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# THE GENIE AND THE BOTTLE: COLLATERAL SOURCES UNDER THE SEPTEMBER 11TH VICTIM COMPENSATION FUND

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## INTRODUCTION

The September 11th Victim Compensation Fund of 2001 (the Fund) was part of legislation enacted just eleven days after the terrorist attacks of September 11th in the wake of extraordinary national loss.<sup>1</sup> It is possible, therefore, that the Fund will always be considered an urgent and unique response to the unprecedented events of September 11th. On that view, the character of the Fund will have little long-term policy significance. It is equally possible, however, that the enactment of the Fund will prove to be a seminal moment in the history of tort and compensation law. The Fund adopts a new model for compensating loss of life. This model will inevitably be invoked as a standard against which other approaches may be measured, and it may well be employed again in the event that we experience another major terrorist attack on American soil. Thus, with respect to this new model of compensation, there is a sense in which the genie may be out of the bottle: What the Fund did will have to be considered whenever new approaches to compensating personal injury and illness are contemplated.

This prediction raises an obvious initial question: What about the Fund's approach to compensating losses is new? The answer depends on what the Fund is compared to. But regardless of the yardstick, the Fund breaks new ground. In one sense the Fund is unusually generous. For example, the Fund can be viewed as an innovative alternative to tort liability, analogous to workers' compensation or auto no-fault insurance, that pays more generous benefits than these systems but (of course) to a more narrowly defined set of beneficiaries. Simi-

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1. The Victims Compensation Fund was enacted as part of the U.S. Air Transportation and Safety and System Stabilization Act, Pub. L. 107-42, 115 Stat. 230 (2001) (codified at 49 U.S.C.A. § 40101 (West 2003)) [hereinafter Air Transportation Safety and System Stabilization Act].

larly, the Fund can be seen as a new type of government-provided life insurance, along the lines of social security survivorship benefits, but again with more generous benefits and fewer beneficiaries. Under either view, for those who happen to be beneficiaries of the Fund, from one standpoint they are treated extraordinarily generously. Indeed, for those who qualify for an award, the Fund comes closer to providing a full compensation measure of recovery than any non-tort compensation regime ever adopted in this country.

From another standpoint, however, the Fund is not only not generous, but stingy in a way that defies all precedent. Although the benefits paid by the Fund exceed those available under existing non-tort compensation regimes, these benefits cannot compare to what one can obtain in a tort recovery, given the possibility of large noneconomic and punitive awards in some tort cases. But tort is universally understood to be more generous in this respect than any of the vast array of available compensation alternatives. Therefore, a compensation alternative to tort, such as the Fund, cannot justifiably be accused of being parsimonious merely because it pays less than a successful tort claimant would receive.

But compared to other non-tort regimes, there is a sense in which the Fund is unusually stingy. The Fund contains a provision requiring that claimants' benefits be reduced by the amount of any compensation for September 11th-related losses that the claimant has received or is entitled to receive from collateral sources, including life insurance.<sup>2</sup> Neither tort nor any significant non-tort source of compensation for lost life in this country requires a collateral offset for life insurance. Moreover, unlike most other types of insurance, which virtually always employ some type of "coordination" or "other insurance" clause to allocate an insured's losses among various insurers in situations in which the insured has multiple sources of coverage, life insurance never requires such an allocation.<sup>3</sup> Instead, life insurance is paid on top of all other benefits. For this reason, the interaction between the collateral offset provision of the Fund and the provisions of standard life insurance policies is unique. Instead of victims' life insurance being paid to claimants on top of other benefits, the amount of life insurance received by claimants is deducted from the benefits paid to them by the Fund.

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2. Air Transportation Safety and System Stabilization Act § 405(b)(6), 49 U.S.C.A. § 40101 (West 2003). For discussion of collateral sources, see Robert L. Rabin, *Indeterminate Harm in the Context of September 11*, 88 VA. L. REV. 1831, 1839-40 (2002).

3. See ROBERT H. JERRY, II, UNDERSTANDING INSURANCE LAW 710, 737 (3d ed. 2002); ROBERT E. KEETON & ALAN I. WIDISS, INSURANCE LAW 227 (1988).

Although the treatment of collateral sources both within and outside of tort is generally an obscure subject, that treatment can have significant implications for distributive justice, corrective justice, and deterrence. The offsetting of Fund payments by life insurance recoveries appears to reflect a special sensitivity to avoiding double—or at least over—compensation of losses created by September 11th. But as we will attempt to explain, the Fund's treatment of collateral sources generally, and of life insurance in particular, strikes a balance among competing considerations that is far from simple.

The salience of the events of September 11th has resulted in an unprecedented amount of publicity about, and public attention to, the way in which victim recoveries are calculated under the Fund. Much, perhaps even most, of this publicity and attention have been focused on the treatment of collateral sources. Thus, a topic that until recently was obscure even for many tort scholars has become a matter of general public debate. In this Article we explore the issues that have arisen out of the Fund's treatment of collateral sources and speculate about the significance of these issues for tort and compensation systems more generally. Our aim is not to resolve these issues, but to analyze them and identify their implications. In this sense this Article might be seen as a first step in the development of a broader theory of the proper treatment of collateral sources in any liability or compensation system.

## II. BACKGROUND ON THE FUND

### A. *The Forces in Play*

The Victim Compensation Fund was enacted at an extraordinary moment in this country's history. To understand how the Fund and its collateral offset provisions were intended to function, we must first understand the principal forces that lead to the enactment of the Fund and the U.S. Air Transportation and Safety and System Stabilization Act of which the Fund is one part. There appear to have been three major considerations that gave shape to this new type of compensation regime.

#### 1. *Full Compensation*

In the immediate aftermath of September 11th there was an enormous outpouring of public sympathy for the victims of the attacks and their families. They were perceived as having made a sacrifice for their country, rather than merely being the victims of a disaster. This perception was manifested in a desire to see the victims' families fully

compensated for the financial losses caused by the death of their loved ones, despite the potentially enormous cost of doing so. Evidence of this desire can be seen, among other things, in the unprecedented magnitude of the charitable response to September 11th.<sup>4</sup> Not only did the terrorist attacks give rise to the largest wave of charitable giving in modern U.S. history, it also became quite clear that the donors were intent on having their gifts go to the victims of the September 11th attacks, even after organizations such as the Red Cross determined that those needs had already been met.<sup>5</sup> This full compensation imperative was immediately influential in Congress. It is reflected in the rhetoric used by members of Congress during deliberations on the bill.<sup>6</sup> And the Fund itself is responsive to this imperative. The Fund provides for the compensation of both economic and noneconomic losses and, as enacted, contains no limits on the total amount of compensation that can be provided for either type of loss.<sup>7</sup>

The extent to which this full-compensation imperative was operative also can be appreciated by comparing the benefits available from the Fund with those paid by other nontort compensation schemes. In virtually every other scheme the goal seems to be to provide not full compensation but only minimal welfare. For example, the death benefit payable under a typical workers' compensation system is a maxi-

4. The American Red Cross's Liberty Disaster Relief Fund received roughly \$1 billion in donations in the year following the attacks, approximately \$800 million of which was expected to have been distributed by the end of 2002. Press Release, American Red Cross, American Red Cross Releases Sept. 11 Report (Sept. 5, 2002), available at [http://www.redcross.org/press/disaster/ds\\_pr020905report.html](http://www.redcross.org/press/disaster/ds_pr020905report.html) (last visited Oct. 18, 2003).

5. In October 2001, the Red Cross stopped seeking donations for September 11th victims, saying that it had received more money than it could use. See David Barstow & Katharine Q. Seelye, *A Nation Challenged: The Charities; Red Cross Halts Collections for Terror Victims*, N.Y. TIMES, Oct. 31, 2001, at B10; Corey Kilgannon, *A Nation Challenged: Donations; Red Cross Offers to Refund Gifts for Sept. 11*, N.Y. TIMES, Nov. 12, 2001, at B11.

6. Representative James Turner (D-Tex.) made the following statement:

Mr. Speaker, I want to address these remarks to the families of the victims, those who were injured on September 11.

One of the best provisions of this bill is that this Congress has provided a method whereby all those injured, *the victims of those who have died, will have full recovery for their economic and noneconomic damages by the establishment of a special master. The Treasury of the United States has been opened by the Members of this Congress to ensure that every family will receive just recovery.* It is one of the best provisions of the bill, and I urge my colleagues to support it.

147 CONG. REC. H5906 (daily ed. Sept. 21, 2001) (emphasis added).

7. The regulations promulgated by the Special Master pursuant to the Act do place a presumed limit on the amount of noneconomic damages that may be recovered from the Fund, based on the number of dependent survivors of a victim. See 67 Fed. Reg. 11,239 (Mar. 13, 2002) (limiting compensation to \$250,000 plus \$50,000 for any spouse and each dependent).

num of roughly \$20,000 per year;<sup>8</sup> under the Federal Black Lung Act that benefit is a maximum of about \$12,000 per year;<sup>9</sup> family members of military personnel killed in the line of duty receive \$250,000;<sup>10</sup> and the maximum survivor benefit under the Social Security program is a relatively small fraction of the deceased workers' average lifetime earnings.<sup>11</sup> In short, as compared to the death benefits available under workers' compensation and federal compensation programs, the benefits payable by the Fund are extraordinarily generous.

## 2. Tort Protection for the Airlines

With the airlines facing possible bankruptcy in the aftermath of September 11th, they needed both financial backing from the government and some degree of protection against tort liability for the alleged security failures that may have made the attacks possible. The Act gave them the former and the adoption of the Fund gave them the latter, though only indirectly. The indirect protection from tort liability came by virtue of the Fund's largely successful effort to provide a nonmandatory, but generally acceptable, alternative to seeking compensation through tort suits.

Although the benefits available under the Fund are generous compared to other non-tort compensation regimes, the amount of any

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8. The majority of states determine death benefits as a percentage of the deceased worker's average weekly wage. Most states have a maximum payment per week and a maximum period during which survivors may collect. 5 ARTHUR LARSON & LEX K. LARSON, *LARSON'S WORKERS' COMPENSATION LAW* § 98.02 (2002). For example, New York pays 66 2/3% of the employee's wage up to a maximum of \$400 per week during the term of widowhood and to children until the age of eighteen. Florida pays 50% of the employee's wages to a spouse only or 66 2/3% of the employee's wages to a spouse and children up to a maximum of \$594 per week. Idaho pays 45% to a spouse only or 60% to a spouse and children up to a maximum of \$315.60 per week for up to 500 weeks. For a complete listing of state worker's compensation death benefits for surviving spouses and children see *id.* at app. B-65.

9. The Black Lung Benefits Act, codified at 30 U.S.C. §§ 901-962 (2000), provides "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." 30 U.S.C. § 901. Effective January 1, 2001, the basic monthly benefit for a totally disabled miner or his or her surviving spouse is \$500.50. This may be increased to a maximum of \$1001 per month for claimants with three or more dependents. Benefits are reduced by payments made for workers compensation. U.S. DEP'T OF LABOR, *EMPLOYMENT LAW GUIDE: BLACK LUNG COMPENSATION* (2000), available at <http://www.dol.gov/asp/programs/guide/blklung.htm> (last visited Oct. 18, 2003).

10. See 38 U.S.C. § 1967 (2000).

11. STAFF OF HOUSE COMM. ON WAYS & MEANS, 105TH CONG., 2D SESS., 1998 GREEN BOOK 15 (Comm. Print 1998). For deceased workers with "average" or lower levels of qualifying wages, the income replacement rate provided by Social Security survivor benefits can be over 50%, depending on how many dependents are left and how many years of Social Security wages the deceased had earned. For above-average wage earners, the replacement percentage is much lower. *Id.*

given claimant's benefits are nonetheless likely to be smaller than what could be obtained in a successful tort suit, in which huge non-economic and punitive damages are at least potentially available. The difference, of course, is that recovery in tort is much less certain than obtaining benefits from the Fund. To secure a tort judgment, a plaintiff would need to identify and obtain jurisdiction over a defendant or defendants whose conduct, both factually and legally, satisfied the elements of a tort cause of action (duty, breach, causation, etc.). In contrast, the only serious question arising in a claim made by an eligible party against the Fund is the amount of economic damages suffered.<sup>12</sup> Hence, discounting potential tort recovery for the possibility that the plaintiff might recover nothing, the benefits payable by the Fund seem at least comparable to tort, and probably a better bet for the risk adverse claimant.

This degree of comparability was politically necessary for two reasons. First, any compensation system designed to be an alternative to tort is inevitably evaluated by reference to what is available in tort. Because the proposal was to make recovery from the Fund an alternative to tort at the option of the claimant, Congress could anticipate that the Fund's benefit structure would necessarily be compared to tort damages. Consequently, Congress could not safely depart too radically from the tort benchmark. As so often happens, the nature of tort liability and the scope of the damages that are recoverable in tort tended to constrain what could be done in creating an alternative to tort.<sup>13</sup> Thus, Congress faced the challenge of fashioning a benefit structure that would be a departure from tort law's measure of damages but nonetheless would be judged in the public mind by reference to what the claimant could have obtained in tort. Nevertheless, by making recovery from the Fund automatic for any eligible party, and thereby eliminating much of the uncertainty inherent in bringing a tort claim, Congress left itself room to provide something less than "full" tort damages in return for relieving claimants of the burden of proving third-party wrongdoing in order to secure recovery.

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12. In some cases, however, this question may turn out to be very much in dispute. For example, Cantor Fitzgerald, which occupied floors 101 through 105 of the north tower of the World Trade Center, lost 658 of its roughly 1,000 employees who worked in the building. See Submission of Cantor Fitzgerald, L.P., eSpeed, Inc., and Tradespark L.P. to the Special Master of the September 11th Victim Compensation Fund of 2001 and to the Department of Justice 5 (Sept. 12, 2002) available at <http://www.cantorusa.com/vcf/DOJsubmission.pdf> (last visited Oct. 18, 2003). The firm's brief argues that the Special Master's proposed approach to the compensation of economic loss threatens to undercompensate the families of deceased employees.

13. See Walter Blum and Harry Kalvan, Jr., *Ceilings, Costs and Compulsion in Auto Compensation Legislation*, 1973 UTAH L. REV. 341, 343 (1973).

Second, it was not only the reaction of the public at large with which Congress had to be concerned. The Fund also had to be attractive enough to the victims and their families that, at least prima facie, they would perceive it as providing an acceptable alternative to tort. Otherwise, potential claimants would have rejected the Fund alternative outright. Then the nation would have been faced with the prospect of an immediate cascade of lawsuits against American businesses—airlines, security companies, the World Trade Center designers, and others—seeking to hold them liable for the results of September 11th. In the aftermath of September 11th that would have appeared unseemly and unpatriotic. The nation was in the process of pulling together to fight terrorism; the sort of recriminations within the “family” that would have been produced by lawsuits were to be avoided, if at all possible. The particular members of the family most in need of protection would seem to have been the airlines. Recall that the Fund was part of the Air Transportation and Safety and System Stabilization Act (the Act), whose primary purpose, as its name suggests, was to shore up the airline industry, which was hit harder by the events of September 11th than any other single industry (perhaps including the insurance industry).<sup>14</sup> The Fund held out the hope that the airline industry and the country would avoid the spectacle of tort litigation over the scope of American entities’ responsibility for the attacks.

### 3. *Avoiding Overcompensation*

Another political factor that influenced the terms of the Fund was the desire to avoid overcompensation. There are two senses in which claimants could conceivably be overcompensated. First, the size of some individual awards might be seen as excessive. Because many of the victims earned sums in the top one-half to one percent of national income, if there was no ceiling on the amount that could be recovered from the Fund, or if the norm of full compensation were applied, the Fund would end up paying some truly extraordinary awards. This concern, however, appears not to have had much influence in the design of the Fund. In fact, no upper limit was imposed on the awards.

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14. In addition to creating the Fund, the Act, among other things, authorized the transfer of \$5 billion in cash and \$10 billion in loans to the airline industry. Also, it limited the airlines’ tort damages from September 11th to the amount of their outstanding liability insurance coverage. See Air Transportation Safety and System Stabilization Act, *supra* note 1, §408. A subsequent Act of Congress extended this liability limitation to any “aircraft manufacturer, airport sponsor, or person with a property interest in the World Trade Center, on September 11, 2001, whether fee simple, leasehold or easement, direct or indirect, or their directors, officers, employees, or agents.” Aviation and Transportation Security Act, Pub. L. 107-71, 115 Stat. 597, 646 (2001).



There was a suggestion that, in the implementation of the Fund, the Special Master might impose a “soft cap” on awards through a “presumed award” procedure.<sup>15</sup> As was made clear in the final regulations, however, although there may be presumed awards, the Special Master does not intend to impose an absolute ceiling on awards, but plans instead to make awards based on the “individual circumstances of the claimant”—a plan that seems to imply an intention to ensure that there is full compensation.<sup>16</sup>

The risk of a second type of overcompensation, however, seems to have been more of a concern. Some Fund beneficiaries would also be receiving large life insurance or pension payouts triggered by the death of their loved ones. In such cases, if no offsets were made for these collateral sources of compensation, the total amounts received by those families could actually exceed the families’ financial (though obviously not their nonfinancial) losses, or at least could involve very substantial sums. It is easy to imagine that lawmakers would have wanted to avoid the possibility that some families would become (or be perceived as becoming) wealthy as a result of the September 11th tragedy. This sort of concern is not unique to September 11th. Federal disaster relief generally, whether in the form of loans or outright grants, is available only for uninsured losses.<sup>17</sup> The political reason for this limitation is clear: public support for disaster relief would wane quickly if there were stories in the media of victims actually profiting from a disastrous event. A desire to avoid this type of overcompensation almost certainly contributed to Congress’s decision to insert the collateral offset provisions in the Fund.

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15. 67 Fed. Reg. 11,236-37 (Mar. 13, 2002). The presumed award is based on a formula that takes into account, among other things, the age and income of the victim. Under one of the two available claim “tracks,” an eligible claimant can seek a preliminary determination of her presumed award, which she can then either accept or reject, in favor of an individualized hearing. The notion of a soft cap arose from the fact that, according to the Special Master, the presumed-award calculations would be made under an assumption that none of the September 11th victims had incomes higher than the ninety-eighth percentile of national income (around \$225,000). This assumption is of course counterfactual in more than a few cases, as a sizeable number of victims had incomes in the top .5 to 1% of national income.

16. “To be absolutely clear: The fact that the ‘presumed awards’ address incomes only up to the [ninety-eighth] percentile does *not* indicate that awards from the Fund are ‘capped’ at that level.” *Id.* at 11,237. If this is so, however, one wonders why the Special Master bothered with the “presumed award” approach in the first place. Perhaps the idea is to encourage the use of the presumed awards in order to minimize the administrative costs of individualized hearings. But that story would seem to support the soft cap characterization.

17. For example, the Federal Emergency Management Agency (FEMA) provides assistance for “uninsured or under-insured, necessary expenses and serious needs.” 44 C.F.R. § 206.110 (2002). Assistance to insured individuals and households is strictly limited. *Id.* § 206.113.

In sum, these three political considerations—full compensation, an attractive alternative to tort, and avoiding overcompensation—helped to shape the Fund as it was enacted by Congress, and as it was implemented through the regulations promulgated by the Special Master. This is especially true of the collateral offset provisions, which we summarize in the next section, and then evaluate in the remainder of the Article.

### B. *The Fund's Treatment of Collateral Offsets*

Although the language in the Act that sets up the Fund is relatively terse on the issue of collateral offsets, its meaning is unmistakable. Congress clearly intended to reverse the traditional treatment of collateral sources, across the board. The Act provides that the Special Master awarding compensation “shall reduce the amount of compensation . . . by the amount of the collateral source compensation the claimant has received or is entitled to receive as a result of the terrorist-related aircraft crashes of September 11, 2001.”<sup>18</sup> The term “collateral source” is then defined to mean “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.”<sup>19</sup>

This was among the most controversial provisions in the Act, and even the objections generated objections. Some commentators have railed against the collateral offset provision on the ground that it would mean that some families of September 11th victims would receive little, or perhaps nothing, from the Fund.<sup>20</sup> That result struck many as especially unfair, given that the collateral offsets would have the greatest effect on the families of those victims who happened to have planned ahead (or whose employer planned ahead) and purchased insurance, a group that included the families of the firefighters and police officers who died while attempting to rescue others. At the same time, however, some commentators have expressed serious concern over the problem of overcompensation (discussed above) and, explicitly or implicitly, offered arguments in favor of the collateral offset provisions.<sup>21</sup>

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18. See Air Transportation Safety and System Stabilization Act, *supra* note 1, § 405(b)(6).

19. *Id.* § 402(4).

20. See, e.g., David W. Chen, *Worst-Hit Firm Faults Fairness of Sept. 11 Aid*, N.Y. TIMES, Sept. 17, 2002, at A1; Jon S. Corzine, Letter to the Editor, *Fix the Victim's Fund*, N.Y. TIMES, Jan. 28, 2002, at A14; Elissa Gootman, *Seeing Families, Senator Calls for Changes in Sept. 11 Fund*, N.Y. TIMES, Jan. 14, 2002, at B2.

21. See, e.g., Robert F. Worth, *Families of Victims Rally for Higher Federal Awards*, N.Y. TIMES, Jan. 18, 2002, at B4 (noting postings on the Victim Compensation Web site expressing

In his comments accompanying the final regulations implementing the Fund, the Special Master attempted to make clear that he was taking both of these competing concerns into account, though emphasizing that Congress had, in important respects, tied his hands by mandating collateral offsets.<sup>22</sup> Thus, although Congress had listed several types of compensation that would have to be considered collateral sources—importantly, including life insurance proceeds—that list was not exclusive. As a result, the Special Master could be viewed as having some discretion in defining what would count as a collateral source and what would not, how to calculate the value of the benefits payable by the collateral source, and under what circumstances the availability of payment from a collateral source would be considered too speculative to be taken into account.

The final regulations accepted the Congressional mandate every bit as far as it expressly extended but exempted from the category of “collateral source” a variety of payments or potential payments about which reasonable people might disagree. Thus, for example, the Special Master defined the term collateral source *not* to include amounts received as charitable contributions, a decision that seems consistent with the statute but certainly was not required by it.<sup>23</sup> In addition, he excluded from the definition certain tax benefits, such as the income and estate tax breaks made available to September 11th victims under the Victims of Terrorism Tax Relief Act of 2001.<sup>24</sup> Also, because the collateral benefits provided under the Social Security survivorship program as well as under some workers’ compensation programs are contingent on future events, such as a surviving spouse’s not remarrying, the Special Master decided to require an offset only for those ben-

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concerns about “greedy people when it comes to the distribution of funds to the victims of September 11”); Editorial, *The Victims’ New Referee*, N.Y. TIMES, Dec. 1, 2001, at A26 (suggesting that the Victim Compensation Fund could incorporate a “ceiling . . . to prevent obscenely large awards.”).

22. See September 11th Victim Compensation Fund of 2001, 67 Fed. Reg. 11,233 (Mar. 13, 2002) (codified at 28 C.F.R. § 104 (2003)). The Special Master stated:

As I have repeatedly stated to the victims and their families, there are many aspects of the fund that are mandated by Congress and cannot be changed by me or by the Department. Indeed, many of the most controversial aspects of the Fund—such as the requirement that awards be offset by life insurance and other collateral source compensation—are specifically required by Congress.

*Id.*

23. This decision may have been a response to the worry that firefighters and other rescue workers would otherwise receive too little compensation because the families of fallen rescue workers seem to have been the primary beneficiaries of charitable contributions. See Stephanie Strom, *Survivors of Firefighters Ask to Look into Union Charity*, N.Y. TIMES, May 9, 2002, at B7.

24. Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, 115 Stat. 2427.

efits that have already been received by the claimant.<sup>25</sup> In addition, he made a decision not to include any element of personal savings as a collateral source, whether it be in the form of a savings or self-funded pension account or in the form of accumulated surrender value within a cash value life insurance policy.<sup>26</sup> The unstated rationale here seems to be that, at least with respect to the particular form of government-provided life insurance represented by the September 11th Fund, individuals will not be expected to have self-insured.<sup>27</sup>

This last exemption of various forms of savings and investment from the definition of collateral sources is of special significance, because the exemption highlights the difference between compensation based on loss and compensation based on need alone. As we will show below, as far as the Fund does go in attempting to base compensation on loss, it stops short of basing compensation on need alone. In doing so, it avoids both the practical and the philosophical problems that would be entailed in prescribing means-tested recoveries.

### III. EVALUATING THE FUND'S COLLATERAL OFFSET PROVISION

#### A. *Coordination, Subrogation, and Collateral Sources*

In order to evaluate the Fund's collateral offset requirement, it is necessary to understand the two available approaches to handling collateral sources in tort cases generally. The traditional approach, adopted by a majority of states, is to reject collateral offsets (this approach we call *collateral nonoffsets*); whereas a minority of states require *collateral offsets* of tort awards to take into account various types of non-tort compensation, not including life insurance.<sup>28</sup> The choice between these approaches is intertwined with the doctrine of subrogation and the function this doctrine performs in coordinating sources of coverage in both insurance and tort law.

#### 1. *Coordination of Insurance Coverage*

The entire coordination issue derives from the fact that private insurance products and social insurance regimes have proliferated in the modern American economy. Insurance is now available to cover a

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25. See September 11th Victim Compensation Fund of 2001, 67 Fed. Reg. 11,233, 11,241 (Mar. 12, 2002) (codified at 28 C.F.R. § 104 (2003)).

26. *Id.* at 11,234. He will also ensure that there are no offsets if those to whom life insurance or pensions are paid are not the parties receiving compensation from the Fund. *Id.*

27. This may be another manifestation of the full-compensation norm discussed above, to which we will return later in the Article.

28. As mentioned in the introduction, the Fund takes this minority collateral offset approach and, in an unprecedented move, expands it to offset life insurance proceeds as well.

variety of risks to health, life, property, and income. As a consequence, there is an ever-increasing possibility of overlapping insurance coverage for any given loss. First, different types of policies may overlap. For example, the medical costs associated with a personal injury may be covered under portions of an individual's homeowner's policy, automobile policy, and employer-provided health insurance policy. Workers' compensation or Medicare may also figure into the equation.<sup>29</sup> Second, multiple policies of the same type may provide overlapping coverage. For example, two spouses and their family members may both be covered by health insurance afforded as a fringe benefit by their respective employers. In a very real sense, the Fund, too, is a source of first-party insurance that overlaps with benefits paid to claimants by collateral sources.

Despite these overlaps, providing policyholders with insurance in excess of their losses would violate the principle of indemnity, which holds that insurance is designed to protect against loss, not to make gain possible. This is a principle that runs through all of insurance law.<sup>30</sup> To prevent payment in amounts that would violate this principle, a patchwork system of insurance coordination that allocates coverage responsibility among potential insurers has evolved. Coverage is coordinated so as to specify which insurer or insurers pay, and in what proportions, when more than one policy provides coverage of a loss that does not exceed the sum of the coverage provided by all available policies.

The goal of a system of coordination need not merely be to ensure that the principle of indemnity is not violated; coordination can perform other functions as well. From the standpoint of loss prevention, for example, primary coverage responsibility should be assigned to the insurer with the greatest capacity to combat moral hazard on the part of the insured. Alternatively, if moral hazard is of comparatively little concern (or if no insurer has much capacity to combat it), the insurer best situated to bear primary coverage responsibility may be the one most able to minimize administrative costs or to distribute the risk in question most broadly, depending on the system's goals.

Our system of insurance coordination is implemented through a combination of market and legal mechanisms.<sup>31</sup> The market mechanisms include insurance policy provisions expressly allocating insuring responsibility among insurers whose policies overlap. These provisions

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29. *See id.* at 133-34.

30. *Id.* at 137; JERRY, *supra* note 3, at 295.

31. *See* KENNETH S. ABRAHAM, *DISTRIBUTING RISK: INSURANCE, LEGAL THEORY, AND PUBLIC POLICY* 148 (1986).

are sometimes called “other-insurance” or “coordination of coverage” provisions.<sup>32</sup> Versions of them can be found in virtually every type of insurance policy, except, interestingly, life insurance. Coordination clauses of this sort attempt to specify which insurer or which policy is to be primary (that is, which will cover the first dollars of insured losses) and which will be secondary (which will cover what is left over).

It is not uncommon, however, for such market mechanisms—contractual coordination provisions—to fail by themselves to produce efficient or desirable risk allocation among the insurers in question.<sup>33</sup> This is because it takes two to coordinate, so to speak. For example, market forces, if left alone, can lead to a situation in which two insurance policies that purport to cover a given risk also contain “other-insurance” clauses that, if read literally, result in no coverage whatever. That is, each policy has a clause making the other policy the primary insurer.<sup>34</sup> In such situations courts are called upon to harmonize conflicting coordination provisions, which sometimes means ignoring these provisions and specifying new rules of coordination. To avoid such conflicts altogether, regulatory authorities sometimes require insurers to insert standardized (and therefore consistent) coordination clauses in their policies.

Thus far we have discussed coordination as if the only form of insurance in play were first-party insurance—that is, insurance purchased by or for those who suffer loss themselves. A broader conception of coordination, however, would also comprehend third-party, or liability insurance, as a source of coverage for such loss. The typical successful tort claimant, after all, is likely to have received compensation for some of his or her losses from collateral sources, such as health and disability insurance, and yet, also to have a right of access to the tort defendant’s liability insurance after settlement or judgment. The rules governing how the collateral sources will be counted—whether they will be offset against a tort award or not—can be understood as the means by which first-party and third-party insurance is coordinated.

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32. *Id.* at 148-57.

33. *Id.* at 157 (“Because market devices mainly make use of bilateral contracts to achieve coordination, their capacity to reflect the multilateral character of the insurance arrangements they create is limited.”).

34. *See, e.g.,* *Blue Cross & Blue Shield of Kan., Inc. v. Riverside Hosp.*, 703 P.2d 1384 (Kan. 1985) (holding that coordination of coverage provisions in two health insurance policies were in conflict).

## 2. *Subrogation as Coordination*

The doctrine of subrogation is central to the way in which first-party and third-party insurance have traditionally been coordinated and the way in which the principle of indemnity has traditionally been served. Subrogation is the process by which one party is substituted for another party relative to the latter's rights against a third party. Through subrogation, an insurer in effect "steps into the shoes" of the insured, succeeding to whatever legal claims that insured may have against third-parties responsible for the insured's loss.

The insurer in that case is said to be "subrogated to" the insured's rights to sue the third party. The authority for this transfer of rights is found either in an explicit subrogation clause in the insured's policy (which can be found in almost every first-party insurance policy, except life insurance) or in the judicially created doctrine of equitable subrogation, which in effect makes a subrogation clause an implied term in virtually every type of non-life first-party insurance.<sup>35</sup>

The traditional collateral source rule, which rejects collateral offsets and permits the plaintiff in a tort suit to recover compensation from the defendant for losses that have been or will be paid by collateral sources of insurance, is actually a method of vindicating first-party insurers' subrogation rights. That approach, among other things, is what the Fund rejected. To see how the traditional approach to collateral sources works, consider a simple example. Suppose that Sarah is injured by Michael. Sarah's hospital and medical expenses may be paid by her first-party health insurer, such as BlueCross. If so, then, owing to either the subrogation language in Sarah's BlueCross policy or the state's equitable subrogation doctrine, BlueCross will become subrogated to Sarah's tort rights against Michael to the extent of its prior payment to Sarah.<sup>36</sup> BlueCross typically will not, however, exercise this subrogation right directly in an action against Michael. Rather, subrogation will occur indirectly, through the insurer's exercise of a right to subrogation via reimbursement by Sarah out of her recovery from Michael.<sup>37</sup>

Thus, subrogation acts as a coordination device. However, instead of allocating insurance responsibility among first-party insurers, as

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35. See KENNETH S. ABRAHAM, *INSURANCE LAW AND REGULATION* 192-93 (3d ed. 2000).

36. *Id.*

37. This ideal, however, is not always realized in practice. For example, insurers may not monitor ongoing tort actions with sufficient care to vindicate their subrogation rights when actions settle or go to judgment; when cases settle, the amount of the insurer's right of reimbursement may be indeterminate. See KENNETH S. ABRAHAM, *THE FORMS AND FUNCTIONS OF TORT LAW* 216-18 (2d ed. 2002).

other-insurance clauses do, subrogation (working together with the collateral source rule) allocates coverage responsibility between first-party insurers and tort defendants and their liability insurers. Through subrogation, the defendant or its liability insurer bears ultimate coverage responsibility for the plaintiff's loss. That is why, under the traditional nonoffset collateral source rule, if an injured person receives compensation from a source other than the tort defendant (such as a first-party insurer), in a subsequent tort suit against the defendant the jury is not allowed to hear evidence on, or in any way take into account, the amount of this collateral compensation.

That is also why the traditional collateral-nonoffset regime ideally has the effect of making the defendant or its liability insurance company the primary insurer of a plaintiff's medical expenses. However, when a defendant has no liability insurance or is judgment proof, the health insurer has no way to vindicate its subrogation rights and ends up bearing the cost of the policyholder/plaintiff's medical expenses as a kind of secondary insurer. In addition, many courts apply what is sometimes called a "make-whole" rule, under which an insurer cannot be subrogated to its insured's rights against a tortfeasor unless the insured has been made whole.<sup>38</sup> Under this rule, subrogation rights are limited when the insured has recovered or settled for less than his or her full losses.

In contrast to the traditional nonoffset/subrogation approach, under a collateral offset rule of the sort adopted by statute in a number of states following the liability "crises" of the 1970's and 1980's—and like the approach adopted by the Fund—awards are in fact reduced by the amounts of first-party insurance proceeds already received or payable in the future.<sup>39</sup> Under these statutes (as under the Fund), the plaintiff's total recovery from the defendant is offset by payments received or receivable from collateral sources. The collateral sources, in turn, typically have no subrogation rights to vindicate and are not reimbursed out of the plaintiff's recovery, which, after all, does not include the sums paid by collateral sources. Collateral sources such as health insurance (and in the case of the Fund, life insurance) thus become the primary course of compensation under a collateral offset regime. Under such a regime, if the medical expenses the plaintiff incurs exceed the limits of (or are not otherwise covered by) health insurance, or if the plaintiff incurs noneconomic losses, those losses are still cov-

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38. See JERRY, *supra* note 3, at 711-14. See *infra* Part III.D.2. (further discussing the make-whole issue).

39. For discussion of these statutes, see Joseph Sanders & Craig Joyce, "Off to the Races:" *The 1980s Tort Crisis and the Law Reform Process*, 27 Hous. L. REV. 207, 217-23 (1990).



ered by the plaintiff's "secondary" insurers—namely, the defendant and its liability insurer.

Thus, the collateral *nonoffset* and collateral *offset* approaches each coordinate coverage and thereby prevent overcompensation, but they do so differently. The former allocates primary coverage responsibility to tortfeasors and their liability insurers. The latter allocates primary coverage responsibility to first-party insurers. The choice between the two approaches depends on which type of insurance one regards as more efficient or otherwise appropriate with respect to a particular type of risk. For instance, the efficiency question turns on which allocation of responsibility would provide the best overall risk-reduction incentives (and thus would produce the least moral hazard) and which would provide the best means of risk spreading. The answer to this question will often come down to one's views on the effectiveness of the threat of tort liability in a given context as a deterrent. Thus, for example, the prospect of tort liability and its effects on auto-liability insurance premiums probably has little effect on individual driving behavior.<sup>40</sup> Given the inherent risks associated with driving, and the potential incentive effect of first-party auto premiums, it seems unlikely that tort law significantly enhances safe-driving incentives. If that intuition is sound, it would suggest that the optimal approach to collateral sources for auto-accident cases would be the non-traditional collateral offset rule, which would leave auto risks to be insured by first-party insurers (and might even eliminate the need for costly tort suits).<sup>41</sup> One might well have a different intuition as to the potential deterrent effect of product liability lawsuits, a conclusion that supports the traditional nonoffset approach to collateral sources.

### B. *The Strange Case of Life Insurance and the Principle of Indemnity*

To the extent that the Fund will operate as an insurance mechanism, it will function primarily as a form of life insurance. This is so because the vast majority of the payouts will be to the families of the almost 3,000 victims who died in the attacks. However, whereas every other type of insurance includes an explicit (or judicially provided implicit) subrogation right or coordination provision, life insurance policies tra-

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40. For discussion of the studies addressing this issue, see Gary T. Schwartz, *Reality in the Economic Analysis of Tort Law: Does Tort Law Really Deter?*, 42 UCLA L. REV. 377, 393-97 (1994).

41. Indeed, this is a principal rationale for and effect of the move to auto no-fault compensation regimes in many states.

ditionally do not contain such provisions.<sup>42</sup> Indeed, life insurance is the type of insurance with respect to which neither insurers, insureds, nor the law has sought to coordinate coverage so as to avoid overcompensation. In the absence of an express subrogation provision in a life insurance policy, it is clear (though there is little law on the point) that the courts will not permit equitable subrogation by the insurer, as they would, for example, in the case of property insurance.<sup>43</sup> And as a matter of practice, insurers never insert such clauses in their policies.

The origins of this rule and the corresponding practice are not clear but may have originated from the (probably inaccurate) supposition that life insurance is not indemnity for lost income but a way of assuaging grief.<sup>44</sup> Because the grief felt over the death of a loved one could never be fully assuaged, the theory went, a policyholder could not be overcompensated by recovery of both life insurance and a tort judgment.<sup>45</sup> This theory was probably reinforced by the now-abolished limitations on the scope of damages recoverable for wrongful death, including the non-recoverability under some statutes of any damages whatsoever for emotional loss.<sup>46</sup> Once these limitations were in place, they were difficult to alter. To permit equitable subrogation by life insurers the courts would have been required to overrule long-settled precedent. And any insurer that attempted to insert a subrogation provision in its policy would have found itself at a distinct public relations disadvantage when it attempted to enforce the provision against, for example, a sympathetic widow.

In any event, the general rule in tort law with respect to collateral sources from life insurance—even in the minority states that have adopted collateral offsets for most types of collateral sources—is that tort awards are not to be reduced by life insurance proceeds. Thus, using our example from above, if the accident involving Michael and Sarah had resulted in Sarah's death, then Sarah's family would have been able to recover not only the proceeds of her life insurance policy,

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42. See JERRY, *supra* note 3, at 710; KEETON & WIDISS, *supra* note 3 at 227.

43. See, e.g., Spencer L. Kimball & Don A. Davis, *The Extension of Insurance Subrogation*, 60 MICH. L. REV. 841, 845 (1962) ("In life insurance, there seems little doubt that, absent contractual stipulation, subrogation would be denied uniformly. Dicta are plentiful, but no cases actually decide the matter.")

44. See, e.g., George Steven Swan, *Subrogation in Life Insurance: Now Is the Time*, 48 INS. COUNS. J. 634, 635 (1981).

45. See, e.g., Mich. Hosp. Serv. v. Sharpe, 63 N.W.2d 638, 644 (Mich. 1955) (Reid, J., dissenting) ("There seems to be little doubt that a life insurance company cannot recover of one who has caused the death of an insured the amount which it has thereby been compelled to pay.") (quoting 29 AM. JUR. 1003-04) (internal quotation marks and citations omitted); Kimball & Davis, *supra* note 43, at 851.

46. Kimball & Davis, *supra* note 43, at 859.

assuming she had such a policy, but could also have brought a wrongful death claim against Michael without any offset for the life insurance proceeds.<sup>47</sup> As a result, depending on a number of factors—including Sarah’s income, the amount of her life insurance, her relationship with her dependents, and the amount of the wrongful death recovery—Sarah’s family might have been, in a purely financial sense, “overcompensated” for Sarah’s death.

Of course, to say that life insurance, as it is used today, is not about indemnity is to indulge in a fiction. When a household decides to purchase life insurance on the lives of the income earner or earners in the household, the whole point is to insure the dependents (for example, the surviving spouse and any young children in the household) against the possibility that earning power will be prematurely lost. “Premature death” in the life insurance context means dying before the time at which the dependents either would be expected to fend for themselves or would have sufficient savings built up to replace the earning power of the deceased breadwinner. Put this way, in terms of insuring earning power or human capital, life insurance begins to look a lot like disability or even property insurance, and the indemnity concept seems at least arguably relevant.

Moreover, one of the most important manifestations of the principle of indemnity—the insurable interest requirement—does in fact apply to life insurance. This doctrine holds that individuals may purchase coverage only against contingencies that will actually cause them to suffer a loss and only to the extent of those potential losses.<sup>48</sup> The obvious reason for having an insurable interest requirement in life insurance is essentially the same as in other types of insurance.

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47. See, e.g., *McKinney v. Cal. Portland Cement Co.*, 117 Cal. Rptr. 2d 849 (Ct. App. 2002); *Bell v. Estate of Bell*, 885 S.W.2d 877 (Ark. 1994); *Estate of Rattenni v. Grainger*, 379 S.E.2d 890 (S.C. 1989); RONALD HORN, *SUBROGATION IN INSURANCE THEORY AND PRACTICE* 39 (1964).

48. JERRY, *supra* note 3, at 296-310. The rules governing what precisely constitutes an insurable interest (such as whether there must be a “legal interest,”—a contract right, in the item insured—or whether, instead, a “factual expectancy” of some return from the insured item is sufficient) vary from state to state. *Id.* The insurable interest requirement is essentially the same for both property and life insurance, with a number of key qualifications. *Id.* at 310-16. For example, with life insurance taken out on one’s own life, or on the life of a close family member, there generally is no doctrinal limit on the amount of coverage that can be purchased. This is in contrast to property insurance, where the insurable interest doctrine limits coverage to the amount of one’s economic interest in the property being insured. However, with life insurance contracts, insurers themselves impose limits on the amount of coverage they will provide. Thus, we would be surprised if a life insurer would be willing to sell a policy on an individual’s life that greatly exceeded a reasonable estimate of that individual’s human capital value. What is important for the purposes of this Article is that insurance law—for both life insurance and property insurance—generally seeks to avoid circumstances in which losses to life or property result in windfall gains to insureds.

The requirement seeks to minimize the especially egregious form of moral hazard that would arise if individuals were permitted to purchase life insurance policies that could generate net economic gain for them.<sup>49</sup>

For all these reasons, and contrary to conventional wisdom, there is a sense in which the principle of indemnity does in fact apply to life insurance. Nevertheless, the doctrine of subrogation clearly does not. With the liberalization of wrongful death statutes to permit recovery of emotional losses suffered by survivors, we must ask why. Perhaps the best explanation is still that nonsubrogation is necessary to compensate for the problem of underinsurance. That is, a case can be made that individuals and households generally buy too little life insurance.<sup>50</sup> Although there is a conceptual and normative difficulty in determining precisely what the “right amount” of life insurance is (an observation that will become important below in our evaluation of the Fund), there is substantial empirical evidence to support the claim that the lives of primary earners within households tend to be underinsured.<sup>51</sup> Moreover, there are cognitive reasons why we might expect this to be so—simple myopia, an unwillingness to face one’s mortality, distaste for dealing with life insurance agents, and even fear of having one’s blood drawn during a physical exam.

If most households have too little life insurance, then also allowing them to bring wrongful death actions without having to share the proceeds with a life insurer will, to some extent, counteract this underinsurance problem. The approach achieves this effect, however, in a way that is sometimes underinclusive and sometimes overinclusive. It is underinclusive in that many households that are underinsured do not have the benefit of a wrongful death claim; and it is overinclusive in that some households that do have such claims will not have been

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49. There is also a low-level anti-wagering concern here that is separate from the moral hazard concern. Although we are generally skeptical of anti-wagering justifications for the principle of indemnity and the insurable interest requirement (given that many states allow various types of gambling and some even have state run lotteries), there would undoubtedly be something untoward about allowing individuals to bet on when someone in whose life they have no personal or economic interest will die.

50. Kyle D. Logue, *The Current Life Insurance Crisis: How the Law Should Respond*, 32 CUMB. L. REV. 1 (2001).

51. B. DOUGLAS BERNHEIM ET AL., THE ADEQUACY OF LIFE INSURANCE: EVIDENCE FROM THE HEALTH AND RETIREMENT SURVEY (Nat’l Bureau of Econ. Research, Working Paper No. 7372, 1999), available at <http://www.nber.org/papers/w7372> (last visited Oct. 18, 2003). According to this study, if their spouses died in 1992, almost one-third of wives and more than 10% of husbands would have suffered living standard reductions of 20% or more. *Id.* at 3. The authors also found that underinsurance tends to be more common among low-income households, couples with asymmetric earnings, younger households, couples with dependent children, and non-whites. Among some groups, the frequency of underinsurance exceeds two-thirds. *Id.*

underinsured. In these latter situations there is, at least theoretically, a moral hazard and the corresponding problem of wagering on death. Thus, there is a tradeoff between the problem of the overinsured and the problem of the underinsured, although we suspect that the latter is of greater concern than the former. Perhaps the biggest weakness with the argument that seeks to justify double-indemnity for wrongful death on grounds of underinvestment in life insurance generally is that there are any number of policy tools that might more effectively respond to the problem. For example, instead of allowing double recovery for certain tort plaintiffs, Congress might enact a new tax break for all who purchase life insurance or for those in the categories of people whom we believe to be most at risk. In the extreme, Congress might even increase the amount of government-provided life insurance offered through the Social Security Survivorship program.<sup>52</sup> Any such approach could be made both more precise and more comprehensive than simply allowing double-recovery for those whose loved one happens to have been killed by a negligent tortfeasor.

In sum, we do not necessarily defend the traditional collateral-non-offset/nonsubrogation approach to wrongful death claims and life insurance proceeds. Indeed, a consistent recognition that life insurance is primarily about indemnity for lost earning power would suggest either a nonoffset/subrogation approach or a collateral-offset approach. However, we can at least see what the argument for the offset/subrogation approach is—one based on a claim of underinsurance. What we argue in the next section is that such an argument would have no application in the September 11th setting and, therefore, to allow the double-recovery approach would clearly have been a bad idea. Thus, the central question for the design of the Fund's collateral source rules becomes this: Which approach to preventing double-recovery makes the most sense? Is it a collateral-nonoffset/subrogation approach, which is traditional for most tort claims but would be radical and unprecedented for wrongful death cases? Or is it the collateral-offset/nonsubrogation approach, which the Fund adopted and which also is unprecedented for wrongful death cases and life insurance proceeds?

### *C. The September 11th Fund as Life Insurance and the Collateral-Nonoffset Alternative*

#### *1. The Irrelevance of Underinsurance*

If there is a case for allowing some degree of double-recovery in the typical wrongful death tort action on the grounds of systematic under-

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52. See Logue, *supra* note 50, at 37-61.

investment in life insurance, that argument, such as it is, would not apply to the Fund. This is *not* because every individual who died in the September 11th attacks had adequate life insurance. To the contrary, many almost certainly did not. If the conclusions of recent research on life insurance coverage holds true, then many of the younger heads of households who died in the attacks had too little life insurance, or none at all.<sup>53</sup> Rather, the point here is that payouts under the Fund are so generous that there will not likely be a widespread problem of undercompensation for September 11th caused deaths. To put the point more directly, except in cases of victims at the very highest income levels, the Fund payouts will come close to providing full compensation for lost income due to September 11th caused deaths, although obviously no human life can ever be replaced with money. Moreover, the per-person level of (in effect) government-provided life insurance provided by the Fund is much greater than the amount that most individuals carry on their lives. For this reason, it did make sense for Congress *either* to include in the Fund a collateral-offset provision of the sort that was included *or* not to include such a provision but to grant life insurers (and other collateral sources) a subrogation right against Fund payouts. In theory, either approach could lead to full compensation while preventing double indemnity. The interesting question is which approach is better. That is the question to which we now turn.

## 2. *The Irrelevance of Deterrence*

First, let us do away with one argument that generally favors the collateral-offset approach, which again is the majority rule for most tort claims. Recall that the cost-internalization benefit of tort law depends on the coordination provided by collateral-nonoffsets and subrogation. Only with a system of nonoffsets and subrogation can the injury costs ultimately be shifted to tortfeasors and their liability insurers through the tort system, which in turn leads (in theory) to optimal investments in accident avoidance. It is this promised benefit of tort-induced deterrence that is typically cited as the justification for the large administrative cost differential between the tort system and a no-fault system of insurance. If, for whatever reason, there is no deterrence benefit from this cost-shifting, then the administrative costs of the tort system are not justified, at least not on deterrence grounds. Again, this is the primary argument that has been made in

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53. See BERNHEIM ET AL., *supra* note 51.

favor of the switch from a fault-based to a no-fault auto-insurance regime.

With this argument in mind, the question arises whether there is any deterrence benefit to be gained in the September 11th context by a cost-shifting from first-party life insurers to the federal government, as a collateral non-offset approach would do. And the answer is almost certainly no. In the September 11th setting, deterrence through tort law seems largely irrelevant. The institution that has been made financially responsible for the September 11th deaths—the United States government—is not a tortfeasor in the class of those who can be deterred in the future by tort law. The government is a third-party that already, without any inducement from tort law, has every incentive to prevent such attacks in the future. (Witness the amount of federal tax dollars already being spent on reducing the risk of terrorist attacks.) Rather, the situation here—involving private life insurers of various sorts and the federal government as life insurer—bears a much closer resemblance to a traditional first-party insurance coordination problem (as in the case of first-party health or disability insurance policies) than to a subrogation problem. Hence, the issue is whether private life insurance companies should be the primary insurers, with the federal government secondary, or vice versa. That is, there is no deterrence rational for choosing one over the other, especially insofar as the collateral-nonoffset alternative would likely have entailed higher overall administrative costs.<sup>54</sup>

### 3. *The Distributional Question: Who Should Bear the Losses—Life Insurers or Taxpayers?*

The most important question in deciding between the offset and non-offset approaches is one of distributional justice: To what extent should the financial losses produced by the deaths of nearly 3,000 people on September 11th be borne by private insurance companies, their shareholders, and perhaps their reinsurers; and to what extent should those losses be borne by the United States government, that is, the United States taxpayer? Again, because of the generosity of the Fund payouts (owing to the full compensation norm discussed above), and

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54. The higher administrative costs would have come from the need for a process by which life insurers would have sought subrogation payments from the federal government. If we assume a no-fault regime (again, because of the absence of any deterrence goal), then such a subrogation process could have been relatively inexpensive, that is, in comparison with a typical tort suit against a private party. However, it seems likely that such a process would be less efficient than simply having the Special Master do the collateral offset determination as part of his overall decision about the size of the award. Certainly there is no compelling administrative-cost savings from the non-offset approach.

because of the likely underinsurance problem among the victims of the attacks, taxpayers would bear some of this burden under either regime; however, the nonoffset/subrogation approach would have greatly increased this drain on federal tax dollars and would have essentially eliminated the September 11th liability of life insurers. The argument for such an approach would go something like this: The September 11th attack was directed at the entire country and not just New York City, or just a group of individuals in New York City—and certainly not at the particular insurance companies who end up bearing most of the costs under the collateral offset approach. Thus, the argument concludes, compensation for September 11th related losses should be funded as broadly as possible across the United States population.

We would reject this argument for two reasons. First, and very simply, the collateral offset approach, in contrast with the nonoffset/subrogation approach, is consistent with contractual obligations assumed by the insurance companies when they sold life insurance policies to the victims of September 11th and their families. Each of those policies, like all life insurance policies, almost certainly contained a promise to pay a given death benefit in the event of the insured's death (upon the presentation of a death certificate) *whatever the cause*. That is to say, life insurance policies, unlike many other types of insurance policies, contain very few exclusions. So long as the incontestability period (almost always two years) has passed and the insured does not die by suicide within a given period after the issuance of the policy, the death benefit will be paid. There are no questions having to do with the number of "occurrences"<sup>55</sup> or, typically, whether the loss occurred during a "warlike action by a military force,"<sup>56</sup> as there might be for property insurance. Thus, we suspect that there have been very few, if any, attempts by insurance companies to deny death claims arising out of September 11th, except in the cases of fraud—for example, when an individual falsely claims to have lost a loved one in the attacks or falsely claims that a lost loved one was insured. Besides those cases of fraud, insurers are almost certainly paying the claims with no objections, both for contractual reasons and for public relations reasons.<sup>57</sup> And this is as it should be: the collateral offset ap-

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55. See *SR Int'l Bus. Ins. Co. v. World Trade Ctr. Props.*, No. 01 Civ. 9291, 2002 WL1163577, at e1 (S.D.N.Y. June 3, 2003) (addressing whether attack(s) on the World Trade Center constituted one or two "occurrences" for purposes of construing property insurance policies.).

56. See JERRY, *supra* note 3, at 1068-69 (discussing wartime exclusion and its application to September 11th).

57. Additionally, even the fraud defenses to coverage will be lost once the incontestability period has elapsed.



proach—which makes the life insurers the primary insurers of the human capital lost on September 11th—gives the life insurers precisely the benefit of their bargain. To go with the nonoffset/subrogation alternative would have amounted to having the American taxpayer pick up a debt that rightly belongs to the life insurance industry.

Second, if we were to decide that the cost of September 11th caused deaths should be borne by taxpayers generally (perhaps because of the notion that the attacks were directed at the nation as a whole), a much more radical departure from past insurance practice would be called for than merely adopting a nonoffset/subrogation approach to collateral sources. If Congress were to take such an argument seriously, the same rationale would apply to property losses. Those losses, in monetary terms only, dwarfed the losses to human capital associated with the September 11th attack. Thus, a move to truly “nationalize” the cost of September 11th and take it off the backs of the insurers would have required a much more radical (and massively more expensive) program than was adopted.<sup>58</sup> The case for nationalizing even more of September 11th losses than was in fact nationalized seems difficult to make, given all of the many risks that we generally leave for private markets to distribute. This conclusion holds despite the fact that there have been reports of shortages of (or dramatically increased prices for) insurance coverage for terrorism-related losses, including life insurance.<sup>59</sup> If the history of the insurance industry is any indication, however, over the long run, as capital returns to the reinsurance market and the hysteria from September 11th subsides, the problems of insurance capacity for life insurance will subside as well. In any event, unless one can tell a compelling market-failure story concerning the market for life insurance for terrorism-related risks (which we doubt), special government intervention—in this case in the form of making the federal government the primary insurer of terrorism-caused loss of life (which is what a subrogation approach

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58. Most of the losses to property resulting from September 11th are expected to be covered by private insurance, and what government relief will be provided—which will not be insubstantial is explicitly limited to those losses not covered by private insurance. Saul Levmore & Kyle Logue, *Insuring Against Terrorism—and Crime*, MICH. L. REV. (forthcoming 2003) (discussing relationships between private insurance, charitable relief, and government relief for September 11th losses to property and life).

59. See *id.* at text accompanying notes 20-21. There is some anecdotal evidence that reinsurers are demanding that group life insurers either pay dramatically higher reinsurance premiums or else include terrorism exclusions in their policies. Diane Levick, *Life Insurers Want Safety Net*, HARTFORD COURANT, Mar. 22, 2002, at E1, available at 2002 WL 4798280.

would in essence have done)—does not seem warranted.<sup>60</sup> A thorough treatment of this question—of the appropriate degree of nationalization of particular risks—is well beyond the scope of this Article. We raise it here only to point out that, whatever the merits of the case for such a nationalization of risk, it would be odd in the extreme to choose only to nationalize the risk that had been contractually assumed by the life insurance industry.

#### D. *Defining Collateral Sources*

Besides the questions (a) whether to allow double-indemnity for loss of life (as the common law does in wrongful death cases, but the Fund opted—for good reason—not to), and (b) which approach—collateral offsets or nonoffsets-plus-subrogation—is the best means of avoiding double-indemnity, there remains the conceptually difficult and morally fraught task of defining what counts as a collateral source. Part of the job was done by Congress and part was left to the discretion of the Special Master. Congress specifically said that “all collateral sources” would be offset from the September 11th payouts, and then it listed some of the most obvious categories of 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.”<sup>61</sup> However, it was clear that Congress did not mean for this list to be exhaustive. In the following sections we discuss some of the difficult theoretical and practical issues raised in defining collateral sources.

##### 1. *Collateral Sources and Savings: A Compensation-Based Approach vs. a Need-Based Approach*

The Special Master has attempted to draw a clear line between any payment that looks like pure life insurance—compensation for lost human capital—which will be considered a collateral source, and any payment that looks like a withdrawal from savings, which will not be considered a collateral source and, hence, will not be offset against Fund payouts. This distinction is easy to draw in most cases. The proceeds of a term life insurance policy are clearly a collateral source; whereas, a personal savings account is clearly not a collateral source under the Special Master’s conception.

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60. For an extended discussion of the arguments for and against government intervention in the terrorism-risk insurance market, see generally Levmore & Logue, *supra* note 58, at text accompanying notes 51-63.

61. Air Transportation and System Safety Stabilization Act, *supra* note 1, § 401(4).

Drawing lines between savings and insurance, however, is not always so straightforward. For example, it will be somewhat more difficult to determine what portion of a death benefit from a cash value policy is pure insurance and what portion is return of capital. A similar distinction will have to be made with respect to certain types of pension funds. Consistent with the savings and insurance distinction, the Special Master has said that defined contribution plans such as 401(k) plans—in effect vested savings accounts that can only be reached (without penalty) upon retirement—are to be treated as savings. However, to the extent such retirement plans contain an element of pure term insurance, as some retirement plans do, that amount must presumably be offset. Distinguishing between the portion of pensions that is insurance and the portion that is savings can be difficult.

Similar measurement problems could arise insofar as September 11th victims have various forms of non-traditional life insurance. For example, some individuals purchase life insurance that pays off their mortgage in the event of their death. Presumably such payments would be treated as life insurance offsets as well. A more difficult line-drawing question is presented by those victims who owned some form of double-indemnity life insurance, which pays double the normal death benefit if the insured dies as a result of a specific listed cause, such as an accident. Should such benefits be considered collateral source offsets, or only the part necessary to replace the individual's earning power? Probably the former, but the answer is not obvious.

All of these questions raise a more general issue regarding the Special Master's decision to draw a line between insurance and savings. Putting aside measurement or line-drawing problems, why is it obvious that such a distinction should be drawn? Why should collateral source offsets include insurance and government benefits and other forms of "compensation" for a given loss *but not savings or wealth*? And the same questions could be applied not only to the Fund but also to those tort jurisdictions that have adopted the collateral offset approach. Ultimately, we conclude that offsets for savings would probably not be a good idea—either in the Fund context or in the tort context—but in this section we argue that the case against such offsets for savings or wealth is not as open-and-shut as one might think.<sup>62</sup>

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62. The arguments in this section could also be applied to the Special Master's decision not to include charity as a collateral source.

In the tort setting the case against collateral offsets for personal savings or wealth might begin something like this: It has long been considered fundamental to the conception of tort law that tort damage awards approximate the harm caused to the plaintiff by the defendant.<sup>63</sup> Thus, whether one subscribes to a corrective justice view of tort law (in which tort law is understood as correcting wrongful harms) or a deterrence view (in which tort law is intended primarily to internalize costs and minimize the costs of accidents), damage awards are supposed to equal the harm caused. Most tort theorists would agree that it is inappropriate to adjust tort awards based on the injured plaintiff's savings or wealth except insofar as such an adjustment is necessary to measure the actual amount of the loss sustained. Moreover, if we were to begin treating various forms of wealth as collateral offsets in tort cases, such a move would radically transform the tort system.

This conclusion, however, is usually reached in discussions of the role of distributive justice in *traditional* tort law, by which we mean a tort regime in which collateral sources are *not* offset—in which the traditional collateral source rule applies. It is with respect to those majority jurisdictions that deterrence and corrective justice are thought to be the leading (albeit competing) justifications of the tort system. To reduce or offset tort awards in *those* jurisdictions to account for the wealth of the plaintiff would indeed work a radical transformation of tort law, from a system of corrective justice or deterrence to one of wealth redistribution, which very few commentators (including us) would regard as advisable. But we are not talking about a tort regime in which there are generally no collateral offsets; rather, we are talking about jurisdictions (including the Fund) that, in an effort to avoid overcompensation or “double-recovery,” have already decided to adopt some collateral offsets—to depart from the traditional collateral source rule. The only remaining question, and the one that we focus on here, is whether to include offsets for savings or wealth along with the other offsets.

Given the way we have framed the question, it is less clear, at least on deterrence and corrective-justice grounds, what is wrong with wealth offsets in tort law, which no more undermine the deterrence and corrective-justice functions of tort law than do any other collateral offsets. As already discussed, collateral nonoffsets, together with the subrogation principle, are essential to tort law's deterrence function of shifting the costs of accidents from victims to injurers and their

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63. This conclusion ignores arguments for the imposition of punitive damages.

liability insurers, at least in circumstances in which first-party insurance is present.<sup>64</sup> A similar point could be made about the corrective justice goal of tort law. Thus, the objective of maintaining the purity of the deterrence or corrective justice functions of tort law would have little purchase as an argument against wealth offsets. And the same could be said of deterrence-based or corrective-justice based objections to wealth offsets in the Fund context: That we are allowing collateral offsets at all suggests that deterrence and corrective justice are not the goals of the Fund.

This conclusion seems right to us. As discussed above, the deterrence justification for tort law does not seem to apply to the Fund, as there is little reason to think of the Fund as a deterrent against future terrorism. Moreover, although one might plausibly argue that the Fund serves a corrective justice goal, if one takes the view that the federal government was morally culpable for the September 11th attacks, such a vision of the Fund does not fit well with its actual design, which offers no opportunity for fact-finding as to the culpability of the government (as a tort suit would allow with respect to a tort defendant), but rather focuses only on the questions (a) whether the claimant qualifies for a payment from the Fund, and (b) what the amount of that payment ought to be.

But if deterrence and corrective justice are not the point of the Fund—as they appear not to be the main point of tort law in collateral non-offset jurisdictions,<sup>65</sup>—what is the point? Presumably, it is simply compensation. But what does that mean? Are we to view the Fund as a substitute for, or an enhancement of, the level of life insurance that rational well-informed individuals would purchase for themselves or their households? On this view, the design of the Fund generally, and the design of the collateral source offsets specifically, should be evaluated on the basis of their correspondence with that hypothetical level of life insurance. This application of the consumer sovereignty norm, borrowed from the fields of contracts law and products liability law, might be said to embody a “compensation-based” or “insurance-

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64. As far as we know, none of the jurisdictions that have adopted a collateral offset approach have included savings or wealth in their definition of collateral sources. Rather, they limit the collateral offsets, as Congress has done in the Fund context, to payments that compensate directly for (or “indemnify”) the loss in question, such as insurance benefits or special government benefits. The reason for this may simply be that those jurisdictions simply do not want to take on the additional administrative headache of determining what counts as savings and what does not, and how much of savings gets offset.

65. We are not saying that in collateral-offset jurisdictions tort law serves *no* deterrence or corrective-justice goals, only that deterrence and corrective-justice in such jurisdictions are less important than in traditional collateral non-offset jurisdictions. We return to this qualification in Part IV of this Article.

based” view of how the Fund awards should be calculated.<sup>66</sup> On this view, full compensation calls for the level of payment that an individual would have bargained for in the insurance market, absent market failures of various sorts.

To apply this framework to the precise question at hand—whether to offset awards by savings or wealth—we need to ask, in effect, whether and to what extent individuals or households purchasing life insurance under conditions of high information, low transaction costs and relatively few cognitive biases, would decide to adopt wealth offsets on their own. Put differently, to what extent would or do life insurance purchasers treat their own or the household’s wealth as a form of self-insurance against the loss of a wage earner? We can imagine, for example, that households with a great deal of wealth relative to income might only partially insure the human capital of a household earner (or, for the truly wealthy, not insure at all), preferring instead to absorb the financial loss of an earner’s income rather than to spend money on life insurance premiums. Thus, it is easy to imagine that Bill Gates, despite his enormous earning power, might not feel the need to purchase a term life policy. For such families, including savings as a collateral offset would make some sense, on grounds of consumer sovereignty, in the sense that the government-provided life insurance would approximate the amount of life insurance that the family would have purchased for itself. Along the same lines, we might suppose that households for whom human capital is the largest household asset would be less likely to self-insure, as there is too little wealth to absorb the loss, and thus such households would be more likely to prefer a policy that provides full replacement of human capital. For such households, an offset for savings would be contrary to consumer sovereignty.

But these are mere speculations. Thus, the most obvious problem with a serious attempt to apply the consumer sovereignty principle in this way to the design of collateral source offsets for the Fund (or wherever such offsets are used) is that we cannot know, without a great deal of empirical research into consumer behavior, whether individuals or households, when buying life insurance, implicitly or explicitly reduce the amount of coverage they purchase to account for their household wealth. It remains an open question as to what extent households, when insuring the human capital of household earners, tend to self-insure. But even if such data on consumer spending deci-

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66. Alan Schwartz, *Proposals for Products Liability Reform: A Theoretical Synthesis*, 97 *YALE L.J.* 353, 355-59 (1988) (discussing the consumer sovereignty norm in contracts literature and applying it to products liability law).

sions were available, and even if the Special Master had wanted to adopt such a fine-tuned consumer-sovereignty approach, the effort would have been rendered almost impossible by the inherent difficulties of modeling the “optimal” amount of life insurance, the amount that a “rational” household would purchase. Relatedly, given all of the reasons why households are believed to purchase too little life insurance on the private market (myopia, aversion to planning for their own death), empirical evidence of private life insurance purchases may be more misleading than informative.

The biggest problem, though, facing collateral offsets for savings at least in the Fund context (especially, but not only, if such offsets were made for some claimants but not others) would have been the political one. As a political matter, collateral sources had to have a uniform meaning across all claimants, even if a fine-tuned life insurance consumer-sovereignty approach would have called for some variation based on varying consumer preferences. And just as the Special Master came under enormous pressure from the representatives of the highest-income victims not to place an overall cap on awards, the political pressure not to adjust the awards downward based on wealth would have been immense.

One might also have advocated savings or wealth offsets to Fund awards not on consumer sovereignty grounds—which is consistent with a “compensation based” view of the Fund—but on grounds of distributive justice, which is not. That is to say, if the Fund is understood more as a type of ad hoc social insurance than as a substitute for the tort regime, making the awards needs-based rather than purely compensation-based is somewhat more defensible, at least as an initial matter. After all, the Social Security program—including the federally provided life insurance available through the Social Security Survivorship program—has an obvious needs-based element to the calculation of benefits. For example, if a qualified wage-earner in a household dies, the Social Security Survivorship benefits paid to the surviving spouse are reduced as the survivor’s income rises above certain thresholds.<sup>67</sup> Likewise, the earned income tax credit, beyond a

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67. SOC. SEC. ADMIN., PUB. NO. 05-10069, HOW WORK AFFECTS YOUR BENEFITS (1999). In general, if the surviving spouse is under the age of 65, for every \$2 he or she earns in excess of \$9,600, \$1 in survivorship benefits is lost. *Id.* at 2.

point, decreases as one earns more income;<sup>68</sup> and many social welfare programs historically have been designed to be “means tested.”<sup>69</sup>

A distributive-justice or needs-based rationale for offsetting Fund awards with personal savings, however, would also have faced enormous political opposition, for the reasons already mentioned. The rhetoric of full compensation, which is directly inconsistent with this needs-based approach, took hold fairly quickly after the September 11th attacks, in part out of sympathy for the families, and in part, as mentioned, to make the Fund alternative an attractive alternative to tort law, and thus, to help stabilize the reeling airline companies. Moreover, the practical difficulties and associated administrative costs of applying a means-tested approach via the collateral-source offsets would have been enormous. If the September 11th Fund had been, instead of a one-time ad hoc system of compensation for a single event, a new ongoing social insurance program—a new form of generally available government-provided life insurance—means-testing of some sort would have been much more likely, not only in the collateral-source offsets but in the size of the initial awards as well. But that, of course, is not what the Fund was designed to be. Rather, the Fund is a more or less one-time program to cover the losses arising out of a single event. If, however, events such as September 11th become more routine, we would expect less generous benefits generally,<sup>70</sup> but also a greater likelihood of wealth-adjusted collateral offsets, or something similar, although again we are speculating.

In sum, although we agree with the Special Master’s decision not to include savings or personal wealth in the definition of collateral sources for the Fund, a decision that seems also to be squarely within the intent of Congress, we believe that the case against a means-tested or need-based definition of collateral offsets is more complicated than has previously been recognized. And although the task of drawing the line between savings and insurance (and between charity and insurance) may not always be easy, it is an inevitable byproduct of a compensation-based approach.

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68. I.R.C. § 32 (2000); *see also*, Ann L. Alstott, *The Earned Income Tax Credit and the Limitations of Tax-Based Welfare Reform*, 108 HARV. L. REV. 533 (1995).

69. Examples of such programs include, among many others, foodstamps, Section 8 housing subsidies, Medicaid, Temporary Assistance to Needy Families (which replaced Aid to Families with Dependent Children), and Social Security’s Supplemental Security Income.

70. *See* Levmore & Logue, *supra* note 58.



2. *The Nonoffset/Subrogation Alternative Revisited: The Make-Whole Issue and Delegating the Collateral Source Question*

Because of the inherent difficulty of defining collateral sources, there might have been a temptation in the design of the Fund to go with the nonoffset/subrogation alternative from traditional tort jurisdictions. Again, this would not have been for deterrence or corrective justice reasons, but simply to avoid the difficulty of deciding what would be and what would not be considered a collateral source. However, the nonoffset/subrogation approach has its own problems of line-drawing. For example, the collateral-nonoffset approach would have required either Congress or the Special Master to identify the life insurance, or savings sources, or both, that would have been granted a subrogation right and under what circumstances. Here the critical decisions would not only have been the identification of sources, but resolution of the difficult make-whole issue, discussed above,<sup>71</sup> that often arises in the context of subrogation. One way of putting the make-whole question is this: Would a collateral source's subrogation right be automatic, or would it be applicable only to prevent overcompensation?

To see the importance of this question, consider a simple example. Suppose there are two identically situated households. Each is a family of four, with two parents (both of whom are wage earners) and two small children; and the income and wealth levels of the two households, again, are the same. The only difference is that the two households carry different amounts of life insurance on the primary earners within the households. Household One carries a \$1 million policy on the life of the primary earner, which we will assume would completely replace the insured's lost earning power. Household Two, however, with an identical earning potential, carries only a \$20,000 policy on the primary earner, which, under our assumptions, would be substantially undercompensatory.

Now consider the effects of giving the life insurers in this example a subrogation right. One can easily imagine concluding that granting Household One's life insurer a subrogation right would make perfect sense, because it would help to prevent overcompensation in circumstances involving multiple sources of recovery. However, this conclusion works only because we have assumed adequate coverage in the first place. Recall that it was the general tendency to underinsure household wage-earners that served as the primary rationale for not

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71. See *supra* note 38 and accompanying text.

allowing subrogation of life insurance in the first place.<sup>72</sup> If we consider the case of the underinsured wage-earner, of which Household Two is an egregious example, we can see that granting the life insurer a subrogation right can contribute to, or at least fail to ameliorate, the undercompensation of the surviving members of the household. In such a situation, if there were some other source of recovery besides the \$20,000 policy, the life insurer for Household Two could seek reimbursement first, before the surviving members of the family.

It is a familiar fact of insurance law that this problem can be policed by a rule requiring that the claimant be made whole before any collateral source could exercise its subrogation right. And such a rule would presumably have been necessary if Congress and the Special Master had taken the nonoffset/subrogation route. But a make-whole rule is no panacea. Enforcing such a rule would require some form of adjudication or at least some standard for determining the amount of the claimant's total "loss." The Special Master's rules seem to presuppose that he will pay all claimants their "full" economic and noneconomic losses, thus circumventing this issue. But this presupposition may prove to be questionable when he pays particular claims, and there is certainly no reason to believe that future compensation arrangements will always pay "full" losses. Consequently, whenever a collateral nonoffset approach is used, the conditions under which subrogation by collateral sources is permitted will have to be addressed and the make-whole issue resolved.

If Congress had decided to adopt the nonoffset approach, it might have been tempted to resolve the make-whole issue by avoiding or delegating it. That is to say, as an alternative to adopting a mandatory subrogation approach, Congress could have merely "authorized" life insurers, pension funds, and similar sources to insert subrogation rights into their policies or contracts and then left it to them and to the courts to decide what these subrogation provisions would mean. But then the job of deciding how to deal with the make-whole issue (and, as a result, what offsets to require or not to require) would fall to the insurers and the courts. Such a solution might have had some short-run political benefits, as Congress and the Special Master would not have been directly responsible for answering the hard questions. However, the questions would not have been avoided altogether. Moreover, we cannot ignore the fact that life insurers have never found it in their interest to assert subrogation rights. This fact suggests that life insurers would be unlikely to start inserting subrogation

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72. See *supra* note 51 and accompanying text.

clauses now, even if they are specifically authorized to do so by statute.<sup>73</sup> Given this fact, we might view the collateral offsets for life insurance prescribed by the Fund as simply the federal government's way of taxing life insurers for part of the cost of September 11th compensation, under circumstances in which the life insurers would have had to pay anyway under a nonoffset subrogation approach.

The approach Congress adopted, of course, contains an element of unfairness for those families of victims who happened to have purchased adequate life insurance. Why are they being punished for having planned ahead? A solution to this concern might be to allow a collateral offset-offset for the amount of life insurance premiums that were paid by the September 11th victims or their families on the policies during the life of the policy, up to September 11th. For victims with outstanding life insurance policies, under this approach, it would be as if the federal government had been paying the premiums all along and thus were now, via the collateral offset, getting the benefit of their bargain. Even this solution, however, would not be perfect.<sup>74</sup>

#### IV. CONCLUSION

An important question raised by our analysis is whether the collateral offset provision in the Fund creates a precedent that will have a broader impact on the future of personal injury and compensation law. That is certainly possible, perhaps even likely. We can easily imagine policymakers following the example of the Fund and adding broad collateral offsets that include life insurance to various existing compensation regimes or to new regimes that are adopted to respond to new sources of harm. Such a possibility provides the sense in which the genie may be out of the bottle: When a policy tool of this sort is used for the first time, especially in such a public manner, it is likely to be used again, at least in similar situations (such as future terror attacks) and perhaps in situations involving other types of losses and other compensation regimes as well.

There are, of course, sound reasons *not* to use the collateral offset approach in some settings, settings in which there is some realistic hope that the threat of tort liability can have a significant deterrent

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73. Given that no one currently has a subrogation clause, the reason for this phenomenon might be a version of the first-mover problem; no insurer would want to be known as the first company to insert such a right in their policies.

74. For example, there would be administrative costs with respect to outstanding life insurance policies that involved some element of savings (that is, cash-value policies), as it would be necessary under this approach to distinguish the pure insurance portion of the premium from the portion that went to cash value.

effect. In such settings, a nonoffset approach, coupled with subrogation, would make more sense, in which case, the question of defining collateral sources becomes moot (although the make-whole issue remains). One of the main insights of our analysis, however, is that *when deterrence is not an issue* (or not the primary issue), and hence, the primary issue is how to provide adequate compensation, a collateral offset approach may indeed make sense, but there will remain difficult and interesting questions.

For example, is full compensation to be the exclusive norm in the compensation regime, or is there room for need-consciousness or means-testing in such an approach? The conventional wisdom has long been that issues of wealth redistribution are best handled exclusively by the tax-and-transfer system and never through other compensation systems, especially not the tort system; however, that conventional wisdom assumes that the tort system is primarily about deterrence; when the tort system is mainly about deterrence and incentives, introducing a redistributive role for tort law produces considerable distortion. However, if the deterrence and corrective-functions are removed from tort law—via collateral offsets, say—then the question of whether to pursue a need-based or redistributive approach gains new strength.<sup>75</sup> Thus, a question that has not previously been addressed, and which our analysis suggests deserves some attention, is whether such tort jurisdictions that have adopted the collateral-offset approach should include some aspect of savings or wealth in their collateral offsets.

We do not take a position on that question here, although we suspect that the administrative problems that such an innovation would entail would not justify the small improvement in distributional equity. Also, we should emphasize that the case for a needs-based approach is stronger in the Fund context, in which deterrence and corrective justice seem to be entirely irrelevant, than in the context of collateral-offset tort jurisdictions. In those jurisdictions, of course, there is still some, albeit reduced, deterrence and corrective-justice function served by tort law. Plaintiffs in those jurisdictions still bring

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75. See Kyle Logue & Ronen Avraham, *Redistributing Optimally: Of Tax Rules, Legal Rules, and Insurance*, 56 TAX L. REV. 157, 196 (2003) (arguing that, if because of cognitive biases individuals ignore tort law and thus tort law has no deterrence significance, the redistributive role for tort law might be more easily defended). There is of course a good practical fairness argument for leaving all income or wealth redistribution to regimes that are relatively comprehensive. Comprehensiveness is one of the appeals of the tax-and-transfer regime, and the lack of comprehensiveness is one of the complaints against the tort system, as methods of reducing wealth or income inequality. *Id.* at 185-88. For a series of responses to this argument, see generally *id.*

tort suits and sometimes recover damages from tortfeasors. Why? One reason is the availability of tort damages that are not offset by collateral sources—namely, pain-and-suffering damages and punitive awards. Another is the expressive or symbolic function that individuals sometimes attribute to their “day in court.” Our point here, then, is not that collateral-source tort jurisdictions should immediately adopt need-based tort awards; rather, our point is that, because the deterrence and corrective justice functions of tort law are reduced in those jurisdictions, the case for need-based tort awards (or the case for including wealth in the definition of collateral sources) is stronger than has previously been recognized. Though it is still not as strong as in the Fund context, in which deterrence is truly irrelevant.

In any event, the adoption of the Fund has put these questions squarely on the policy table, and they are questions that will recur not only after any future terror attacks, but also in connection with any new compensation regime that we can imagine. By breaking new ground in its prescription of offsets from Fund compensation for life insurance benefits, the Fund puts at issue an entire area that has until now been off limits to debate. By placing the proper role of life insurance recoveries at issue, the Fund has done what happens periodically in the tort and insurance systems. It has raised questions about the fundamental purposes we seek to achieve in providing compensation to the victims of personal injury and illness.