Series 1 Hearing*, *supra* note 151, at 7 (statement of Ann Spragens, Vice President and General Counsel, Alliance of American Insurers).

262. In the early 1990s, the NAIC designed the System for Electronic Rate Form and Filing (SERFF). The SERFF system is designed to enable companies to send and states to

behind a federal charter is based upon the competitive disadvantage insurers face getting products to the market, if Congress is able to pass uniform standards addressing this issue directly, it may eliminate much of the push among insurers for a federal charter.

c. Company Issues—Licensing, Reviews, Governance, Solvency Standards

In order to effectively reform and streamline the regulatory process, companies also need a single set of requirements dealing with company licensing, reviews, governance, and solvency standards. Most of these issues are ripe for some form of national standard because they directly impact a company's bottom-line and its ability to remain competitive. In every state in which they do business, insurance companies must satisfy a variety of solvency and governance requirements and go through multiple reviews of proposed corporate transactions and audits.[263] This requisite compliance in multiple states creates delays and adds unnecessary costs without adding any tangible consumer benefit.[264] National standards governing these issues could help reduce the regulatory burden on companies and improve upon their efficiency, particularly with regards to licensing and market conduct examinations. However, similar "race to the bottom" concerns may arise in this situation as with producer licensing. Individual state insurance departments will most likely also be hesitant to accept licensing, solvency, and auditing determinations made by another states.[265]

The complexities surrounding solvency issues require greater scrutiny and probably would not lend themselves to national standards. While

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receive, comment on, and approve or reject insurance industry rate and form filings. *See* National Association of Insurance Commissioners, System for Electronic Rate and Form Filing, *at* http://www.serff.org/information/SERFF-Background.htm (last visited Nov. 9, 2002). The states currently licensed to use SERFF and actually accepting filings include: Alabama, Alaska, Arizona, Arkansas, California, Colorado, Connecticut, District of Columbia, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Montana, Nebraska, New Hampshire, New Jersey, New Mexico, New York, North Carolina, North Dakota, Nevada, Ohio, Oklahoma, Oregon, Pennsylvania, South Dakota, Tennessee, Texas, Utah, Vermont, Wisconsin and Wyoming. National Association of Insurance Commissioners, System for Electronic Rate and Form Filing, *at* http://www.serff.org/participation/states/index-states.htm (last visited Nov. 9, 2002).

263. *Improving Insurance Hearing, supra* note 100, at 3 (testimony of Ronald A. Smith on behalf of the IIAA).

264. *Id.*

265. McKechnie Interview *supra* note 226.

arguably financial oversight is a regulator's most important role, history shows the reality is that this regulatory oversight will on occasion fail.[266] Regulation in this area must contemplate the financial risks at stake if insurer solvency is not sufficiently regulated and companies become financially unstable.[267] In light of problems surrounding the savings and loan crisis in the 1980s, concerns about possible strains on the insurance guaranty system and need for bailouts must be dealt with before any overhaul of this area of regulation.[268]

Since the insurance industry has also suffered periodic failures, the safety net function of the state guaranty system is critical.[269] Most all parties agree that the state guaranty fund system is one aspect of state insurance regulation that has worked extremely well.[270] The existing state guaranty fund system operates in accordance with local statutory provisions that vary according to the insurance market conditions in each state.[271] When an insurer is declared insolvent, the guaranty fund steps in and acts as the insurer, processing and paying claims according to state statutes, local conditions, and state tort and contract law.[272] Many argue that any federal charter option would undermine state coverage terms and rules and could threaten the assessment capacity of the state funds if companies at

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266. *Series 2 Hearing*, *supra* note 63, at 16 (statement of Tony Nicely, Chairman, President & CEO, GEICO Insurance Companies on behalf of the National Association of Independent Insurers (NAII)).

267. Hennosy Telephone Interview, *supra* note 28.

268. The original savings and loan (S&L) charter restricted thrift institutions to making long term mortgage loans and accepting short-term deposits. *See* Dan Goldwasser, *The Liability Ramifications of the S&L Crisis (Savings and Loan)*, CPA JOURNAL ONLINE (Jan. 1990), *available at* http://www.nysscpa.org/cpajournal/old/08135520.htm (last visited Nov. 9, 2002). When rising inflation and interest rates began to pose a serious threat to the thrift industry, Congress relaxed regulations and introduced legislation intended to make federally chartered S&Ls more competitive. *Id.* The deposit insurance cap was increased, restrictions on the use of brokered deposits were loosened, and thrifts were allowed to expand their portfolios. *Id.* Backed by federally guaranteed deposits, many thrifts invested in risky commercial real estate ventures. *Id.* After many of these investments failed, the government was forced to seize and liquidate insolvent thrifts and organize an S&L bailout. A number of S&L operators were prosecuted for engaging in fraudulent lending practices. *Id.*

269. *Series 2 Hearing*, *supra* note 63, at 16 (statement of Tony Nicely, Chairman, President & CEO, GEICO Insurance Companies on behalf of the National Association of Independent Insurers (NAII)).

270. *Id.* at 18.

271. *Id.* at 17.

272. *Id.*

the federal level were exempted from assessment at the state level.[273] As such, even among the charter supporters, many are very "skeptical of any federal intervention that would abolish or modify the state guaranty fund system."[274]

d. Market Conduct Examinations

Although not a major issue, the fact that insurers are subject to examination from multiple state insurance departments denotes another area of inefficiency that may be ripe for a national standard solution. States argue that they are better positioned than the federal government to accommodate the changing needs of the industry, and that they are best suited to reform the current system while still ensuring continued adequate consumer protection.[275] As such, each state has its own requirements and standards that insurers and producers must meet, some of which are much more stringent than others and include multiple market conduct examinations throughout the year.[276] Unfortunately for insurers, these examination requirements often leave open-ended costs such as salaries, meals and lodging that are charged to the companies.[277] The lack of uniformity often results in duplicative and costly processes, which could be avoided with some form of national standard.

Market conduct, however, directly involves consumer protection issues and as a result, involves sensitive political positions not likely to be ceded to another state.[278] A possible solution to this inefficiency would be national standards for examination procedures. Congress could adopt a market regulation program that would rely on existing market data to reveal performance deviations rather than the varying open-ended market conduct examinations currently in existence throughout the states.[279] Congress could also set the maximum number of times a year that an insurer could be subject to examination, and dictate that in non-resident states examinations

273. *Id.* at 18.

274. *Id.*

275. Press Release, NAIC, NAIC Officers Emphasize Continued Focus on State-Based Reforms and Statement of Intent Initiatives (Apr. 17, 2001).

276. *See Series 1 Hearing*, *supra* note 151, at 13 (statement of Wayne F. White, President & Chairman of Home Mutual Fire Insurance Company on behalf of the National Association of Mutual Insurance Companies (NAMIC)).

277. *Id.*

278. Hennosy Telephone Interview, *supra* note 28 (on file with the author).

279. *See Series 1 Hearing*, *supra* note 151, at 13 (statement of Wayne F. White, President & Chairman of Home Mutual Fire Insurance Company on behalf of the National Association of Mutual Insurance Companies (NAMIC)).

may be conducted only to review compliance with properly promulgated statutory and regulatory requirements. If states refuse to comply they would be preempted by federal statute.

IV. THE ALTERNATIVE: LIMITED PREEMPTION

There is no question that the insurance market has evolved to the point that state regulation of insurance needs to become more efficient and coordinated.[280] The question is whether this need warrants or requires federal government intervention in a state regulatory system that has survived on its own through decades of change and national emergencies. The current state-based system has not resulted in any market failure.[281] It is fraught, though, with inefficiencies that can no longer be ignored. Achieving reform, however, will depend both on the details of the solution and the political dynamics surrounding the issue.

The federal chartering option and the national standards approach each fail to adequately address the political realities surrounding implementation of the respective approaches. The chartering proposal makes logical sense in banking terms, but involves a complete regulatory overhaul of a fundamentally different insurance market.[282] If GLBA is a good example, this could take over a decade to enact.[283] The piecemeal approach in the national standards theory avoids complete overhaul problems but opens up a whole new can of worms with regard to federalism and federal preemption.

The central and most prominent issue fueling both of these reform proposals surrounds insurers' fear of being at a competitive disadvantage in the new market. Particularly of concern for insurers are the delays and duplicative cumbersome hassles they face over producer licensing requirements and speed-to-market issues consisting of rate, form, and

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280. *Iowa Commissioner*, *supra* note 159.

281. Interview with Professor Norman Gillespie, George Mason University School of Law, in Arlington, VA. (Jan. 23, 2002), (on file with the author).

282. *See Series 2 Hearing*, *supra* note 63, at 25 (statement of Tony Nicely, Chairman, President & CEO, GEICO Insurance Companies on behalf of the National Association of Independent Insurers (NAII)).

283. On November 4, 1999, in a speech on the Senate floor leading up to final passage of the GLBA, then Senate Majority Trent Lott stated "I have heard this financial services modernization issue discussed for my entire career in the Congress, which is now up to twenty-seven years. It has been tried by Republicans, by Democrats in the Congress, House and Senate, administrations of both parties. It never quite occurred." *See* 145 CONG. REC. S13883 (daily ed. Nov. 4, 1999).

product approval requirements. If these limited issues can be adequately addressed, either by the states themselves or by Congress, the push for a federal charter will likely diminish. However, given the current track record of the states, federal action will be required to implement the reform that insurers need. Instead of a federal charter or national standards left to the states to enact, federal preemption of state law with respect to these limited issues is the most likely solution that could adequately address the needs of insurers and survive politically.

A. Dual-Charter Concept is Overrated

Proponents of the federal chartering option simply assume that an optional insurance federal charter will prove as successful as the dual banking system without providing adequate reasoning for this assumption.[284] The problems that consumers face with insurance are different than those consumers face with banking.[285] It should not be assumed that regulatory models for these types of situations will work in the insurance arena.[286] State law almost always mandates insurance coverage, whereas consumers are not required to utilize banking services.[287] This fact may or may not play a role in regulation reform, yet this remains a fundamental difference that should be explored before one can take the position that the two systems will work the same.

While the insurance industry is slowly joining forces with the banking industry in the push for an optional federal insurance charter, it is not really a complete overhaul that insurers want. A NAIC working group study concluded that the motivation for change within the industry is dependent upon whether or not insurers faced direct competition from other financial services industries.[288] In fact, many insurance companies doing business in the U.S. have indicated that they would choose to remain state regulated even if a federal option became available.[289]

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284. *See generally, Series 1 Hearing, supra* note 151 (statement of Steve Harter on behalf of the National Association of Professional Insurance Agents (PIA)).

285. Patrick C. Moore, Editorial, *New York Agent Group Opposes Dual Charter Proposals*, NAT'L UNDERWRITER, Sept. 10, 2001, *available at* http://www.nunews.com (last visited Nov. 9, 2002).

286. Eljas, *supra* note 261, at 15A.

287. *See generally, Series 3 Hearing, supra* note 2, at 3 (statement of Tom Ahart on behalf of the Independent Insurance Agents & Brokers of America (IIABA)).

288. Sebelius, *supra* note 237, at 397.

289. ACLI Press Release, *supra* note 153 (quoting ACLI Board Chairman Joe Gasper, President and COO of Nationwide Life Insurance Co.).

Enactment of a federal chartering option will face tremendous political hurdles that will delay needed reforms. There are too many factors to be addressed and not enough political motivation to secure enactment. Most agree that this type of comprehensive legislation will not be enacted within the next few years, and in fact could take over a decade for Congress to sort through all the technical details.[290] As a representative from the Alliance of American Insurers recently noted, the issue of federal chartering is not likely to be warmly received in Congress given the macroeconomics of the industry.[291] Even the problems involving insurance availability after the September 11th terrorist attacks on the World Trade Center and the Pentagon did not provide much political motivation for Congress to jump start this debate.[292] This wait on congressional action is no better than waiting on the states to act. While Congress may ultimately enact the dual-charter approach, insurers are left in the meantime at a competitive disadvantage without any relief in sight.

There is also no guarantee that the industry will like the final insurance chartering product that Congress might ultimately adopt. The political reality is that the ideal alternative always looks better than what results at the end of the legislative process.[293] As one state insurance commissioner recently stated, proponents of the federal charter "are trying to pull the plug

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290. Steven Brostoff, *Federal Charter Law Passage Seen As Unlikely This Year*, NAT'L UNDERWRITER, Jan. 28, 2002, at 14-16.

291. *Id.* at 16 (quoting David Farmer, Senior Vice President of Federal Affairs, AAI).

292. There is serious concern within the insurance industry and some in Congress that the unavailability of terrorism insurance coverage after the September 11, 2001 terrorist attacks will have detrimental impacts on the economy because lenders will refuse to invest in new development. *See e.g.*, Joseph B. Treaster and Leslie Eaton, *Insurance Could Largely Shape the City's Economic Future*, N.Y. TIMES, Oct. 15, 2001, at F1; Jackie Spinner, *Insurance Aid Plan Takes Shape: Parties Split on Repayment to U.S. For Terrorism Coverage*, WASH. POST, Nov. 8, 2001, at A4; Editorial, *How to Insure Terror*, WASH. POST, Nov. 6, 2001, at A22.

The insurance industry faced total loss estimates of nearly $70 billion after the terrorist attacks. While quick to assure Congress and the public that the industry has sufficient reserves to ensure all claims are paid, it told Congress in numerous hearings that it could not survive another attack without some form of federal backstop to cover future losses. The new realities of terrorism make it impossible for insurers to calculate their risks. As a result, reinsurers, who provide insurance for primary insurers, began withdrawing from the market on January 1, 2002, refusing to provide terrorist insurance coverage. *See e.g. Insurers: Gov't Must Help on Attacks*, N.Y. TIMES, Oct. 22, 2001, at A1; Jackie Spinner, *Insurers ask to end Terrorism Coverage*, WASH. POST, Nov. 16, 2001, at E1.

293. Dennis Kelly, *New York Life's Sternberg: Favors Reform Over Federal Regulation*, BEST'S REVIEW, Apr. 2002, at 113 (quoting Sy Sternberg, President of New York Life Insurance Co. and former ACLI Chairman).

out of the bottle, thinking a genie will emerge, but the genie will take on a life of its own and will not necessarily grant the wishes that they want."[294] Furthermore, once Congress does take up the idea, there is nothing to stop the federal government from jumping in with both feet and imposing a mandatory federal insurance regulatory system.[295]

B. National Standards: More Than Meets the Eye

The national standards approach does not fare much better when it comes to securing the necessary reforms in a fairly short time frame. In order to withstand a constitutional challenge, the national standards approach would require that the states choose to and actually enact legislation adopting the standards. This could take years. Furthermore, any national standards proposal would require Congress to figure out what to do with those states that refuse to enact laws adopting the standards. This opens a whole new can of worms which could also take years to sort through. There are solutions other than creation of a federal regulator, such as creating a new self-regulator organization (SRO) with enforcement authority, or even giving the NAIC similar powers to act like a SRO. However, creating this type of structure involves numerous factors that would take Congress years, if done correctly, to put together an effective governing system.[296]

One possibility under the national standards theory would be to follow a regulatory structure similar to that applicable to corporate America. One manner in which to do this would be for Congress to enact a "single license" standard similar to that used in the European Community's ("EC") open passport system of insurance regulation.[297] In the EC, once an insurance company establishes a principle host country with the EC, it may conduct its business in any EC member country without obtaining additional licenses or being subjected to additional rate and product approval.[298] To achieve a similar system in the United States, Congress would need to preempt state licensing laws and require states to grant

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294. *Iowa Commissioner*, *supra* note 159 (quoting Frank Fitzgerald, MI Financial and Insurance Services Commissioner).

295. *Federal Chartering Proposals put Chaos Theory to the Test*, NAT'L UNDERWRITER, Feb. 28, 2002.

296. *See* Douglas C. Michael, *Federal Agency Use of Audited Self-Regulation as a Regulatory Technique*, 47 ADMIN. L. REV. 171, 191-203 (1995).

297. Guy Soussan, *New EU Access Rights vs. Local Interference*, Remarks at a Regional Roundtable on Insurance Conditions, New York City, N.Y. (May 4, 1995).

298. *See Series 2 Hearing*, *supra* note 63 (statement of Paul Mattera, Sr. Vice President & Chief Public Affairs Officer, Liberty Mutual Group).

licenses to nonresident agents and brokers if they are already licensed in good standing in their home states.[299] Congress would also have to preempt all rate and form regulations.[300] While this may sound simple, the fact that the EC does not yet have a truly unified insurance regulatory system highlights the real complexities involved in such a solution.[301] In fact, insurance companies in the EC remain subjected to non-rate and form regulations of the member countries in which they do business, including local financial, accounting, and tax rules.[302]

Further discrediting this idea is that such a home state rule system could create pressure for states to establish lenient requirements in order to attract more resident licensees.[303] This "race to the bottom" approach could be detrimental to the goal of fair and responsible regulation and would require state insurance commissioners to give up some aspects of their regulatory authority and discretion.[304] Given the political realities of state insurance regulation, where many insurance commissioners have aspirations for higher political offices themselves, it is not likely that state regulators will give up this powerful position willingly.

There is something to be said, however, for directing the focus of reform onto specific issues rather than overhaul of the entire regulatory structure. A piecemeal approach to reform, as that advocated in the national standards theory, is much more likely to get congressional results.[305] As evidenced with the issue of producer licensing, Congress has shown its willingness and ability to address issues that are deemed to be serious impediments to efficiency and competition.[306] As such, it may be politically feasible for insurers to achieve their desired reforms by approaching Congress, not with an overall comprehensive restructuring of

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299. This would also address the competitive advantage that non-U.S. based insurers have over domestic insurers. Because of trade agreements, foreign insurers often have an advantage over U.S. insurers because the foreign insurers can receive approval from a port-of-entry state, and other state insurance departments rely on that to allow the foreign insurer to conduct business. However, U.S. insurers must still comply with the rules and regulations of every individual state they wish to do business. Wood, *supra* note 238, at 168.

300. *See Series 2 Hearing*, *supra* note 63 (statement of Paul Mattera, Sr. Vice President & Chief Public Affairs Officer, Liberty Mutual Group).

301. *Id.*

302. *Id.*

303. Allen Interview, *supra* note 110.

304. *Id.*

305. Interview with Scott A. Sinder, Partner, Collier, Shannon, & Scott, LLP, in Washington, D.C. (Jan. 26, 2002).

306. *See* NARAB discussion, *supra* Part III.B.3.a.

the regulatory system, but with a plan to address a limited number of issues.

C. Limited Preemption is the Ticket

The most effective means to satisfy the primary concerns involving insurance regulation may be limited federal preemption of state insurance laws. Insurers seem to be most concerned about the competitive disadvantage they face as a result of changes in the insurance and financial services national and international markets.[307] Specifically, as previously mentioned, the areas of producer licensing and speed-to-market issues appear to pose the greatest competitive threat for insurers. Enacting minimum federal standards through limited federal preemption would create a floor of standards that each state regulator would be required to comply.[308] This would avoid the overarching and unnecessary creation of a new federal bureaucracy and the continual delay and uncertainty surrounding requiring state enactment of such standards.

The objective goal for reform should be to remove the unnecessary and burdensome requirements and apply principles of consistency and efficiency to insurance regulation.[309] As one insurance industry executive stated, "cumbersome regulatory burdens in the area of licensing should be eliminated or substantially alleviated" and "the regulatory structure should permit insurance products to compete on an equal regulatory footing with the products offered by other financial services providers, emphasizing speed-to-market as well as uniformity and consistency of regulation."[310] This two-fold approach to reform can only be achieved with congressional assistance. However, such assistance should be limited to addressing the most pressing issues burdening the industry while giving the states within the existing insurance regulatory system the opportunity to step up to the plate and reform the remaining issues of concern.

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307. *See generally Series 3 Hearing*, *supra* note 2 (statement of Glen J. Milesko, Chairman of Banc One Insurance Group on behalf of ABIA); (statement of John L. Van Osdall, Chairman of the Counsel of Insurance Agents & Brokers); *Series 2 Hearing*, *supra* note 63 (statement of Joseph Gasper, Chairman, ACLI); *Series 1 Hearing*, *supra* note 151 (statement of Steve Bartlett, CEO Financial Services Roundtable).

308. Macey, *supra* note 39, at 46.

309. Allen Interview, *supra* note 110.

310. Interview with David A. Winston, Vice President-Government Affairs, the National Association of Insurance and Financial Advisors (Aug. 29, 2002).

It is true that preemption questions can be both politically and substantively difficult.[311] However, preemption in this situation could prove attractive to the insurance industry. Similar to the preemption model involving federal thrift charters, Congress could preempt the entire field of state law relating to issues of producer licensing and rate/form/product approval, creating a national standard for compliance in these areas.[312] This approach would provide the needed uniformity without requiring insurers to wait on the states to opt-in and participate.

While preemption may seem at first to be a drastic solution, in this situation, limited preemption surely beats the alternatives. The optional federal charter solution would require a comprehensive overhaul of the current system. While it may not replace the existing state insurance system, it would require Congress to design a completely new federal bureaucracy. This is a drastic plan unequated to the problem it would attempt to solve.[313] The national standards alternative would not require such drastic measures but could not ensure that states would actually enact the national standards.[314] While the NAIC is working on efforts to address these issues, without some form of federal incentive or threat, it is highly unlikely that anything substantive will result of these efforts. The states have historically proved that they are unable to enact truly uniform insurance standards in a reasonable period of time.

Given existing constitutional constraints, preemption is the only viable political solution that poses the most likely chance for enacting needed reforms in a reasonable time. Admittedly, the preemption alternative suggested here involves significant factors not fully addressed in this paper. Such factors include the scope and nature of the preemption and the nature to which the federal government will be involved in enforcement of the preempted areas of insurance regulation. Nevertheless, it is not only reasonable but also politically feasible to believe that if the industry develops a plan addressing speed-to-market issues and, if needed, producer licensing issues not adequately addressed by the NARAB threat, Congress will react favorably to the industry's concerns. Federally dictated standards in these areas could allow companies to operate more efficiently on a nationwide basis and help cement relations with their existing insurance

311. Robert C. Eager & Cantwell F. Muckenfuss, *Creating Federal Insurance Regulation: A Zero-Based Approach*, *in* OPTIONAL FEDERAL CHARTERING AND REGULATION OF INSURANCE COMPANIES 153(Peter J. Wallison ed., 2000).

312. *Id.* at 156.

313. *See* Optional Federal Charter discussion, *supra* Part III.A.

314. *See* National Standards discussion, supra Part III.B.

customer base. Once the details are worked out, preemption in this sense would improve insurers' competitive position, in that upon enactment, insurers will have a guaranteed set uniform national standards instead of being left waiting in the wings while the individual states decide whether to participate.

While historically bucked by the states, preemption does not have to be a bad thing. Preemption does not automatically mean that the federal government will come in and usurp all state jurisdiction and authority over a particular issue. Congress could transfer power to administer limited new standards from the state insurance regulators to a federal entity or person. In this case, the most logical choice would be for the Secretary of Treasury to assume the powers to ensure state compliance with the federal standards.[315] In this limited preemption proposal, however, the Secretary of Treasury would be given only limited authority to ensure compliance of only the specific areas of insurance dictated by Congress. The remaining sectors of insurance would remain regulated by the states.

There is also another path that Congress could take in this limited preemption approach. In GLBA, Congress provided the states with a mechanism designed to preserve the historic role they play in the field of insurance regulation while still ensuring state compliance with minimum national consumer privacy protection standards.[316] Congress gave the states authority to regulate and control consumer insurance privacy standards despite the fact that insurance is ripe for federal preemption.[317] With regards to GLBA's consumer privacy standards, state insurance regulators are empowered to enforce state privacy standards that are consistent with the federal standards set forth in GLBA.[318] However, if the state's insurance regulator fails to adopt privacy regulations that carry out Title V of GLBA, then Congress will preempt inconsistent state banking consumer protection regulations.[319] In this sense, Congress does not force states to enforce the GLBA consumer insurance privacy standards, but uses

315. The federal agency most referred to as the default federal insurance regulator is the Department of the Treasury. All three optional federal chartering proposals currently being circulated, and the Schumer and LaFalce chartering bills, would establish a federal insurance regulator under the oversight of the Secretary of the Treasury. *See* ABIA Press Release, *supra* note 178.

316. Under Title V of the GLBA, if a state privacy statute or regulation is inconsistent with provisions in Title V, then the state law will be preempted, but only to the extent of the inconsistency. *See* GLBA, Pub. L. No. 106-102, 113 Stat. 1338, at §507(a).

317. Pandozzi, *supra* note 80, at 231.

318. *Id.* at 211.

319. *Id.* at 216-17.

its preemption power over state banking law in order to influence the state's policy choices with regards to insurance law.[320] Congress could have preempted all state insurance consumer protection laws, but instead adopted an alternative scheme allowing states to continue their regulation of the business of insurance.[321]

A similar method could be utilized to deal with the issue of speed-to-market and producer licensing preemption. Congress could preempt state insurance laws dealing solely with producer licensing issues and rate/form/product approval regulation, but defer to the state insurance regulators to enforce the standards. While not directly forcing state insurance commissioners to enforce these limited standards, Congress could put pressure on the states to voluntarily comply or face federal preemption of more or even all state insurance laws. This of course, would leave Congress with the task of determining what other areas of law it might preempt and similar formation problems that would arise under a federal charter option. It may, however, be the very threat that states need to ensure enactment of laws equivalent to the licensing and speed-to-market standards that Congress enacts.

CONCLUSION

While the insurance industry is slowly joining forces with the banking industry in the push for an optional federal insurance charter, it is not really a complete overhaul that insurers want. If the central issues surrounding producer licensing and speed-to-market regulation are adequately addressed, it may very well take the wind out of the sales behind the push for a federal charter from the insurance industry. The current state "system of command and control" does not allow the insurance industry to respond to the market or the consumer rapidly, thus making it cumbersome and anti-competitive.[322] The most logical and immediate solution to this problem is for Congress to preempt the duplicative, unnecessary, and cumbersome laws dealing with producer licensing and speed-to-market issues, and replace them with national standards designed to increase efficiency and ensure uniformity in these areas. While admittedly, there are no simple answers as to how to effectively reform the insurance regulatory system, this limited preemption approach would appear to be the

320. *Id.* at 231.

321. *Id.*

322. *Iowa Commissioner*, *supra* note 159 (comments of the American Bankers Association).

most direct and least comprehensive approach with the most promise of getting regulatory relief to insurers in the foreseeable future.

FROM THE JOURNALS: INSURANCE LAW ABSTRACTS

Edited by Tatiana Connolly

AUTOMOBILE INSURANCE

J. David Cummins, Richard D. Phillips & Mary A. Weiss, *The Incentive Effects of No-Fault Automobile Insurance*, 44 J.L. & ECON. 427 (2001).

Through theoretical and empirical analysis, this Article analyzes the effects of no-fault automobile insurance on fatal accident rates and concludes that no-fault automobile insurance is more closely associated with fatal accidents than tort.

The theoretical analysis of the Article builds upon past no-fault automobile insurance research. Past research has argued that no-fault automobile insurance, which is generally composed of compulsory first-party insurance for personal injuries and restrictions on the right to sue when involved in an automobile accident, reduces incentives to drive carefully and leads to more accidents. To more thoroughly evaluate this hypothesis, the Article evaluates the impact tort restrictions have on accident rates by closely using and analyzing the effects of care levels on accident rates and negligence probabilities, evaluating expense loading effects and assessing the impact experience rating has as an incentive device. The Article then creates a model to evaluate the hypothesis and sets forth the structure and assumptions of the model. To test no-fault and incentives in the model, the level of care is used as the only variable. By varying the level of care in this model, the authors find that the effect of tort restrictions, as restrictions on the motorists' ability to sue, on incentives to drive carefully are ambiguous, but that more accidents are likely to occur with no-fault insurance providing negligence or responsibility assignment and premium rates are sensitive and responsive to care levels. The study further finds, however, that the potential effect of higher accident rates from no-fault plans may be diminished by better experience-rating plans.

Next, the Article empirically evaluates the effects of no-fault on accident rates. To test this, the authors use dummy variables to create a no-fault state, estimate the proportion of automobile injury claims that could result in tort claims in this state, and then determine whether the number of possible tort claims is inversely related to the rate of fatal accidents. The authors use regression analysis to test this hypothesis and argue that if this relationship holds true, then tort provides an effective deterrent to careless driving. They find that tort does provide a deterrent against reckless

driving that is likely to lead to fatalities when the assignment of fault for the accident is suitably accurate.

Other studies that were conducted produced various results, some that did not find a positive relationship between no-fault and higher accident rates. The authors argue that their study better tested the relationship between no-fault and accident rates because their estimation methodology was sophisticated and controlled for such factors as endogeniety of no-fault along with variables such as annual snowfall and rural interstate driving that are strongly correlated with fatalities.

In sum, the Article reports that non-fault automobile insurance causes higher fatality rates because they weaken the incentive that exists in tort to drive carefully. However, within a no-fault system, an improved experience rating system can create more of an incentive to drive carefully.

LIFE INSURANCE

Kyle D. Logue, *The Current Life Insurance Crisis: How the Law Should Respond*, 32 CUMB. L. REV. 1 (2001-2002).

This Article asserts that currently the life insurance coverage in the United States is inadequate and suggests various ways the U.S. government may step in to aid an impending crisis.

In the introduction of the Article, Logue points out that in 1998 the average amount of life insurance per household was a mere 2.8 years' worth of disposable income. In many cases, this amount is not enough for a family and may dramatically change a family's standard of living, perhaps to below the poverty line. Should this happen to many families, society as a whole is worse off and the author argues that for the sake of social welfare, the government should take measures to aid this situation. Through this Article, Logue hopes to stimulate household discussions about the adequate amounts of life insurance.

The Article first evaluates the purpose of life insurance and gives a brief description of the present life insurance market including brief descriptions of different policies. After this background, the author provides empirical support for his claim that households are not consuming an adequate amount of life insurance, defined as that amount that will at least maintain the survivor's standard of living after the loss of the policy-holder, by evaluating studies that have been conducted on this topic. Acknowledging the potential uncertainty of the results of the studies, Logue then gives further reasons why underinsurance should be of concern, such as issues with adverse selection, negative externalities, myopia among

individuals, household consumption decisions among individuals and market failure. The author then argues that this information should be sufficient to place the issue of life insurance adequacy on the policymaking agenda and to stimulate discussion about possible solutions.

Logue himself assesses different possible solutions and suggests that government involvement would be best, either through a combined government term insurance and government subsidy plan or through a greater government-mandated or government-provided coverage plan.

Amy Bucossi, Notes & Comments: *Ascertaining Duty of Care in the Life Insurance Industry: A Survey of Insurance Law and a Proposal for State Mandatory Disclosure Legislation*, 18 N.Y.L. SCH. J. HUM. RTS. 51 (2001).

This Note argues that life insurance companies in New York should be required by statute to disclose any adverse medical conditions they find upon examining a patient for life insurance coverage. Such a requirement will promote public welfare both for the individual, who may benefit from early detection and treatment of a disease, and for the community because fewer third parties will be exposed to unknown health risks.

The Note begins by providing background information on the insurance industry, specifically the underwriting process. It then discusses several medical disclosure cases. In New York, the duty to disclose the results of an HIV test is mandated by statute. However, this does not extend to any other adverse medical findings. With other adverse medical findings, the duty to disclose depends upon whether a physician-patient relationship exists. Bucossi argues that requiring direct physician contact even when physician evaluation of the information takes place appears "illogical." Several courts have held, however, that physicians do not owe a duty to the patient, but owe a duty to the insurer in determining whether an applicant was an "insurable risk".

Next, the Note proposes to extend the duty of care by expanding the duty of disclosure to persons beyond the physician and by expanding the scope of disclosure. Such an expansion is necessary for public welfare. Nondisclosure, the Note argues, creates health risks due to loss of critical treatment time for the individual and increased public exposure to untreated diseases. The Note then provides legal arguments in favor of enacting disclosure legislation, suggests elements to be included in such legislation and then includes a model insurance disclosure statute. Before concluding, the Note briefly discusses genetic testing and the need for the legislature to

address the use of such information before life insurers adopt their own policies, which could potentially be discriminatory.

LIABILITY

Ellen S. Pryor & Charles Silver, *Defense Lawyers' Professional Responsibilities: Part II-Contested Coverage Cases*, 15 GEO. J. LEGAL ETHICS 29 (2001).

The Article discusses defense lawyers' responsibilities in contested coverage cases and sets forth rules for defense lawyers to follow when involved in coverage contests.

The authors begin by distinguishing between insurance law and professional responsibility law, and discussing the overlap between the two. They point out that while insurance law influences professional responsibility by limiting the defense lawyer's scope of representation and by creating a situation where the insurer in essence controls the defense for the insured, this does not necessarily impinge upon the ordinary duty of loyalty not to harm one client for the benefit of another, because both clients share the joint goal of minimizing losses on covered liability claims. Consequently, to do their job, defense attorneys must "only defend a liability suit competently and zealously."

Next, the authors discuss coverage contests. Coverage contests arise when an insurer states that an asserted claim is not covered by its policy or when the insurer reserves the right to make this assertion in the future. When this takes place, a conflict of interest can develop and new risks surface, particularly when the defense attorney represents both the insurer and insured. For example, a complaint against an insured could assert two theories of liability, the first covered by the insurer and the second uncovered. If to defeat the first claim an affirmative defense is necessary and such a defense would leave the insured in court without a paid defense, the authors suggest that the defense attorney should refrain from asserting the defense unless the attorney secured the insured's informed consent and believes both clients may still be effectively represented. Otherwise, a defense attorney may want to withdraw from representing both parties and the insured may want to consider appointing independent counsel.

The Article then goes on to explore the defense lawyer's professional responsibilities in depth, starting at the beginning of a contested coverage case. It discusses the insurer's power to hire a defense attorney, the scope of the attorney's representation, conflicts of interest that might arise for such a defense attorney, the attorney's role in advising an insured about the right to independent counsel, and the depth of knowledge a defense

attorney should have about insurance law and coverage issues. Finally, in sum, the Article provides attorneys "rules to live by when defending liability suits in contested coverage cases."

Douglas R. Richmond, *Liability Insurers' Right to Defend Their Insureds*, 35 CREIGHTON L. REV. 115 (2001).

This Article discusses the importance of an insurer's right to control the defense of lawsuits against insureds. It explores the origin, contours and limits of this right, and evaluates when an insurer should lose the right to defend. Finally, it evaluates when an insurer should be held vicariously liable for a defense attorney's malpractice, even if the defense attorney is independent counsel.

Richmond finds an insurer's right to control its insureds defense valuable for the insurer. By controlling the insureds defense, the insurer can protect its legitimate financial interests in the outcome of litigation. It can protect its financial interest by selecting skilled attorneys, participating in strategic decisions, defeating baseless or overstated claims, and preventing collusion between insureds and claimants.

Richmond also determines that the insurers' right to defend its insureds does not always arise from contract and the language of the insurance policies. He finds that only the standard CGL policy expressly grants insurers the right to defend their insureds. The right in standard personal auto and homeowners policies is as clear. He argues that in cases where the right is not expressly stated, it should be implied from either an insured's duty of good faith and fair dealing, or independently from the interests of all insureds.

Next, Richmond considers when an insurer should lose its right to defend. He suggests that a conflict of interest or reservation of rights defense alone is not enough to cause an insurer to lose its right to defend its insured. Instead, when "the insurer's defense of the insured and its defense of its own interest are mutually exclusive," an insurer should lose its right to defend. This arises when the "manner in which the third-party action is defended can affect coverage."

Finally, Richmond discusses whether malpractice claims against defense attorneys should extend to insurers through a vicarious liability theory. Richmond argues that, in general, insurers should be held vicariously liable for defense attorneys' malpractice, even if the defense attorney is an independent contractor, because the insurers should not be permitted to delegate their duty of good faith and fair dealing. Ultimately, however, vicarious liability should be determined on a case-by-case basis.

Katherine E. Giddings and J. Stephen Zielezienski, *Insurance Defense in the Twenty-First Century: The Florida Bar's Proposed Statement of Insured Client's Rights—A Unique Approach to the Tripartite Relationship*, 28 FLA. ST. U. L. REV. 855 (2001).

This Article argues that recently issued state bar association ethics opinions on the ethical concerns in the tripartite relationship may harm insureds by undermining insurance contracts, increasing premiums, and attempting to impose remedies for a non-existent problem. It suggests using the recently developed disclosure statement, Statement of Insured Client's Rights (the "Statement"), as an alternative way to promote the ethical obligations of the defense attorney in the tripartite relationship. The Statement, the authors argue, will not undermine the insurance contract or existing law.

The authors begin the Article by outlining the tripartite relationship and evaluating the contractual relationships between the insurer, insured and defense attorney hired by the insurer to represent both the insurer and the insured. They then analyze the ethical obligations within the contractual relationship including confidentiality and the duty of loyalty. They point out that an ethical dilemma may arise for a defense attorney in the tripartite relationship only if an insurer's decision creates a substantial risk to the insured.

Next, the authors look at the litigation management practices. They evaluate the benefits of such practice and explain why these practices do not violate ethics rules or endanger attorney client privileges.

The authors then assess the advisory opinion letters that limit litigation management practices and explain how the state ethics opinions contradict substantive law, misinterpret ethics rules, create imagined threats to the attorney-client privilege and mistakenly rely on ill-founded ethics opinions from other states.

Finally, the authors evaluate Florida's Statement. This statement provides guidance to defense attorneys and information to insureds about their representation in the tripartite relationship. Unlike the ethics opinions that restrict insurer litigation practices and endanger the tripartite relationship, the Statement does not prohibit guidelines or undermine the provisions of the insurance contract. Instead, it alerts the insured to the fact that the insurer may impose guidelines and that the attorney is required to alert the insured if the insurer denies the attorney authorization to perform a service or action that the attorney believes is necessary for the insured. The Statement and rule reveal that the attorney may share confidential

information with the insurer, the insurer may have a contractual right to make final settlement decisions, and the attorney may not obtain an insured's consent to take action in cases where it is impractical. By providing such a Statement, Florida's ethics laws are not breached and the Article urges the Florida Supreme Court to adopt this "refreshing approach."

Douglas R. Richmond, *Rights and Responsibilities of Excess Insurers*, 78 DENV. U. L. REV. 29 (2000).

This Article provides an in depth discussion and analysis of excess insurance issues. It begins by comparing primary and excess insurance. It evaluates their obligations to one another in terms of notice, timeliness of notice, providing a defense for the insured, reimbursement and allocation of defense costs, and then discusses the role of umbrella policies within this framework. Next, the Article focuses exclusively on excess insurance and evaluates the excess insurer's duty of good faith and fair dealing to the insured and the obligations the insured may have to the excess insurer. Then it turns again to the relationship between excess and primary insurers and explores when a primary insurer's failure to settle a case within its policy limits may rise to the level of a third-party bad faith tort and permit an excess insurer to recover from the primary insurer.

Richmond then discusses exhaustion of coverage and loss allocation issues and the role of excess insurers in this situation. Finally, Richmond evaluates malpractice suits against defense counsel and discusses when courts have allowed and disallowed excess insurers to sue the defense counsel hired by the primary insurer for malpractice. Richmond suggests that the insurance industry should standardize excess, and umbrella, insurance policies.

Jennifer D. Johnson, *Comment: Potential Liability Arising out of the use of Trademarks in web Site Meta Tags and Ensuring Coverage of Meta_Tag Trademark Infringement Claims Under Commercial Insurance Policies*, 50 CATH. U.L. REV. 1009 (2001).

This Comment discusses the potential trademark infringement claims that can arise from the use of meta tags and assesses whether Commercial General Liability (CGL) insurance policies would cover such claims.

The Comment first explores trademark law and the general principles that could apply to meta tags, such as trademark infringement due to the "likelihood of confusion" of the origin of the mark or trademark dilution

when the use of the mark "lessens . . . the capacity of the famous mark to identify and distinguish the plaintiff's goods or services." These principles may apply because meta tags are tags placed within a Web page's Hypertext Markup Language (HTML) which guide search engines in sorting out information. A company may misuse a meta tag to ensure that its information appears when a search is executed to find a different company. While legitimate reasons for using another company's meta tag within an HTML do exist, the increase of actual trademark infringers has resulted in an increase in claims against innocent meta tag users. The Comment cautions such users to ensure they have the proper insurance to protect against such claims.

The Comment next assesses trademark infringement coverage under the "Advertising Injury" provision in CGL policies, analyzes precedent addressing meta tag treatment under trademark law, and then evaluates Advertising Injury provisions and trademark violations for meta tag use and determines that precedent provides inconsistent answers. As a result, the Comment suggests steps for businesses to take to ensure proper insurance coverage. It advises businesses to include disclaimers, to ask for permission to use other marks, to clearly include trademark infringement coverage in the CGL policy including retroactivity clauses to cover prior acts, and to consider adopting specific Multimedia Liability Insurance policies to supplement the CGL policies.

Edson K. McClellan, *Ethical Issues Raised When Multiple Insurers Cover the Same Risk and One of the Co-Insurers Appoints In-House Counsel to Represent the Mutual Insured*, 30 SW. U. L. REV. 149 (2000).

This Article discusses an increasing trend in the insurance field. The trend is for insurers to insist upon using in-house counsel to defend an insured, even in cases where multiple insurers cover the same risk. Noting that many insurers are unhappy with this arrangement, the Article evaluates whether an insurer can discourage or prevent another insurer from appointing in-house counsel by applying California's ethical rules to this situation.

The Article begins by presenting a scenario to capture the issues involved in the appointment of in-house counsel when several insurers cover the same risk. Specifically, each insurer owes the insured a duty to defend, and typically either the insurers will share in the defense or share the defense costs pro-rata. However, when one insurer insists upon appointing in-house counsel and a co-insurer has reservations about the

appointment, problems arise. The Article explores whether ethical issues can be raised to dissuade or prevent this appointment of in-house counsel.

There are three main ethical issues that could be raised under California law in an attempt to dissuade or prevent an insurer from appointing in-house counsel to defend an insured. These three issues are: whether utilizing in-house counsel to represent an insured signifies unauthorized practice of law, whether this arrangement violates the in-house counsel's duty not to split fees with non-lawyers, and whether this arrangement creates a conflict of interest. By looking at case law and opinions from the California Standing Committee on Professional Responsibility and Conduct, the Article concludes that the utilization of in-house counsel to represent an insured is an authorized practice of law, fee-splitting is likely to be held ethical as long as the insurer is not profiting from it, and conflict of interest laws could potentially be used to discourage the appointment of in-house counsel because a co-insurer may be able to prevent in-house counsel from representing any clients adverse to it.

Joan Gabel, Nancy Mansfield, Ellwood Oakley & Tom Lundin Jr., *Evolving Conflict Between Standards for Employment Discrimination Liability and the Delegation of That Liability: Does Employment Practices Liability Insurance Offer Appropriate Risk Transference?*, 4 U. PA. J. LAB. & EMP. L. 1 (2001).

This Article explores the issue of whether Employment Practices Liability Insurance (EPLI) removes incentives for employers to combat sexual harassment in the workplace.

EPLI is an insurance product that permits employers to transfer the risk of penalties for discrimination and sexual harassment judgments on to insurance companies for a premium. Prior to the creation of EPLI, employers were solely liable for such penalties. This Article argues that some forms of EPLI conflict with the strict standards that the law imposes on employers in an attempt to prevent discrimination in the workplace. It then proposes a regulatory framework for resolving these conflicts.

The Article begins by tracing the evolution of employer liability for acts of discrimination and sexual harassment in the workplace. Employer liability is grounded in Title VII of the Civil Rights Act, the Civil Rights Act of 1991, and the Restatement (Second) of Agency; and in 1998, the Supreme Court held that the determinative factor in ascertaining employer liability is whether a "tangible employment action" has taken place. Under principles of agency, an employer is vicariously liable for a supervisor's sexual harassment, but if no adverse, tangible employment consequences

resulted from such harassment, then an employer may assert an affirmative defense that it exercised reasonable care to prevent and correct any sexually harassing behavior and that the employee failed to avoid harm. If a tangible employment action took place, then an employer is strictly liable for the supervisor's actions.

Next the Article explores the scope of adverse "tangible employment actions" and evaluates when the two prongs of the affirmative defense are satisfied. The Article then evaluates the 2000 case of *Reeves v. Sanderson Plumbing Products, Inc.*, 530 U.S. 133 (2000) and argues that it further tightens employer liability because employees only need to establish a prima facie case and a question of fact for the jury in order to defeat a summary judgment motion, whereas before courts left room for "pretext and mixed motive without damages owed." Additionally, employers held vicariously liable for sexual harassment may be subject to the imposition of punitive damages under *Kolstad v. American Dental Association*, 527 U.S. 526 (1999).

After describing the evolution of the EPLI product and the employers' rationale for using such a product, the Article evaluates whether EPLI permits employers to avoid the current liability standard for sexual harassment. It argues that by allowing coverage for imputed liability, EPLI may undermine the Court's efforts to deter sexual harassment in the workplace. By permitting employers to shift the risk of financial loss from adverse sexual harassment judgments to a third-party insurer, EPLI products arguably create less of an incentive for insured employers to enforce nondiscriminatory practices in the workplace than if the employer had to incur the full cost of such judgments. To resolve the conflict, the Article suggests that state regulators could require underwriting guidelines that incorporate the elements of the affirmative defense as a pre-condition to EPLI coverage.

HEALTH

Lisa N. Bleed, *Enforcing Subrogation Provisions As "Appropriate Equitable Relief" Under ERISA Section 502(A)(3)*, 35 U.S.F. L. REV. 727 (2001).

This Comment argues that the Ninth Circuit's holding based on a narrow interpretation of the United States Supreme Court's decision in *Mertens v. Hewitt Assoc.*, 508 U.S. 248 (1993) that stated that the enforcement of subrogation provisions does not constitute an "appropriate

equitable relief" under the Employment Retirement Income Security Act (ERISA) of 1974 § 502(a)(3) is inconsistent with the goals of ERISA.

The Comment begins by providing background information on the specific ERISA plans at issue. It looks at various circuit court interpretations of *Mertens*, and then focuses in on the Ninth Circuit's interpretation. It argues that the Ninth Circuit's interpretation of *Mertens* is too narrow and defeats ERISA's goal of uniformity by creating a situation where similarly situated participants in the same plan will receive different benefits depending upon where the participants file their suit. The Ninth Circuit's interpretation also permits some plan participants to receive a windfall and appears to direct employee plan litigation to state courts, which is problematic because state courts do not have jurisdiction over ERISA. Next, the Comment evaluates why *Mertens* does not preclude the enforcement of subrogation provisions. Then, it explains that the Ninth Circuit's approach may adversely impact ERISA plans and plan participants because subrogation provisions help to control the costs of providing benefits and if subrogation is not allowed, then plans may exclude benefits for injuries cause by third parties. Finally, the Comment argues that subrogation provisions should be enforceable under ERISA § 502(a)(3) and that the Supreme Court should hold that the enforcement of subrogation provisions is equitable relief under ERISA § 502(a)(3) considering the Ninth Circuit case, *Great-West Life & Annuity Insurance Co. v. Knudson*, 534 U.S. 204 (2002).

Lisa J. Andeen, *Improving Health Care for Uninsured Children in the Wake of the State Children's Health Insurance Program (SCHIP)*, 27 J. LEGIS. 299 (2001).

This Note evaluates the effects the State Children's Health Insurance Program (SCHIP) has had on providing low-income children with adequate health insurance coverage. SCHIP was created in 1997 as part of the Social Security Act in order to help children receive health care when their parents are ineligible for Medicaid but cannot afford private health insurance. Evaluating this program three years after its implementation, Andeen concludes that states must do more to enroll eligible children in this program and to provide coverage for children who still remain uncovered by any program.

The Note begins by providing a background on health care legislation in this area, and explaining the problem that SCHIP intended to address. It then describes SCHIP and explains what states must do to obtain federal funding. Next, it evaluates state progress with SCHIP. It finds that over

three million children enrolled in SCHIP in 2000, but even still, many children who are eligible remain uninsured. Andeen suggests increasing outreach efforts, simplifying SCHIP procedures, and maintaining low premiums fees. Finally, Andeen notes that even with perfect SCHIP and Medicaid implementation, some children would still lack health care coverage, and she urges the implementation of local and state initiatives to fill this gap.

Phyllis C. Borzi, *Distinguishing Between Coverage and Treatment Decisions under ERISA Health Plans: What's Left of ERISA Preemption?* 49 BUFF. L. REV. 1219 (2001).

This Article chronicles the interpretations of § 514 of the Employee Retirement Income Security Act of 1974 (ERISA) in the courts, and evaluates the implications of the recent judicial decisions for participants in ERISA-covered group health care plans who wish to hold their plans responsible for the plans' decisions. The Article posits that the latest judicial trend in this area is to limit ERISA preemption of state laws.

To start, Borzi provides some background on ERISA and explains § 514, which permits ERISA to preempt any state law that "relates to" an employee benefit plan. She then addresses the scope of ERISA preemption and provides case law to illustrate the broad interpretation of "relates to" in the courts. However, the judicial trend of interpreting "relates to" so expansively arguably changed after the United States Supreme Court held that hospital surcharges did not "relate to" employee benefit plans in *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Insurance Co.*, 514 U.S. 645 (1995) because they applied to all hospital bills and did not explicitly single out ERISA plans. After this decision, in which Justice Souter stated that Congress' objective with ERISA § 514 was to "eliminate the threat of conflicting and inconsistent state regulation in order to permit nationally uniform plan administration," courts began to focus more on whether ERISA plans were being targeted, and if they were not and the state laws were not in clear conflict with ERISA, then state laws addressing areas of traditional state regulations were presumably valid.

Borzi argues that after *Travelers*, a new paradigm for ERISA preemption appears to have emerged. After *Travelers*, the scope of ERISA preemption with regard to employee welfare benefit plans under § 514 appears to be narrower. Also, state laws addressing traditional areas of state regulation, such as medical decision-making, are presumed to be valid unless Congress has explicitly stated ERISA should preempt the area.

While state laws that directly conflict with ERISA will be preempted, a state law that does not conflict with ERISA and does not specifically target ERISA plans or interfere with their administration, would most likely survive a challenge of ERISA preemption.

Finally, Borzi also suggests that the methodology for examining ERISA preemption may be changing since *Travelers*. By evaluating *Pegram v. Herdrich* in the context of *Dukes v. U.S. Healthcare* and *Corcoran v. United Healthcare, Inc.*, Borzi points out a possible further limitation on ERISA preemption based on the distinction presented by Justice Souter in *Pegram*. This distinction is between pure and mixed eligibility decisions, the latter of which would not be subject to ERISA preemption because it requires medical judgment for making a decision. Borzi indicates that in applying the *Pegram* distinction to Corcoran, which permitted ERISA preemption of negligence and wrongful death claims because the utilization review entity was acting in its capacity as a plan administrator, activities of utilization review entities may not be that straight forward if they involve mixed eligibility decisions requiring medical judgment. If the *Pegram* analysis is applied to such a case, the scope of ERISA may be limited even more.

GENERAL

Robert M. Roach, Jr. & Daniel L. McKay, *Technology Risks and Liabilities: Are You Covered?*, 54 SMU L. REV. 2009 (2001).

The Roach and McKay Article looks at the new types of risks and liabilities that face businesses exploiting cyberspace opportunities and evaluates whether insurance policies would cover such claims and provide a defense attorney in the event of litigation proceedings.

The authors begin by presenting four short sections that cover the risks arising out of the following: operations that are based primarily upon intellectual property; invasion of privacy, slander, libel and defamation claims; network, system, and computer unavailability or failure; and loss of intellectual property rights and trade secrets. After identifying these risks, they then begin an in depth discussion of the insurance coverage issues that arise from intellectual property litigation or the threat of such litigation.

The authors first discuss the insurer's duty to defend or indemnify a policyholder during intellectual property litigation in Texas. Coverage depends upon whether an "advertising injury" has taken place under Coverage "B" of the standard CGL policy and requires that the policyholder show that the injury was "causally related" to advertising

activities and that injury first occurred when the policy was in effect. The authors then discuss different intellectual property cases that have dealt with various duty to defend issues, including what criteria are necessary to link allegations to advertising activities and when coverage is precluded because the loss was considered known. Next, the authors move outside of Texas and evaluate coverage issues in the areas of patent, copyright, trademark, service mark and unfair competition.

Next, the authors highlight various areas that policyholder and insurers should consider when evaluating proper insurance coverage. These include the 1998 revisions to "advertising injury." These changes could potentially affect the insurer's duty to defend against specific claims. Also, the authors mention the new specialized insurance policies that are now being offered to specifically cover intellectual property claims. Finally, the authors consider coverage for an array of losses, including corruption or loss of data, hackers, and defamatory or libelous statements in cyber-space. The authors conclude that standard insurance policies do not cover common intellectual property risks and warns policyholders and insurers to "proceed with an abundance of caution and foresight."

Russell B. Wuehler, *Rethinking Insurance's Public Policy Exclusion: California's Befuddled Attempt to Apply and Undefined Rule and a Call for Reform*, 49 UCLA L. REV. 651 (2001).

This Comment evaluates how insurance's public policy exclusion is applied in California courts. It finds that California courts have unsuccessfully applied this public policy exclusion and urges the California legislature to adopt objective, predictable rules for determining when insurance coverage for an insured's willful act is void against public policy.

The Comment reviews insurance's public policy exclusion both in California, where it is codified in California Insurance Code § 533, and nationally. In California, § 533 states that "an insurer is not liable for a loss caused by the willful act of the insured." Written over 100 years ago, the provision provides no definitions for its terms and has no corresponding legislative explanation of its purpose or intent. As a result, California courts have interpreted that its intent is to "discourage willful torts and to deny coverage for willful wrongs," and have assumed "insurance policies indemnifying the insured against liability due to his own willful wrong [are] void against public policy." Nationally, the use and application of the public policy exclusion varies dramatically. Some states purport to have clear standards for determining when the exclusion applies, other states have eliminated the exclusion completely.

Next, the Comment evaluates how the courts have interpreted § 533. It breaks its evaluation into three periods: the Pre-Clemmer Era, the Clemmer Era, and the Post-Clemmer Era. Prior to the California Supreme Court decision *Clemmer v. Hartford Ins.*, 587 P.2d 1098 (Cal. 1978), "willful act" was in general a very vague concept. Then in the Clemmer Era, the California Supreme Court first defined "willful act" to include both a general intent to commit an act and a subjective or specific intent to injure. In a child molestation case in 1991, the application of *Clemmer* ceased when the California Supreme Court set forth three criteria necessary for § 533 to apply in *J.C. Penney Cas. Ins. Co. v. M.K.*, 804 P.2d 689 (Cal. 1991). To determine whether a "willful act" took place under § 533, courts must assess whether the act was intentional, wrongful, and whether the harm was inherent in the act itself. Although supposedly a clear definition of "willful intent," the holding was limited to child molestation cases. But lower courts have not adhered to this limitation, and as a result the definition of "willful act" under *J.C. Penney* has been applied broadly and appears to be narrowing the scope of insurance conduct. The Comment urges the California legislature to address § 533 and define "willful act" because the courts have been unable to do this and have not been able to address all competing public policy considerations that need to be taken into account when determining the scope of insurance's public policy exclusion.