Tort Liability and Insurance Practice

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1. The importance of liability insurance for the discussion of tort problems is nowadays generally recognized, although rather reluctantly by many legal scholars, in Europe as well as in USA. It has upset a great deal of the venerable theories built upon the assumption that the liable party, at least primarily, pays the compensation himself.[1] In Sweden as well as in other Scandinavian countries, the idea of the close connection between liability insurance and tort law has influenced legislation during most of the 20th century. The Scandinavian courts, too, refer at times to the *possibility* of insurance. The *existence* of a liability insurance in the individual case is seldom mentioned in ordinary tort cases, as it will influence the liability only in particular situations (*e.g.* concerning minors); but one can be sure that, in reality, the overwhelming majority of claims against private persons and most claims against business firms are in reality directed against an insurance company that will pay the compensation awarded.[2]

The fairness of liability insurance should not be discussed here. Largely, it depends upon the value that one attaches to the compensatory function of the tort rules and the advantages of risk distribution. In any case, the insurance still entails a considerable complication to those who emphasize the moral and deterrent aspects of tort liability, as well as for the economic analysis of liability rules that has had increasing importance during the last decades. It is true that even most representatives of the economic school seem to think that their conclusions will not be seriously affected by the existence of this form of

1 Cf on this conflict G.T.Schwartz, *The Ethics and the Economics of Tort Liability Insurance*, Cornell Law Review 75 (1990) p. 313 ff.

2 At present, about 90 % of Swedish households have insurance coverage. As for U.S. households, coverage reported was in 1993 for homeowners 95 % (68 % of the public), for renters 41 % (28 % of the public). See O.E. Rejda, *Principles of Risk Management and Insurance*, 5th ed.1995; cover text.

insurance.[3] Also other legal writers have tried, in various ways, to reduce the importance of the insurance; here, a kind of reaction against the attitude of the legislator has set in at least in Swedish literature.[4] However, it can be called in question whether the effects of liability insurance have been fully realized, especially the implications of insurance technique in this connection.[5] The relationship between tort law and insurance is usually discussed in a rather abstract way, without regard to the details of insurance technique and insurance practice. In this paper, it is emphasized that such matters should be more closely analyzed before we can draw any conclusions concerning the appropriate liability rules; this might lead to more diverse solutions both in theory and in practice or, at least, cast some doubt upon the prevalent way of reasoning on these problems. Analyses of this kind seem to be valuable also in case of a purely economic approach to the tort rules; however, I shall not deal with such problems here.

2. An essential postulate in much of the literature is that *tort law is primary in relation to liability insurance.* According to this view, insurance has no influence of its own upon the distribution of the risk between the parties: an extended liability only involves a higher premium. [6] As a consequence, courts, legislators and legal writers will discuss which of the parties should bear the costs of the accidents without paying particular regard to the access to insurance, as the risk in any case would be located in the same manner (provided that, when insured property is damaged, the insurer paying the damage is subrogated to the claim against the liable party).[7]

To a certain extent, the idea that the risk is independent of the insurance seems to be connected with the idea that the deterrent function of the liability rules does not to any essential extent depend upon the possibility of buying liability insurance or the existence of such an insurance in the individual case:

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3 See, however, Shavell, *On Liability and Insurance*, The Bell Journal of Economics 12 (1982) p.120 ff, where after a discussion on a theoretical model he concludes that the presence of insurance markets mitigates the difference between strict liability and fault liability and alters incentives to take care. The results, however, seem too abstract to give any guidance concerning the appropriate liability rules in the concrete situation. - For Scandinavia, cf further the recent discussion between Henrik Lando and Jan Hellner concerning the general relationship between tort law and economic theory: Lando, *Tort Law from the Perspective of Economic Theory*, Tidsskrift for rettsvitenskap 1977 1997 p. 919 ff; Hellner, *Skadeståndsrätt och rättsekonomi*, Tidsskrift for rettsvitenskap 1998 p. 357 ff; Lando, *On the Use of Economic Theory in the Design of Accident Law*, Tidsskrift for rettsvitenskap 1998 p. 958 ff; Hellner *Lando on Tort Law and Economics*, Tidsskrift for rettsvitenskap 1999 p 190 ff.

4 This is the case with some of the leading Swedish authors on tort law in the nineties; see, above all, Bill Dufwa, *Flera skadevållare* (1994); Håkan Andersson, *Skyddsändamål och adekvans* (1993) and *Tredjemansrelationer i skadeståndsrätten* (1997).

5 Cf *Prosser and Keaton on the Law of Torts* (1984) p. 589, 596.

6 Cf e.g. G.L. Priest, *The Current Insurance Crisis and Modern Tort Law*, Yale Law Review 96 (1987) p. 1525 and, in Swedish literature, Håkan Andersson, *op.cit.* and A. Agell, *Adekvans eller skyddsändamål. Om rättsvetenskaplig metod och skadeståndsrättslig regelbildning*, Juridisk tidskrift 1994-95 p.803.

7 Of course, this is a simplified version of the argumentation; however, the main reasoning may be summed up in this way.

the protection afforded by liability insurance will not make it more probable that a person causes injuries or damage to third parties. If the legislator or the courts tighten up the liability rule, for instance by changing fault liability to strict liability, this is assumed to increase deterrence in spite of the protection afforded by the insurance. The well-known theory of general deterrence implies that at all events the party liable for the damage will have to pay for it, sooner or later. Anyway, the liability will be an incentive to take measures against the risk of damage, especially if it is strict. Even if there is liability insurance this incentive will exist, as the insurance company will raise the premium because of the claim or, by particular clauses in the policy, prescribe far-reaching sanctions for neglecting safety measures and similar conduct. For such reasons, the insurance is not supposed to affect the function of the liability rule in this respect either; extending the liability will still have a deterrent effect. - It is natural to discuss also this theory in the light of insurance practice, when treating the relationship between liability insurance and the rules of tort law.

On the whole, both the idea of the primary position of the tort rules and the theory of general deterrence appear to be accepted today by the courts as well as in the bulk of legal writing (although the theory of general deterrence has met some opposition, see below). At times, legislators and even courts have drawn rather far-reaching conclusions concerning the influence of the liability rule upon the insurance premium, for instance when discussing whether an exemption clause is reasonable in view of the possibility of insurance.[8] However, the result of the abstract reasoning should be checked by studying what actually happens in the insurance companies. Of course I cannot claim to have a full knowledge of the somewhat varying practice of the different insurers; for a reliable discussion of this practice and its economic importance, it would at all events be necessary to make far more thorough and time-consuming sociological and statistical investigations than is possible in this context. Still, even an analysis based upon the limited material accessible may have some interest.

3. A fundamental principle of insurance technique is that the premium should correspond to the risk insured, with the addition of an amount covering the administrative costs and an amount as a reserve for losses exceeding the predicted ones. (It is natural that some part of the premium also covers calculated profit of the insurer, although it is seldom expressly mentioned in this context.) As for the liability insurance risk, we can distinguish between three separate elements: the risk that the accident insured against will occur (here called the *accident risk*), the risk that the insured will have to pay for this accident according to the liability rules (the *liability risk*), and the risk that the insurer will incur costs connected with the insurance that do not concern either the accident risk or the liability risk, e.g. because of an increased tendency to file unfounded claims (the *cost risk*).

The characteristic element in liability insurance is the liability risk. Essentially, the problem of the relation between tort law and liability insurance

8 Cf Hellner, *Consequential Loss and Exemption Clauses*, Oxford Journal of Legal Studies, 1981, vol. 1, p. 44 ff.

amounts to the influence of the liability risk upon the premium; as mentioned before, an extended liability is generally supposed to exercise a direct effect on the price of the liability insurance. However, such a change seems, even theoretically, to have a limited impact upon the premium.

Suppose, for instance, that the fault liability of the insured for a certain type of accident is changed to strict liability. If he (or his employees) can be expected to cause the damage in a negligent way in 90 % of the accidents in question (a rather realistic supposition, especially in case of dangerous activities), the increased liability risk only concerns 10 % of the total sum. As the change concerns only the risk for a particular type of accident, no other risks that the insurance covers are affected by the new liability rule. If that type of accident represents 10 % of the total risk, the effect of the extended liability will be limited to 1 % of this risk. - Even this effect may be neutralized in two ways. It is well-known that on the whole, strict liability is cheaper to administrate than fault liability, as the question of negligence on the part of the insured need not be dealt with; for such reasons, the cost risk will be reduced. Further, if the common idea that a more severe liability rule will have a deterrent effect is correct (cf 2 above), there will also be a reduction of the accident risk.

It is true that the influence upon the premium may be different when the change in the tort law concerns the main risk covered by the kind of insurance in question. One instance is when the manufacturer's products liability is extended. (However, it can be doubted even in this case that the premium of the products liability insurance must follow the liability risk; see 4 below.)

Of course, extending or reducing the liability in law has sometimes affected the premium.[9] The well-known tort crisis in the USA in the 1980s was no doubt partly caused by the development of tort law in certain respects, above all products liability. The expansion of joint and several liability, as well as the generosity in awarding non-economic damages in new situations (above all punitive damages), has often been mentioned as an important explanation of the sudden rise of premiums and the reluctance of insurers to renew certain types of insurance. But it is only a partial explanation; evidently, there were other factors contributing to this result. At least in products liability insurance there was a considerable increase of the accident risk insofar as the causal connection between the use of asbestos and certain diseases was established, causing a flood of claims against the liability insurance. It has further been pointed out that the uncertainty of insurers concerning the future development drove up premiums much over the level motivated by the legal change; also the general economic situation, among other things a low interest during the period, has been mentioned as an important factor.[10] Anyway, the increase of the premium was clearly disproportionate to the increased liability risk. - After the following reforms of the tort law in many states the premiums sunk, but not to an extent corresponding to the mitigation of the liability rules; the reform had above all a restraining effect upon premiums, and the profit of the insurers increased at the

9 Cf Prosser and Keaton, *op. cit.* p. 590 f.

10 See e.g. K.S.Abrahams, *Making sense of the Liability Crisis*, Ohio State Law Journal 48 (1987) p. 404 ff, Priest, *op. cit.* p. 1521 ff.

same time.[11] So far, it seems unwarranted to speak of the premium being dependent of the liability rules, except in a very general manner. It seems futile to make any exact calculations concerning the influence of the liability rules upon the size of the premiums.

The tort crisis may appear to be an isolated case, as it was the result of a combined tendency in many fields of tort law to expand the scope of liability in order to protect victims. The question is whether the liability risk has a closer connection with the premium in more ordinary circumstances. In a perfect market, the risk will have a direct influence on the price of the insurance, but in practice the market is far from perfect. It is striking that rating in General Liability Insurance seems to take place without any particular reference to the liability rules, although the classification of a business must be supposed to depend upon the experience of damages earlier paid and, consequently, also upon the liability rules. However, the two types of risk seldom seem to be calculated separately. - Apart from that, the decisive factors usually refer to the accident risk, above all to the size and type of the business in question.[12] Apparently, the essential consideration is the probability that the insured will be involved in accidents and the probable size of the injury or damage caused by such an accident. It should be noticed that to the portion of the premium needed to pay losses, a ”loading” should be added covering loss-adjustment expenses,[13] other administrative costs, profit, and a margin for contingencies. These amounts do not depend on the size of the liability risk; in this way, the relative importance of that risk will be still less.[14]

The model that we generally bear in mind when discussing tort problems implies that the premiums are differentiated to such degree as to correspond rather closely to the risk. However, it is necessary to standardize premiums to a certain extent in order to save administrative costs; a rating exactly corresponding to the risk in the individual case is impracticable, and the classes of insured must generally be defined in a rather rough manner. This might agree with the liability risk as long as the same liability rules are applicable to all members of the class; but this need not be the case. In the Swedish Home

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11 See e.g. P. Born and W.Kip Viscusi, *Insurance Market Responses to the 1980s Liability Reforms: An Analysis of Firm Level Data*, The Journal of Risk and Insurance, 61(1994) p. 192 ff.

12 See, concerning USA, *General Liability Rating*, 7th ed. 1994. Rejda (*op. cit*. p. 561 ff) does not mention the liability risk particularly in this context. - The same holds true about rating in Swedish insurance practice.

13 At times, the amount needed to pay losses and the amount needed for loss-adjustment are referred to as the "pure premium" (Rejda, *op.cit.* p. 561). However, for our purposes, the former amount should be kept apart.

14 At times, the costs of the insurer will even be reduced, as strict liability does not demand any investigation concerning possible negligence on the part of the insured (see below). - Here, I pass over the problem of setting up reserves to cover future contingencies; an increase of the liability risk may at least theoretically motivate some increase of the reserves, especially when the change in law indicates a general tendency of this kind which makes the future development difficult to predict. Cf G. Eads and P. Reuter, *Designing Safer Products. Corporate Responses to Product Liability Law and Regulation* (1983) p. 25 f, 28 ff, and above about the tort crisis.

Insurance, as well as the American Homeowners' Insurance, at least the part of the premium concerning liability insurance is generally not differentiated.[15] The legal liability covered is above all fault liability, but this may be more or less severe depending upon the activities of the insured; the standard of care is not the same for household work, sports and hobbies of various kinds, cycling, walking or hunting. Such differences in the liability risk do not affect the premium in any way; it is influenced essentially by other factors.

Besides, it should be underlined that both business firms and private persons usually buy *combined* types of insurance where the liability insurance premium is only a part of the total amount - often a small part, as in Home Insurance. Evidently, only radical changes in the liability risk will motivate a raise in the price of such insurance. The same will hold true regarding many types of business insurance.

Further, the cost risk might be diminished at the same time as the liability risk is increased. As mentioned before, a rule of strict liability is generally cheaper to administrate, and it may encourage less unfounded claims than a rule of liability for negligence. On the other hand, certain social conditions can raise costs to a considerable extent. One instance mentioned particularly in the USA is the increasing claims consciousness of the public, which has complicated rating *inter alia* in medical malpractice insurance. This may have some connection with the liability rule, but it can evidently depend upon other circumstances too, for instance the attention that media pays to the problem. Still another factor without any connection with the liability risk (or even the accident risk) is the procedural rules in different states, which at times can have considerable influence upon the premium.[16]

It should finally be borne in mind that in all liability insurance, a portion of the rate is intended to cover, besides profit, a margin for contingencies. There seems to be no reason why the risk of an unexpected change in the liability rules should not be calculated in the same way as the risk of such events as unusual weather conditions. Most changes can be expected to be covered by the loading of the premium.

4. A conclusion may be that the liability risk will influence the premium only in particular cases. One instance is some radical change of liability rules concerning a situation that is very common in the the business of the insured (e.g., if fault liability of hospitals is changed into strict liability for all kinds of mistakes in the treatment of patients). However, you cannot even then be certain about the consequences. The principle of fault liability can be applied in such a rigorous manner concerning a risky activity that the victim will generally be able to find some kind of negligence; the change to strict liability will then have small importance. Thus, when strict products liability was introduced in Sweden by the Products Liability Act (1992) instead of fault liability, most Swedish insurers did not find it necessary to raise the premium. One reason may have

15 Cf, concerning USA, Schwartz, *op. cit*. p. 318 ff.

16 This seems to be the case in the USA with discovery rules as far as concerns malpractice insurance. Cf P.Danzon, *Why are Malpractice Premiums so High or so Low* (1980) p. 21: premiums were 16 % higher in states with a discovery rule.

been that according to earlier case law the manufacturer was considered lacking in foresight, prudence or care in almost all situations when a product caused some personal injury. - In the same way, several insurance companies omitted to raise the price of liability insurance covering blasting operations when the Environment Damage Act (1986) prescribed strict liability for such activities.

Another possible instance is when some general rule applicable in a great many situations is extended in a significant way, e.g. if the possibility of imposing punitive damages would be extended to new situations. Experience from the American tort crisis suggests that this would make a rise of premiums necessary in many kinds of liability insurance. (In Swedish Law, punitive damages are not awarded at all.) On the other hand, less important changes for instance concerning the standard amounts of non-economic damages seem to have small influence upon premiums.[17] If an exemption clause is applicable in a very practical case, for instance if it excludes liability for ordinary negligence by all employees, the invalidity of the clause will no doubt have an impact upon the liability insurance (to the extent that such contractual liability is covered), while it can be questioned whether clauses aiming at some very particular type of damage have any such effect at all.

It should also be underlined that rises in premiums motivated by a change in the tort law will not occur until policies are renewed; there are generally no policy provisions entitling the insurer to raise the premium during the insurance period on account of such changes. As the usual insurance period in business insurance is several years, the effect of the new liability rule will often be delayed for a considerable time.

In this connection, it should be kept in mind that the great majority of liability claims are settled by negotiations between the adjuster of the insurer and the victim. Of course, the tort law will be the basis of such settlements; but undoubtedly the results will often differ from what a strict application of the liability rules will imply, being influenced by a great many factors that have nothing to do with the state of the law.[18] It must be supposed that in a considerable number of cases the victim gets some payment although he would not be entitled to compensation in law.[19] The departure from the liability rule may be more or less significant from an economic point of view; at all events, it is another uncertain factor concerning the liability risk. The increase of risk may

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17 According to a proposal of a Swedish commission, close relatives of victims killed in traffic accidents should be compensated for psychological trauma caused by the shock. The rise of the costs of motor third party liability insurance was estimated to be only 1-1,5 %. A 50 % increase of the current compensation level for the damages category of disfigurement or other permanent disadvantage in the most serious cases, and a certain increase of the compensation level for injuries not quite as serious, would entail a 2 % increase in the costs of that insurance (and the same increase in the costs of labour market no-fault insurance). See Statens Offentliga Utredningar 1995:33 p. 432 ff.

18 See, e.g., Ross, *Settled out of Court: The Social process of Insurance Claims Adjustment* (from Rabin, *Perspectives in Tort Law*, 4th ed. 1995) p. 174 ff, Prosser and Keaton, *op.cit.* p. 590.

19 Cf Sugarman, *Doing Away with Personal Liability Law* (from Rabin, *Perspectives on Tort Law*, 4th ed. 1995) p. 170 f, J.F. Fleming, *The American Tort Process* (1988) p. 174 ff. – The same tendency is observed in Swedish insurance practice.

not correspond to the actual payments made by the insurer, and the influence upon the premium will be distorted to some extent.

Another factor that affects the location of risks is the practice of insurers when they exercise subrogation rights. If they do not claim back the compensation paid under property insurance contracts, the risk will rest upon victims even if there is a liability in law for the damage. This factor is under the exclusive control of the insurance companies; if for instance they make a general agreement (as in Swedish practice) that their claims against liability insurers should be restricted, the victims insuring their property will pay for a number of accidents that by rights should have been compensated by others who now, at least in some cases, may have the premium of their liability insurance reduced. However, such consequences cannot be taken for granted, as some types of insurance may very seldom concern damage caused by third parties; the subrogation rules will not then have any influence upon the premium on either side.

Finally, an important factor is the competition on the insurance market and other business reasons influencing the rating of the insurers. Compared to such considerations, the liability rules will often have limited weight. For reasons of competition, the premium can be reduced independently at least of the liability risk borne by a certain class of the insured; in some situations, the market situation may permit that the premium instead is raised to a level that is not motivated by the risk insured. In both cases, the loss can be placed upon another collective than that of the liable party or even upon another kind of insurance: a profitable home insurance can compensate losses in motorist insurance, or vice versa. - However, it may be assumed that the competition factor above all affects the profit loading, seldom other parts of the premium.

To sum up, it is rather doubtful to what extent the liability rules have any influence upon the liability insurance premium. Many facts point towards an influence only when the rules concern some essential risk connected with the activity of the insured, or some general principle concerning the amount of damages. Even then, a change in the liability risk will hardly be proportionate to the change in the price of the insurance. To a considerable extent, the economy of the liability insurance seems to take its own course, essentially independent of the economy of such liable parties that have no insurance. It is often difficult to know whether a loss will really lie upon the liable party when damage of a particular type is discussed. Of course, a change in the liability rules can be an incentive to a number of firms, and perhaps also to some private persons, to insure themselves against the liability in question, but this does not mean that the insurance must be more expensive because of the change. Self-insurance, for instance by setting aside a fund to meet claims for damages, does not involve the same locating of the risks as buying liability insurance.

It should be noted that there are several types of liability that cannot be covered by liability insurance, at least not in practice. Besides various kinds of contractual liability should be mentioned liability for continuous nuisance, for instance pollution. One essential reason is that damage caused under such circumstances is often expected, at times even a necessary consequence of the activity, though the activity may be lawful because of its utility in general. Here,

the difference between fault liability and strict liability will have considerable economic consequences, as a liability only for negligence would exclude compensation for damage caused in a foreseeable way by activities permitted by the authorities. However, for our present purposes it is not necessary to discuss these situations.

Further, one should make allowance for the possibility that the insurer in the future will exclude the liability in question from the coverage; the reason may partly be an increase of the liability risk,[20] but most insurers will be reluctant to take such a step above all for reasons of competition. The risk of such a development does not seem to be very practical except when insurers have already hesitated about the coverage, for instance because the accident risk is too difficult to predict or, on the contrary, too predictable.[21]

Yet another complication is that especially big firms may react to an increased premium by shifting to self-insurance, above all in order to save some administrative costs. As mentioned above, this will have some impact upon the location of the risk and even upon the insurance industry in general.[22] Only in exceptional cases, however, can an increase of the liability risk be supposed to have such far-reaching consequences.

5. As mentioned above, these problems have a close connection with the question about the *deterrent* effect of liability rules. Here, the theories of general deterrence play an important part, reducing the objections to liability insurance common in earlier discussion (see 1 above). According to these theories a more severe liability will be an economic incentive to the liable party to take safety measures or to organize his activity in a less risky way even when he is insured.

I shall not enter upon a discussion of the detailed ways in which the liability rules are supposed to encourage safety measures and similar conduct. Here, the question is only whether (apart from the doubt one can feel concerning a one-sided stress upon the economic motives of human activities) the economic incentives function in the same manner independently of liability insurance. The deterrent effects of tort law have been contested by legal scholars who have emphasized among other things the influence of such insurance in this context.[23] There are reasons for calling the theory of general deterrence in question particularly from this point of view, although it may be valid in some situations. Even persons making rational choices between alternative courses of conduct may be influenced by the possibilities of liability insurance or by an existing insurance to an extent that is not quite compatible with the theory.

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20 This happened in some cases as a cause of the American tort crisis mentioned above.

21 When in 1986 the coverage of liability for pollution was abolished in ordinary American commercial liability insurance, it seems to have been motivated by such a combination of motives. Cf *Current Problems and Issues in Liability Insurance*, 1987, p. 40 ff.

22 Cf Eads and Reuter, *op. cit.* p. 134 f.

23 See e.g. Sugarman's analysis, *op. cit.* p. 143 ff. Cf also Schwarz, *op.cit.* p. 346 ff. In *Atiyah's Accident, Compensation and the Law*, 5th ed. 1993 by Peter Cane, this effect of liability insurance is often pointed out. In Sweden, the deterrent function has been called in question by Jan Hellner in several contexts (see for instance, the discussion mentioned above in footnote 3), while Bill Dufwa, among others, has put certain stress upon the deterrent arguments (e.g. in *Flera skadeståndsskyldiga*, 1993).

As pointed out above, there seems to be a rather loose connection between the size of the liability risk and the premium. For such reasons, the idea that an extended liability will in itself exercise some kind of economic pressure upon the insured is questionable; not even the difference between fault liability and strict liability must be reflected in the price of the insurance. It seems rather doubtful whether such changes in tort law can be justified by arguments of deterrence. This holds true whatever the rating methods of the insurer may be; even if the premium is differentiated to such a degree that it closely relates to the insured's actual risk level, as for instance by retrospective rating (see below), it is not granted that the differentiation goes so far as to comprise the *liability* risk. And even if the premium is changed for such reasons, this will hardly *in itself* stimulate any safety measures; the rise of the premium is due to the decision of the legislator or the courts, and it has generally nothing to do with the level of care in the business of the insured.

However, if the insurer paying the damages reacts in some way as a consequence of a particular claim, the tort law might still contribute to the deterrent effect in spite of the protection given by liability insurance. Evidently, the weight of the theory of general deterrence here depends to a considerable extent upon the acting of the insurance companies. Surprisingly often it is taken for granted that they can control the conduct of the insured in such an effective manner as to uphold the deterrent effect of the tort rules.

Of course, insurers can insert clauses in the policy that forbid certain risky conduct, excluding damage from such causes from the coverage. However, as the point of liability insurance is covering the consequences of negligent behaviour, such clauses can only be used to a limited extent. Another way of acting is raising the premium on account of the negligence of the insured, in accordance with the general theory that the premium will follow the risk; the rates can be determined by studying the loss experience over a certain period ("experience rating"). This method mostly requires a considerable statistic material and long insurance periods; for such reasons, it is possible above all in certain kinds of business insurance for comparatively large firms, although it is used also in motor insurance.[24] Anyhow, the reaction against risky conduct comes rather late (often only when the insurance is to be renewed, which may be several years later). From this point of view, a more effective method should be so-called retrospective rating: a preliminary premium is charged and the final premium will be determined on the basis of the claims during the insurance period. However, this method appears to be used only in particular types of liability insurance, above all for big firms.[25] - Besides, even if the insurer wants to react by raising the premium, you must take competition considerations into account. A rather natural answer on the part of the insured is turning to another insurance company where he can get more favourable terms. Evidently, many

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24 Cf concerning American practice Rejda, *op.cit.* p. 563 f, G. Eads and P. Reuter, *op. cit.* p. 29, Sugarman, *op. cit.* p. 156 ff, Schwartz, *op. cit.* p. 320 f. In Sweden, experience rating is used for big firms by certain insurers; according to other insurers, the method is rather uncommon.

25 Cf Rejda, *op. cit.* p. 564, Eads and Reuter, *op. cit.* p. 27. – In Protection & Indemnity insurance, this method is generally used.

insurers hesitate to treat customers in this way, especially big firms.[26] A more effective way of promoting safety measures will be by introducing terms concerning deductibles or coinsurance in policies, provided that the insured bears a considerable part of the liability.

As for home insurance, such reactions by the insurance company will obviously have small importance. Experience rating and retrospective rating do not occur in these relations, and policy conditions concerning safety regulations are seldom used in the liability insurance included in home insurance.

Of course, it is rather difficult to make any positive statements concerning insurance practice in these respects. It should only be underlined that any theories concerning economic deterrence in situations where liability insurance is common should be based on a closer study of insurance practice, for instance the rating method generally used and the actual reactions of insurers on risky conduct by the insured. However, even such studies cannot be expected to throw light upon the deterrent effects of liability rules, for instance the difference between fault liability and strict liability in such respects. Here, we can only go on mere guesses, possibly supported by certain common sense arguments.

To sum up, it remains to be proved that the type of liability in itself has any natural connection with the deterrent effect of the liability rule, as long as the liable party is likely to insure himself against the liability risk.

6. It is remarkable that information afforded by insurance practice and insurance technique has so seldom been used in discussions concerning tort problems. Though the possibility of liability insurance and, at times, insurance principles are often referred to in a general way, there seems to be small interest in the actual interaction between insurance and liability.[27] Attention should be drawn to the possibilities of legal research in this field based upon the study of insurance practice. Here, for once, there exists a voluminous and comparatively reliable material directly bearing upon the economic consequences of, among other things, the liability rules. Analyzing such material will give a more concrete knowledge concerning the economic and practical implications of the rules discussed by the courts and recommended in legal literature.

It is true that much of this material is difficult to get hold of and complicated to handle without misunderstandings. A satisfactory analysis of insurance practice and its impact upon tort liability would take considerable time and, to a certain extent, demand assistance by insurers. However, it may be in the interest of the insurance companies themselves to produce material of this kind, at least for courts and legislators. When for instance a defendant (which mostly means his liability insurer) argues about the economic consequences of an extended liability, it is often natural to place the burden of proof upon him. In most cases, only the liability insurer has access to the statistic material and observations from insurance practice necessary for any positive conclusions on such

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26 Cf Superman, *op. cit.* p. 189. In Sweden, the common attitude of insurers is the same.

27 Of course, there are exceptions; as for American literature, the works of Sugarman, Schwartz and Shavell here referred to contain an analysis of some of the insurance factors mentioned here.

matters.[28] Courts and legislators should not be satisfied with vague references to the experience of insurers or abstract speculations on the general consequences of locating the risk on the plaintiff or the defendant; nor should scholars base any theories on the effect of liability rules upon such dubious foundations. To attach any decisive importance to such arguments as the unreasonable burden that an extended liability would place upon defendants in the same situation, we should demand hard facts: either that the type of liability cannot be covered by liability insurance or that premiums for such defendants would rise to a level which cannot reasonably be accepted. If there is no such evidence supporting the arguments, we may be entitled to act upon the assumption that in reality the liability will not imply any considerable additional burden upon the class of defendants concerned. Of course, this does not mean that the existence of a liability insurance, or even the practice of a particular insurance company, need be discussed in court; the evidence called for should regard the experiences and statistics of insurers in general in cases where similar liability is insured.

As mentioned above, some scepticism is motivated also when a plaintiff points out the beneficial deterrent effects of strict liability or a rigorous application of fault liability. The defendant (and, in particular, his liability insurer) would be in a somewhat strange position if he should prove that insurers in general do *not* react in case of similar accidents resulting in liability for the insured. On the other hand, we cannot reasonably demand that the plaintiff produce evidence that insurers really react in such situations; evidence of this type can be difficult to get hold of without any particular contact with insurance companies. For such reasons, it is doubtful what principles should be laid down as to the burden of proof on this point. However, even when we can suppose that insurers try to control the conduct of the insured and his employees, this seems to be a rather weak argument for tightening up the liability rule. The only conclusion will be that we should be restrictive in emphasizing the deterrent effects when we discuss the appropriate liability rule, unless it is obvious that liability insurance does not cover the type of damage in question. - This approach, however, seems justified already by other objections made against the theory of general deterrence.

It may seem surprising that even jurists with expert knowledge on insurance matters are apt to emphasize the liability rules to such a degree. One explanation might be that the legal profession has a certain tendency to overestimate the legal system and undervalue other circumstances influencing the economy of the insurance (as well as other economical questions), for instance factors affecting the damage risk and the cost risk, as well as commercial considerations. Among actuaries and other non-legal insurance experts one can find a somewhat different attitude to the influence of the liability risk that is perhaps more realistic. On the other hand, it does not seem very common that insurers try to analyze the impact of liability rules with statistic methods. The analyses

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28 A number of American courts have specifically ordered defendants to produce manuals and guidelines containing such information, although in cases concerning interpretation of policies. See J.E. Heintz and D. Danforth, *Construing Standard Policy Language for the Sophisticated Insured*, Insurance Coverage Litigation, 1994, p. 346 f. In Sweden, such a practice is not known.

generally treat the results without separating the liability risk from other risk elements.

7. The previous discussion implies that to a certain extent, the economic risk connected with injuries and damages caused by other persons may often in reality be placed otherwise than the liability rules imply. In many cases, an increased liability risk caused by a more rigorous rule will not be borne by the defendant or even by persons of the same class as the defendant but by a wider collective that perhaps will not even include the defendant. Then we cannot reasonably refer to the possibility of his raising the price of his products or services; this should not be necessary, as he pays the same premium as before. We cannot even be sure that a severe liability rule serves the purpose to incite measures preventing damage; a liability insurance may neutralize such effects altogether or to a considerable extent, contrary to the theoretical suppositions of many legal scholars. However, when a risk cannot possibly be covered by liability insurance, the traditional arguments will be of considerable weight.

If these results are accepted, it may be asked what the consequences should be for the law of tort. It should not be without interest that we (including the present author) have based our discussions concerning tort law, consciously or unconsciously, upon assumptions that are often fictitious and at times clearly incorrect. An essential conclusion is that we should pay attention to what actually happens in insurance practice to a much greater extent than today, and at times even resort to actuarian expertise to analyse the implications of a liability rule. It is true that it is difficult to survey this practice, and even more difficult to come to any certain results concerning the appropriate rules on such a basis; but it does not seem more futile to reason along such lines than trying to solve the problem by theoretical discussions disregarding the complications that insurance will imply in concrete situations.

Using this method, we may in particular cases be able to judge the impact of the liability rule upon the insurance premium, on the basis of insurance technique and insurance experience; then we can be entitled to pronounce some definite opinion concerning the economic effects of a liability rule - at least that it will not influence the premium to any appreciable degree. At times, we may be sure that a more rigorous liability rule will raise the premium to some extent, although it is impossible to say how much; this is the case when more general reforms are proposed, for instance extending the right to non-economic damages or punitive damages in some practical situations. In other cases, we should not make too much of such economic arguments, and even less of arguments stressing the deterrent effects of tightening up some liability rule. The uncertainty inherent in such reasoning will justify considerable restraint when we speculate upon the consequences of alternative liability rules. As pointed out above, there may even be reasons for placing a burden of proof upon the party alleging that a more severe liability will have serious economic consequences, by making the liability insurance too expensive for people of the same category to insure themselves. Such objections should be supported by evidence concerning the relationship between the liability rule and the premium.

Under these circumstances, it might at times lie near at hand to attach decisive importance to the compensatory and distributory effect of an extended

liability combined with a liability insurance. Social considerations will outweigh the opposite arguments. But then we would be back to the ideas of the era of ”progressive” tort reform, which many scholars even in Sweden today regard as a thing of the past (though this attitude is hardly shared by the Swedish legislature). The concepts of the primary position of tort law and the importance of general deterrence may be so firmly rooted in the legal thinking that it will demand extensive research to move them even partly from their present positions.