Michigan Law Review

Volume 75 | Issue 4

1977

The Interlocking Death and Rebirth of Contract and Tort

Jeffrey O'Connell
University of Illinois

Follow this and additional works at: <https://repository.law.umich.edu/mlr>

Part of the [Contracts Commons](#), and the [Torts Commons](#)

Recommended Citation

Jeffrey O'Connell, *The Interlocking Death and Rebirth of Contract and Tort*, 75 MICH. L. REV. 659 (1977).
Available at: <https://repository.law.umich.edu/mlr/vol75/iss4/2>

This Article is brought to you for free and open access by the Michigan Law Review at University of Michigan Law School Scholarship Repository. It has been accepted for inclusion in Michigan Law Review by an authorized editor of University of Michigan Law School Scholarship Repository. For more information, please contact mlaw.repository@umich.edu.

THE INTERLOCKING DEATH AND REBIRTH OF CONTRACT AND TORT†

Jeffrey O'Connell*

I. INTRODUCTION

IN his brilliant and elegant—if controversial—little book, *The Death of Contract*,¹ Grant Gilmore has pointed out that when adversity confronts a party to a contract, courts are now much less inclined to follow either traditional contract law or even contract provisions specifically designed to govern such a mishap. Instead, just as they would deal with any other “accident,” courts tend to resolve the matter through the use of tort-like principles, and they allocate losses accordingly.² A classic illustration is the contract for the purchase of a car that limits the seller's liability for an accident due to a defect in the car to the cost of repairing the defective part: In such a case, if an accident occurs and causes personal injury to the buyer, the provision is ignored.³ Personal injury damages beyond the repair costs *are* recoverable and the contract be damned.⁴

Tort law has always been primarily concerned with picking up the pieces after accidents between strangers who certainly had not anticipated the mishap and consequently had not purported to anticipate how the pieces should (or should not) be picked up. But now, Gilmore tells us,⁵ tort law is swallowing up contract law through its application not only in transactions between strangers but also in those between persons in privity; when the unexpected happens⁶ (in

† This article is based on the author's remarks at the Torts Round Table at the Annual Meeting of the Association of American Law Schools, Houston, Texas, December 28, 1976.

* Professor of Law, University of Illinois. B.A. 1951, Dartmouth College; J.D. 1954, Harvard University.

1. G. GILMORE, *THE DEATH OF CONTRACT* (1974).

2. *See id.* at 87-99.

3. *See, e.g.,* Henningsen v. Bloomfield Motors, Inc., 32 N.J. 358, 161 A.2d 69 (1960).

4. Although other examples not limited to personal injury cases or contracts of adhesion could be cited, this paper focuses on tort and contract as applied to personal injury cases.

5. *See* G. GILMORE, *supra* note 1, at 55-85.

6. Even if the “unexpected” is covered in the contract, the courts often feel free to ignore the contract since such results were not the focal point of attention during the contracting process. This is especially the case in, but not limited to, consumer contracts. In the words of Professor Arthur Leff:

[W]ith respect to consumer “contracts,” most of the boilerplate is about con-

the form of an illness that prevents a coronation, a fire that destroys a crop, a late payment of a life insurance premium, or a charitable donor failing to honor his commitment), neither traditional contract law nor specific contract provisions, with their precise, orderly, demanding and often cruel requirements, now control.⁷ Rather, as in the case of tort law, a concept much vaguer and more amorphous—framed in terms such as “fairness” or “efficient allocation of resources,” or “reasonable behavior or expectations,” or “comparative risk-bearing capacity”—will control.

The first portion of this article will examine the growing inclination of courts to apply tort principles to cases based on contracts; at the same time, the defects of tort will be discussed insofar as they militate against the wisdom of so extending tort principles. In the last half of the article, an alternative contractual method for allocating losses in one particular area will briefly be presented; this method does not contain the defects in loss allocation that have impelled courts to reject traditional contractual principles, but it also avoids many inefficiencies of traditional tort remedies.

II. THE TANGLED HISTORY OF TORT AND CONTRACT

The substitution of tort for contract affects not only *who* will bear the loss when the smooth world the parties normally expect at the time of contract suffers some vulgar intrusion of imperfect reality, but also *how* that loss will be measured. With its rigid requirements of offer, acceptance, and consideration, traditional contract liability was not only difficult to impose but relatively unprofitable as well. “Consequential” damages were not part of the traditional contract law: When a seller’s defective machine injured a buyer, the buyer could recover only the cost of repairs, not his medical expenses or wage loss stemming from the injury; and *if* a seller failed to deliver machinery as promised, the buyer could recover only the difference between the price of the machine under their contract and the price the buyer paid to a substitute seller; the buyer’s lost profits for the period he was without a machine due to the seller’s breach were beyond recovery.

tingencies, things that will become important only if the product or deal breaks down [such as the product or service resulting in unexpected personal injury]. It is hard to focus attention on what should not ordinarily happen, or at least to focus as carefully as upon what will happen for sure; *i.e.*, the price and the nature of the goods. . . .

Leff, *Unconscionability and the Crowd—Consumers and the Common Law Translation*, 31 U. PITT. L. REV. 349, 353 (1970).

7. *Id.* at 350. This is in contrast to former days when “[t]he austerity of [contract] doctrine would not be tempered for the shorn lambs who might shiver in its blast.” G. GILMORE, *supra* note 1, at 21.

As Gilmore suggests,⁸ however, those limitations are disappearing. Courts are no longer inclined to allow the impositions of burdens upon those who, in the judges' opinion, ought not to bear them, regardless of traditional contract law or specific contract provisions. Furthermore, consequential damages far beyond the repair costs or the difference between the contract and market price are now routinely imposed.⁹ According to Gilmore,

[W]e are fast approaching the point where to prevent unjust enrichment, any benefit received by a defendant must be paid for unless it was clearly meant as a gift; where any detriment reasonably incurred by a plaintiff in reliance on a defendant's assurances must be recompensed. When that point is reached, there is really no longer any viable distinction between liability in contract and liability in tort. We may [also] take the fact that damages in contract have become indistinguishable from damages in tort as obscurely reflecting an instinctive, almost unconscious realization that the two fields . . . are gradually merging and becoming one.

. . . .

Speaking descriptively, we might say that what is happening is that "contract" is being absorbed into the mainstream of "tort." Until the general theory of contract was hurriedly run up late in the nineteenth century, tort had always been our residual category of civil liability. As the contract rules dissolve, it is becoming so again.¹⁰

Gilmore further observes, quite justifiably, that "the theory of tort into which contract is being reabsorbed is itself a much more expansive theory of liability than was the theory of tort from which contract was artificially separated a hundred years ago."¹¹ Tort law, like old-fashioned, formalized contract law, closely limited liability. If the rewards were often greater under tort than under contract (in the form of "consequential damages"), recovering in tort was more difficult than recovering in contract. A claimant was required to prove not only the fault of his injurer but also the absence of contributory fault.¹² And it was no coincidence that the thicket of tort law, so protective of those who might be held liable, grew up in an era of expanding entrepreneurial activity, for the clear purpose of the

8. See G. GILMORE, *supra* note 1, at 88.

9. *Id.* at 83, citing Comment, *Lost Profits as Contract Damages*, 65 YALE L.J. 992 (1956).

10. G. GILMORE, *supra* note 1, at 87, 88 (citations omitted). It is Gilmore's view that the general theory of contract law emerged full blown out of Dean Langdell's head with the publication of his casebook in 1871, and that Langdell's thesis was developed by Holmes and Williston. See *id.* at 12-14. Gilmore's view of the birth of contract law has been criticized. See, e.g., Speidel, Book Review, 27 STAN. L. REV. 1161 (1975); Epstein, Book Review, 20 AM. J. LEGAL HIST. 68 (1976).

11. G. GILMORE, *supra* note 1, at 87 (citation omitted).

12. W. PROSSER, LAW OF TORTS § 65, at 416-27 (4th ed. 1971).

restrictions was to nurture commerce.¹³ If, as Gilmore suggests, "the decline and fall of [traditional contract] theory . . . and, in most quarters, of laissez-faire economics may be taken as remote reflections of the transition from nineteenth century individualism to the welfare state and beyond,"¹⁴ then the rise of modern tort law with its expanded criteria and extent of liability, especially for personal injury, reflects the same evolution. Presently, their great extent and scope frequently make both contract and tort law scourges to entrepreneurial activity. One need only observe the uproar from the medical profession and industry generally as premiums for medical malpractice and defective products liability have expanded exponentially.¹⁵

It is ironic that contract has rejoined tort just at the time when tort has been subjected to the most intense theoretical and practical attacks in its long history. The deeper irony is that critics of tort law are attacking it as woefully inadequate on the basis of its risk distribution features—the very features, it should be recalled, that account for the simultaneous process of tort's absorption of contract law. Thus, legal scholars and others relentlessly point to the tort system's failure to pay most accident victims, its dilatory payment to those who are compensated, and its gross inefficiency in using up most of the insurance proceeds in legal fees and insurance overhead.¹⁶

In light of these flaws, the longevity of tort, not to mention its absorption of other areas of law, is itself surprising. The vitality of tort law is particularly difficult to explain when one realizes that its fundamental weakness was perceived and extirpated, in one area at least, sixty years ago, through the adoption of workers' compensation laws. At long last, though, just as traditional tort law was banished from the first great area of its application—industrial accidents—it now faces banishment from the second great area of its application—

13. Malone, *Ruminations on the Role of Fault in the History of Torts*, in U.S. DEPT. OF TRANSPORTATION, *AUTOMOBILE INSURANCE AND COMPENSATION STUDY: THE ORIGIN AND DEVELOPMENT OF THE NEGLIGENCE ACTION* 1, 25-26, 30-31 (1970), reprinted in J. O'CONNELL & R. HENDERSON, *TORT LAW, NO-FAULT AND BEYOND: TEACHING MATERIALS ON COMPENSATION FOR ACCIDENTS AND AILMENTS IN MODERN SOCIETY* 31-32, 38-39 (1975).

14. G. GILMORE, *supra* note 1, at 95-96 (citation omitted).

15. It should be noted that in both cases described in the text, the cause of action is a subtle and complex mix of tort and contract. For a discussion of the interlocking application of contract and tort law in product liability cases, see Franklin, *When Worlds Collide: Liability Theories and Disclaimers in Defective-Product Cases*, 18 STAN. L. REV. 974 (1966). On medical malpractice, see 1 D. LOISELL & H. WILLIAMS, *MEDICAL MALPRACTICE* § 8.03, at 194-200 (1973).

16. See, e.g., J. O'CONNELL & R. HENDERSON, *supra* note 13, at 42-67, 99-143, 170-90, 223-30, 241-53, 581-91. For a summary of and citation to much of the literature, see W. PROSSER, *supra* note 12, § 84, at 556-70.

automobile accidents. Unless the thirty-four states without no-fault auto laws act within a short time, a federal no-fault law seems inevitable; indeed, it may be enacted regardless of state action.¹⁷ A further irony in the switch of common-law courts from contract to tort criteria is that the statutory solutions for industrial accidents and auto accidents simplified the insured event by a switch from tort to contract-like criteria.

The liability rules applied by workers' compensation and no-fault auto statutes, like traditional contract rules, are viewed by some as harsh, undifferentiated, and often unfair;¹⁸ but they also have contract's traditional virtues of simplicity, clarity, and ease of administration. For example, some find it unfair that liability is imposed on an employer to his employee or a motorist to a pedestrian, even though the employer or motorist is free from fault and it is the victim who is actually at fault.¹⁹ Indeed, the supposed harshness of such liability served as one of the main bases for early rulings that workers' compensation statutes were unconstitutional as a denial of due process of law.²⁰ The same issues are raised with regard to damages, where some see as harsh the simple, but easily ascertained, cost-cutting limits of contract law applied by such statutes. In effect, only liquidated damages for limited wage loss (with a maximum of, for instance, \$100 or \$200 a week) can be recovered, and no damages for pain and suffering are permitted.²¹ Here, too, these limits are perceived to be so unfair that they have served as a primary reason for not only striking down workers' compensation, but also attacking the constitutionality of auto no-fault laws.²²

Why have legislatures turned from tort to contract-like criteria at precisely the time when courts are doing the opposite? The answer is that, for all the admitted shortcomings of workers' compensation and no-fault auto laws, their far superior efficiency achieves much greater effectiveness—and even fairness—than tort law. Under traditional tort law, we litigate endlessly and at great expense such incredibly intractable issues as whether a motorist, doctor,

17. For a summary of the empirical studies of the operation of no-fault laws, see O'Connell, *Operation of No-Fault Auto Laws: A Survey of the Surveys*, 56 NEB. L. REV. 23 (1977); reprinted in 1977 INS. L. J. 152.

18. See, e.g., Editorial, TRIAL, Oct.-Nov. 1967, at 10-11.

19. *Id.*

20. E.g., *Ives v. South Buffalo Ry.*, 201 N.Y. 271, 94 N.E. 431 (1911).

21. See G. GILMORE, *supra* note 1, at 48 (arguing that "a restrictive approach toward damage recovery seems a necessary component of any idea of absolute liability").

22. See note 20 *supra* and accompanying text; *Grace v. Howlett*, 51 Ill. 2d 478, 283 N.E.2d 474 (1972) (dictum).

manufactured product, or accident victim was at fault²³ and the precise extent of loss of the accident victim, including the pecuniary value of nonpecuniary loss (pain and suffering).²⁴ These tort criteria are astonishingly complex and cumbersome when compared to the contract criteria that govern most insurance policies. Life or health insurance proceeds, for example, are not withheld if injury could have been prevented by the exercise of due care.²⁵

In a brilliant spoof, which merits lengthy quotation, torts professor Willard Pedrick has pointed out how ludicrous it would be to turn from contract to tort for most insurance payments:

[I]n the field of fire losses the courts have been largely abandoned in favor of almost exclusive reliance on insurance [contracts] to spread or distribute losses instead of fixing blame and pinning the loss on the person whose fault caused the loss in the first place. Since loss of life and destruction of property is excessive under this system of loss distribution, it is appropriate to consider the benefits that might be expected to come from changing the system . . . to provide for judicial determination of individual responsibility for fire losses.

. . . .

. . . [F]ires for the most part are not accidents. In a great many fire situations, someone has been at fault, has deliberately taken a chance or has failed to exercise the care of a reasonably prudent man. Whether it be in connection with smoking and use of matches, electrical wiring and appliances, cooking and heating equipment and other fire hazard activities, the human factor figures in a large portion of . . . fires.

. . . .

To shift from the present "the insurance will pay for the fire" attitude [of contract] to a judicially supervised [tort-like] assessment of individual responsibility will be a real shift. It ought to be possible to alter the system and the behavior of persons within the system, however, so that for very large numbers of fires, some sort of adversary claim, either within the family or against some outsider should result. This would offer the prospect of assessment of moral responsibility for fire damage, affixing the blame, of finding the fault. Surely this ought to have a most salutary affect in generating sensi-

23. Under the negligence theory of tort, plaintiff must prove defendant's conduct faulty; under the strict liability theory of tort, plaintiff must prove defendant's product faulty. See W. PROSSER, *supra* note 12, §§ 28-36, 98-99, at 139-204, 656-62; cf. Fleming, *Draft Convention on Products Liability (Council of Europe)*, 23 AM. J. COMP. L. 729, 732 (1975). In either case the problems of proof are similar—and prodigious. See R. KEETON, *VENTURING TO DO JUSTICE* 109 (1969); J. O'CONNELL, *ENDING INSULT TO INJURY: NO-FAULT INSURANCE IN PRODUCTS AND SERVICES* 12-18 (1975). See also note 25 *infra* and accompanying text.

24. See generally M. FRANKLIN, *INJURIES AND REMEDIES: CASES AND MATERIALS ON TORT LAW AND ALTERNATIVES* 416-41 (1971).

25. See Needed: *A Basic Reform of Auto Liability Insurance*, 27 CONSUMER REP. 404, 406 (1962).

tivity to fire hazards with the prospect of dramatic reduction in the number and severity of fires. Moreover the assessment of fault and the solemn setting of the judicial trial contribute to the satisfactions of a well ordered society. It is good to know that wrongdoers will be brought to book, that anti-social conduct does not go unnoticed and unpunished. Moreover, to develop a system for assessing individual responsibility for fire losses will bring this part of the law into harmony with the vast areas of tort law where fault and individual responsibility are widely accepted as the sound way for dealing with claims for personal injury and property destruction. The legal profession can be expected to develop experts in handling fire litigation who will bring the art to a high level.

. . . .

The proposed improvement in the system for dealing with fire losses could be instituted [by] . . . fire insurance companies themselves . . . by the simple expedient of rewriting the basic fire insurance contract to provide that losses will be paid only in those cases where the insured has no [tort] claim against another—either within or without the family. That change should do much to encourage litigation with all of its satisfactions.²⁶

Professor Pedrick brings a smile to one's face through the rhetorical device of *reductio ad absurdum* as he illustrates the senselessness of abandoning contract for tort. Yet the smile disappears when one realizes that, as Professor Gilmore tells us,²⁷ this very absurdity is being solemnly achieved by the courts.

III. ALLOCATION OF LOSSES AND THE PROBLEM OF TRANSACTION COSTS

The shift by courts from contract to tort principles of loss allocation has not gone unchallenged. As one might imagine, the absurdity is particularly resented at the University of Chicago—that temple of the marketplace's contract economics. Thus, in an article entitled *Medical Malpractice: The Case for Contract*,²⁸ Professor Richard Epstein of the University of Chicago Law School argues that the solution to tort law's mishandling of personal injury law lies in allowing tortfeasors and their potential victims almost complete freedom to contract away tort liability. He would, illustratively, allow doctor and patient to contract for no liability for negligent treatment, or for limited liability, which might take the form of a ceiling on the

26. Pedrick, *Tangential Introduction*, in WALTER E. MEYER RESEARCH INSTITUTE OF LAW, DOLLARS, DELAY AND THE AUTOMOBILE VICTIM vii-xii (1968) (citations omitted).

27. See G. GILMORE, note 1 *supra*, at 87-99. Actually, some readers took Pedrick seriously.

28. Epstein, *Medical Malpractice: The Case for Contract*, 1976 AM. B. FOUNDATION RESEARCH J. 87.

dollar recovery for any negligent act or recognition of liability only for acts of gross negligence. Such a device, Professor Epstein asserts, could dramatize the virtues of decentralization by private decisionmaking and would make it possible to avoid the cumbersome attempts by the courts to apply public law solutions (such as redistributing income from large corporations or insurance companies to injured individuals) to private law problems.²⁹ Although Epstein applies his principle only to medical malpractice, he asserts that "its implications extend to all areas of private law."³⁰

Given current circumstances, Epstein seems to go too far, as he himself realizes. Modern courts are very unlikely to uphold a contractual provision between a doctor and his patient, or a manufacturer and its customer, if the provision's only function is to abolish or dramatically limit common-law tort rights.³¹ That, of course, is precisely Gilmore's point. The courts would look at such an arrangement from a *tort* perspective, and contractual provisions purporting to control tort-like consequences would be ignored. Even a reduction in the contract price for the proffered goods or services in light of the reduction of tort liability is unlikely to assuage the courts' hostility to any bartering away of common-law tort rights, especially where parties unequal in bargaining power are contracting with regard to personal injury.³²

Nor is the distrust of contract limited to courts; other branches of government often display it when they concern themselves with consumer protection or safety standards. Professor Arthur Leff has perhaps best identified the reason. The government, he points out, whether acting through legislatures, administrative agencies, or

29. *Id.* at 95, 106, 149.

30. *Id.* at 96.

31. Virtually all of the general discussion of malpractice law and virtually all of the judicial opinions upon the subject take it for granted that the specification of the substantive rules of medical malpractice rests, in the absence of legislative command, upon the courts, and that the parties themselves are not free to vary those terms by private arrangement. Although most courts have not expressly stated the extent to which specific provisions in the physician-patient contract are void and unenforceable for reasons of public policy, some uneasy combination of the doctrines of "unequal bargaining power," "contracts of adhesion," "economic duress," and "unconscionability" today block any private effort to contract out of the liability rules for medical malpractice.

R. Epstein, *Medical Malpractice: Its Cause and Cure* 17 (paper delivered at a conference on The Economics of Medical Malpractice sponsored by the Center for Health Policy Research of the American Enterprise Institute for Public Policy Research, Dec. 16, 1976 [hereinafter cited as AEI Conference]).

32. Compare *Jefferson County Bank v. Armored Motors Serv.*, 148 Colo. 343, 366 P.2d 134 (1961) (contract between bank and armored car service limiting liability upheld), with *Hunter v. American Rentals, Inc.*, 189 Kan. 615, 371 P.2d 131 (1962) (contract between motorist and trailer rental company exempting the latter from tort liability invalid as against public policy).

courts, is most active when the failure of a buyer of goods to protect himself is likely to have "serious and irreversible consequences." If, for example, a failure to shop carefully and diligently can lead to death or bodily harm, governmental regulation to achieve at least minimum standards for the goods in question is more likely, as in the case of automobile safety standards. On the other hand, when the risk is not of bodily harm but merely that the buyer will get less than he expected, government will less often intervene, except through devices designed to give notice to the buyer, such as the Prospectus requirement of the Securities Act of 1933. Thus, argues Leff, "when the risk to the buyer goes beyond the value of the thing bargained for," the intervention of the government is most likely; for example, the government is most likely to step in if the risk is not merely that one will be bilked by worthless or shoddy goods such as a power lawn mower that will not start, but rather that one will lose a foot once the mower does start. Obviously, in Leff's insightful phrase, the loss of the foot "is beyond the value of the thing bargained for"—namely, the lawn mower. In analyzing the cases closely, Leff purports to find that when the courts invoke the doctrine of unconscionability they seem to be implementing, though perhaps unconsciously, some such criterion as "risk beyond the value of the bargain" as a test for deciding which contract clauses must be validated (if ever validatable) by a "form of super-assent" from a court. Warranty disclaimers, says Leff, present the clearest example, for courts will tolerate least of all a contract provision eliminating a tort remedy against a provider of goods. This is because under such a provision a buyer is threatened not only with defective or worthless goods but also with uncompensated personal injuries.³³

The irony, to repeat, is that the courts, in rejecting contract for tort because contract is so unfair to victims from a loss distribution perspective, drive those same victims back into an area of law that is itself increasingly recognized as extremely unfair from that same perspective.³⁴

The irony is further compounded by the work of another University of Chicago market stalwart, Ronald Coase, whose theories are premised on the *necessity* of varying tort by means of contract if sensible loss distribution is to be achieved.³⁵ Prior to Coase's seminal writing, it had long been thought that a decision in tort whether or

33. Leff, *supra* note 6, at 353 n.19.

34. See O'Connell, *supra* note 17; O'Connell, *An Alternative to Abandoning Tort Liability: Elective No-Fault Insurance for Many Kinds of Injuries*, 60 MINN. L. REV. 501, 529-37 (1976).

35. See Coase, *The Problem of Social Cost*, 3 J. LAW & ECON. 1 (1960).

not to impose social losses on the perpetrators of a given activity would inevitably affect the allocation of resources. For example, if tort law made power lawn mower manufacturers liable for all damage caused by malfunctions of their mowers, then

in theory, mower prices would then rise and sales fall; some families would be induced to shift to manual mowers, the total amount of power mowing would be reduced, and the level of accidents would abate. Moreover, manufacturers might become choosy about customers, raising prices to non-institutional buyers or perhaps simply to obvious [incompetents]. . . . Finally, they would have an incentive to redesign mowers to impose safety features. A variety of market forces would be set in motion to lower the total loss through accidents.³⁶

Conversely, the traditional conclusion was that if accident costs were not imposed upon an activity—that is, if they are divorced from the activity that generates them—“then the activity in question will receive a hidden subsidy which will invite us [through the marketplace] to vote for more accidents than we should be willing to pay for if we realized their cost.”³⁷

Under the Coase theorem, however, optimal allocation of resources need not depend on tort-imposed liability. Regardless of the manner in which tort law imposes liability for losses, the parties concerned will arrive at an optimal allocation of resources if they are allowed to contract to reshift the loss.

The significance of the Coase theorem can be illustrated by reference to *Sturges v. Bridgman*,³⁸ a well-known nineteenth-century English case. A doctor had instituted a nuisance action against a neighboring confectioner because the noise and vibration produced by the confectioner's machinery rendered useless the consulting room that the doctor had constructed near the property line. The court held that the doctor was entitled to an injunction to restrain the confectioner from using his machinery in a manner that would prevent use of the consulting room, on the ground that such a use constituted a serious interference with the plaintiff's enjoyment of his own land. Professor Patrick Atiyah has described Coase's evaluation of the case:

The decision is criticized by Professor Coase on the ground that the real question facing the court in an action of this sort is the economic question, namely which of the services which have to be sacrificed here are more valuable to society? But he also points out that

36. Ross, Book Review, 84 HARV. L. REV. 1322, 1323 (1971) (reviewing G. CALABRESI, *THE COST OF ACCIDENTS: A LEGAL AND ECONOMIC ANALYSIS* (1970)).

37. James, Book Review, 1966 UTAH L. REV. 297, 303, *quoted in* F. HARPER & F. JAMES, *THE LAW OF TORTS*, Supp. vol. 2, at 5 (1968).

38. 11 Ch. D. 852 (1879).

since the parties could have modified the court's ruling by subsequent [contract] between themselves, the ruling did not, in fact, greatly matter from an economic point of view [of optimal allocation of resources]. Thus if, for instance, the additional value to the confectioner of the use of his machinery was (say) £500 a year, while the additional value to the doctor of the use of his consulting room at the end of his garden was (say) £200 a year, it would plainly have been in the interest of both parties for the confectioner to resume using his machinery, and [to contract] to pay the doctor anything between £200 and £500 a year [the precise point between £200 and £500 a year at which the bargain will be struck depending on their bargaining talents, etc.]. In the economic world in which all men are economic men, this is just what would have happened so that the court's original decision to grant an injunction would not have stopped the confectioner using his machinery. Equally, if the doctor's loss of income from his inability to use his consulting room was £500 a year and the confectioner's loss from inability to use his machinery was only £200, and the court had refused an injunction, it would have been profitable for the doctor to pay the confectioner anything between £200 and £500 a year not to use the machinery, and it would have been profitable for the confectioner to take it. So, once again, there is no misallocation of resources, whatever result [tort] law arrives at. If it places the risk on the party who should bear it in order to optimize the allocation of resources, the risk will remain there, whereas if [tort] law places the risk on the wrong party, the parties will correct the law's mistakes by [contract]. . . .³⁹

A crucial assumption made both in traditional economic literature and in the Coase theorem that the parties can correct by contract any erroneous court decision concerning tort liability is that there are zero transaction costs. Many critics have identified this as the crucial problem and have dismissed Coase's theorem as meaningless precisely because it makes what one economist has called "the heroic assumption" that there are no negotiating or transaction costs in, for example, determining the exact costs imposed on the doctor by the conduct of the confectioner. So, too, Coase assumed away the cost of negotiating, drafting, and policing the contract that allocates those costs between the two parties.⁴⁰ Moreover, transaction costs also include expenses incurred in obtaining information. In short, because transaction costs involve *any* costs incurred by entering into and completing any designed transaction, they can amount to very significant, perhaps insuperable, barriers to contractual arrangements.

In defense of Coase, he did not create the assumption of no transaction costs. Conventional economic theorists who preceded

39. P. ATIYAH, ACCIDENTS, COMPENSATION AND THE LAW 532-33 (2d ed. 1975), reprinted in J. O'CONNELL & R. HENDERSON, *supra* note 13, at 602-03.

40. See Gilmore, *Products Liability: A Commentary*, 38 U. CHI. L. REV. 103, 105 (1970).

Coase had postulated that it would be necessary, even without these costs, in order to achieve optimal loss allocation either to shift liability by tort or to levy a tax in any situation where one individual engaged in an activity that imposed uncompensated-for costs on others. In other words, Coase was concerned with a problem ancillary to, and in fact beyond, the existence of transaction costs—namely, the supposed necessity of correcting by tax or tort liability externalities imposed on one person by another. In ignoring transaction or negotiating costs for contracts, Coase was not adding an unrealistic component to economic thought; rather, he was refining an aspect of conventional economic thought that had itself always ignored transaction or negotiating costs and had assumed the existence of perfect competition.

Yet the question of transaction costs obviously must be addressed. What happens when, as is commonly the case, the parties are *not* in a bargaining relationship at all? Auto accident victims are obviously not in a contractual relation with people who cause auto accidents. There is, for example, no convenient means of bringing together all pedestrians and all owners of automobiles to bargain over who should bear the costs of accidents between the two groups: "There is, therefore, no obvious method by which if [tort] law places the cost on one group, that group can [contract to] shift it to another group."⁴¹

The facts in *Sturges v. Bridgman* illustrate a different situation, in which, although the parties were not originally in a bargaining situation, they were in an easy position to contract after the intervention of tort law. But even where a bargain is possible, we must, as Professor Atiyah urges, take account of "the actual costs of striking the bargain by which [tort] . . . law's misplacing of the risk may be corrected".⁴²

Here the confectioner and the doctor have to get together, negotiate, and perhaps draw up a contract, which then has to be implemented by regular payments, year by year. Let us vary our hypothetical figures now and assume that the value to the confectioner of his machinery is £500 a year and the value to the doctor of his consulting room is £470 a year. Suppose that the cost of a bargain between the parties is £50. Now, if the court places the burden on the doctor and refuses an injunction, there will be a correct allocation of resources, whereas if the court grants the injunction there will be a misallocation, *and in this case the misallocation will not be corrected by a bargain because it will be too expensive to correct it*. In this type of case therefore, the correct placing by [tort] . . . law of the initial liability is of great importance.⁴³

41. P. ATIYAH, *supra* note 39, at 531-32 and 602 respectively.

42. *Id.* at 533 and 603 respectively.

43. *Id.* (emphasis added).

In other words, if transaction costs were zero, the optimal result could be achieved by having the most efficient user of the resources pay for the privilege of using them. But the cost of making a contract and enforcing it may be greater than any marginal benefits that would have accrued to the confectioner under such a contract. Consequently, although the confectioner is the more efficient user of the resources, he would not get control over them because of transaction costs.

Because they deal with parties who face the market system as it actually operates, the courts must address this problem of transaction costs. And, before they adopt a rule of tort liability, they must weigh the effects of such a decision—a task noted by Coase, who has thereby recognized the potential complications caused by transaction costs.⁴⁴ Because a particular imposition of tort liability may produce an inefficient allocation of resources that the parties may *not* be able to correct by contract, the initial imposition of tort liability becomes crucial. As a result, according to Coase, there are two major obligations that the courts must discharge. First, they must attempt to determine what rule of tort liability would lead to the most efficient resource allocation if a rearrangement of those rights by contract were not feasible. Second, even where a contract can effect a rearrangement of tort rights, the court must aim at reducing the need and the cost of such contractual reallocation. In other words, Coase concludes that, in a perfect market system, the courts need only be concerned with the effect of tort liability rules on income distribution.⁴⁵ (The decision of courts to redistribute income is often based on political or moral considerations. For example, tort law traditionally decided that if one party had been at fault, he should be forced to redistribute his income to his faultless victim.) As far as the allocation of resources is concerned, in a perfect market system there will be contractual reallocation of tort rights to achieve an optimal situation. On the other hand, in the real world of the market system the initial determination of tort rights will often be dispositive. Transaction costs may, as we have seen, prevent contracts from properly rearranging tort rights to achieve efficiency. As a result, Coase would have the courts, in designating who has what tort rights, consider the allocation of resources that will be most efficient.⁴⁶

In many situations, the parties do, in fact, deal with each other prior to the accident and thus could conceivably contract with refer-

44. Coase, *supra* note 35, at 15. See note 40 *supra* and accompanying text.

45. See *id.* at 13.

46. The textual material between footnotes 43 and 46 is a paraphrasing of unpublished writings by Professor Geoffrey Palmer of Victoria University, Wellington, N.Z.

ence to personal injury. Legal problems of medical malpractice, for example, often arise in a context of extensive consultation between the patient and the health-care provider prior to treatment, because the health-care provider must gain the "informed consent" of the patient before beginning treatment.⁴⁷ By definition, the sale of products that may lead to product liability actions involves a contractual relationship. In such situations, either the parties themselves or the courts (or the parties altering the court's initial determination) could agree to allocate any loss stemming from the sale of goods or services by deciding who is the most efficient risk-bearer:

In the case of products' liability, for instance, the manufacturer can clearly secure insurance more easily and cheaply than the consumer. To be weighed against this is the fact that the consumer is in a better position to assess the peculiar risks which need to be covered by insurance which arise from his own personal position (*e.g.*, his income, the size of his family and so on), as well as the fact that the risk may vary between consumers because some may be more vulnerable than others, or more skillful in avoiding the danger of the defective product and so on. If liability is on the manufacturer, therefore, factors of this kind may tend to increase the cost of insurance, though to such a small extent that in this sort of case it is unlikely to counterbalance the other considerations. In other cases, however, this factor could have considerable importance. If, for example, we are considering whether the law should place the risk of goods being lost at sea on the consignor or the carrier, the fact that the consignor knows more about the goods, how they should be packed, what kind of damage may be incurred, and so forth may make it cheaper for him to insure.⁴⁸

And so, economic theory and judges following economic theory⁴⁹ conclude that there is little cause to worry about the inadequacy of tort rules because the parties will correct their inequality by contract. When this adjustment is not feasible, the economists say, the courts, in imposing tort liability, should hypothesize what liability the parties

47. See 1 D. LOUISELL & H. WILLIAMS, *supra* note 15, §§ 22.01-22.08, at 594.43-.62.

48. P. ATIYAH, *supra* note 39, at 530-31 and 601 respectively. For an early and provocative attempt to explore the effect of comparative loss-bearing capacity as a basis of tort liability, see Morris, *Hazardous Enterprises and Risk Bearing Capacity*, 61 YALE L.J. 1172 (1952).

49. Especially since Roger Traynor's pioneering liability decisions in California, more and more judges have purported to use economic criteria in personal injury cases. One leading authority has cast aspersions on the quality of this economic thinking. In discussing the development of product liability, Professor Friedrich Kessler of Yale Law School notes that a "theory of enterprise liability has emerged frequently based on vague and unanalyzed notions of public policy and economics." Kessler, *The Protection of the Consumer under Modern Sales Law, Part I*, 74 YALE L.J. 62 (1964). For a report on federal judges taking a formal course in economics, sponsored by the Law and Economics Center of the University of Miami School of Law, see N.Y. Times, Dec. 20, 1976, § A, at 20, col. 4.

would have imposed if given an opportunity to contract. But contract, Gilmore has shown, is dying; the courts will apply what are essentially tort criteria in deciding who bears the loss when contracts fall apart. A profound contradiction should now be apparent: *How can the courts use contract doctrines to impose tort liability if they are using tort doctrines to impose contract liability?*

An example of the judiciary's struggle with this conundrum is found in the seminal case of *Goldberg v. Kollsman Instrument Corp.*⁵⁰ In that case, plaintiff's intestate died in an airplane crash. Plaintiff sued the airline (American), the aircraft manufacturer (Lockheed), and the manufacturer of an allegedly defective altimeter (Kollsman). With some wonderful legerdemain, the Court of Appeals of New York imposed strict tort liability for the defective altimeter on Lockheed, *not* on Kollsman or the airline. The court airily dismissed any incongruity in result with a bow to, if not an express acknowledgment of, Ronald Coase's theorem: "Adequate protection is provided for the passengers by casting in liability the airplane manufacturer which put into the market the completed aircraft."⁵¹ The implications of this cryptic statement are that the plaintiff needs only one source of payment and that the parties in the chain of transmittal to the plaintiff can adjust the liability as between themselves by contract. An explicit statement to the same effect is found in another leading products liability case, *Elmore v. American Motors Corp.*,⁵² where the California Supreme Court said that the manufacturer and retailer "can adjust the cost of such protection [against strict products liability] between them in the course of their continuing business relationship."⁵³

As a crude example of the kind of bargaining by contract that might follow the imposition of tort liability in the *Kollsman* decision, assume that Lockheed, operating in a competitive market, can pay only \$3,000 for altimeters; further assume that after the court decision it must pay \$300 for liability insurance ascribable to altimeter-caused accidents. It makes no practical difference whether Lockheed pays \$2,700 for altimeters and \$300 for insurance or whether, alternatively, Kollsman charges \$3,000 for altimeters, out of which it pays \$300 for insurance to indemnify any loss to Lockheed from

50. 12 N.Y.2d 432, 191 N.E.2d 81, 240 N.Y.S.2d 592 (1963). For a lucid description of the Federal Aviation Agency investigation of this accident, see Hunt, *The Case of Flight 320*, THE NEW YORKER, April 30, 1960, at 119, reprinted in W. HADDON, E. SUCHMAN & D. KLEIN, ACCIDENT RESEARCH: METHODS AND APPROACHES 721 (1964).

51. 12 N.Y.2d 432, 437, 191 N.E.2d 81, 83, 240 N.Y.S.2d 592, 595 (1963).

52. 70 Cal. 2d 578, 451 P.2d 84, 75 Cal. Rptr. 652 (1969).

53. 70 Cal. 2d at 587, 451 P.2d at 89, 75 Cal. Rptr. at 657.

altimeter-caused accidents. In other words, Kollsman may contract to pay Lockheed for any and all tort losses caused by altimeters.

It may be, however, that in light of its greater specialization in altimeters and thus its specialized insurance, Kollsman can insure altimeters more cheaply than could Lockheed—at \$200, for example. In that event, even though the court puts tort liability on Lockheed, Kollsman will contract with Lockheed to price altimeters somewhere between \$2,900 and \$3,000, with the \$100 savings split between Lockheed and Kollsman on the basis of their bargaining strength. In other words, the actual distribution of the \$100 savings will be determined by contract rather than by tort, but there *will* be that \$100 to split.⁵⁴

The *Kollsman* court, then, implicitly acknowledged (just as the court explicitly stated in *Elmore*) that a continuous bargaining relationship may render unimportant the decision as to who will bear the actual tort liability. On the other hand, courts are much more cautious when they consider contracts that vary the rights of individual consumers—especially with reference to personal injury. The judiciary obviously distinguishes between the reshifting of tort rights as between commercial establishments, such as airlines and aircraft and component parts manufacturers, and the reshifting of tort rights as between such parties and airline travelers.⁵⁵

The distinction is not without justification. Allowing sophisticated commercial parties to contract away tort liability on the basis of economic theory makes sense, but economic theory as applied to employees who suffered personal injury proved terribly unrealistic in one historic battleground of social legislation. Prior to the introduction of workers' compensation in the late nineteenth and early twentieth centuries in England and the United States, economists often opined that workers' compensation would have no effect on the relative financial positions of the parties. If an employer had to pay workers' compensation premiums, it was argued, he would pass all or part of the costs on in the form of lower wages; if he didn't have to pay for workers' compensation, he would be obliged

54. For a much more elegant and complete discussion of the greater subtleties involved in deciding upon the proper risk-bearer for purposes of resource allocation among victim, airline, aircraft manufacturer, and component parts manufacturer, see Klemme, *The Enterprise Liability Theory of Torts*, 47 U. COLO. L. REV. 153, 201-09 (1976).

55. But see the dissent by Judge Burke in *Goldberg*, wherein he mentioned, as a reason for not stretching common-law rules to compensate air victims, that aviation accident insurance "is readily available [to air travelers] at moderate rates." *Goldberg v. Kollsman Instrument Corp.*, 12 N.Y.2d 432, 438, 191 N.E.2d 81, 84, 240 N.Y.S.2d 592, 596 (1963).

to pay higher wages so that the employees could use the extra money to buy accident insurance for themselves.⁵⁶ With the exception of the economists who still solemnly parade the above argument before their classes, few persons today would, as a practical matter, assert that such thinking should have served as a basis for rejecting workers' compensation.⁵⁷

The subject of workers' compensation reveals the practical flaws in Professor Epstein's proposal for freewheeling contractual abrogation or alteration of tort law by doctors, manufacturers and others dealing with individual patients and customers. Assume for the moment that we did not have workers' compensation legislation and instead left workers to their common-law tort rights. Assume further that, as is the case with product liability and medical malpractice, tort liability for industrial accidents was costing huge amounts, but payments to injured victims were dilatory and relatively infrequent, and the bulk of insurance dollars was spent on insurance overhead and legal fees. Professor Epstein would apparently suggest that employers be allowed untrammelled freedom to contract with their employees to abolish or severely limit common-law liability for personal injury. Yet that solution would have been deemed politically and legally dubious even in the early part of the century,⁵⁸ when workers' compensation was being enacted, and it is most unlikely that any legislator or insurance commissioner would today authorize, or any court enforce, such contracts.⁵⁹

IV. A THIRD ALTERNATIVE FOR LOSS ALLOCATION

As we have seen, the government—whether acting through the legislative, executive or judicial branch—does not favor contracts in which potential accident victims have waived their tort remedies. I suggested not long ago that a partial solution to products liability woes, at least for capital goods manufacturers, is to allow employers, employees (through their unions) and third parties to contract away employee tort remedies (in the form of products liability claims) against third parties; the resultant savings in products liability pre-

56. See P. ATIYAH, *supra* note 39, at 531 and 601 respectively.

57. See *id.*

58. *Johnston v. Fargo*, 184 N.Y. 379, 77 N.E. 388 (1906). But see *Wells Fargo & Co. v. Taylor*, 254 U.S. 175 (1920). Cf. *Baltimore & O.R.R. v. Voigt*, 176 U.S. 498 (1900).

59. See O'Connell, *Bargaining for Waivers of Third-Party Tort Claims: An Answer to Product Liability Woes for Employers and Their Employees and Suppliers*, 1976 U. ILL. L.F. 435, 436-50 [hereinafter cited as *Bargaining for Waivers*], reprinted in part in 1976 INS. L.J. 530, 541-45. See also notes 31-33 *supra* and accompanying text.

miums would be divided up among the employers, employees and third parties on the basis of their bargaining.⁶⁰ Presumably, the union's presence in the bargaining would guarantee that at least some of the savings in products liability insurance would go to the employees in the form of privately negotiated supplements to often-inadequate workers' compensation benefits or to other fringe benefits.

The reason why waiver of these tort rights might be approved by the courts, whereas other contracts stripping potential victims of their tort rights would not, is that workers' compensation benefits provide a compensatory base.⁶¹ Courts would probably react differently to the abolition of uncertain and wasteful tort liability insurance where alternative remedies assure more certain, even if considerably lower, recoveries for injury victims.⁶² In other words, a contract can replace tort only where the basic benefits supposedly furnished by tort are not lost and perhaps, indeed, are thereby improved. Thus, simple abrogation of tort remedies (as Epstein suggests) would probably fail. It is significant that Professor Epstein asserts that first-party benefits, such as health insurance, are a better source of compensation than tort liability for injuries in the course of medical treatment, and that he uses the existence or potential existence of

60. O'Connell, *Bargaining for Waivers*, *supra* note 59. For a précis of the article in nontechnical terms, see O'Connell, *Bypassing the Lawyers*, Wall St. J., April 8, 1976, at 20, col. 4.

61. But see O'Connell, *Bargaining for Waivers*, *supra* note 59, at 448 and 538 respectively. See also notes 67-68 *infra* and accompanying text.

62. See generally O'Connell, *Bargaining for Waivers*, *supra* note 59. This is why I argue that my original proposal for elective no-fault insurance could be expected to meet with both legislative and judicial approval. Under that proposal anyone—including businesses or professionals—would be allowed to elect to pay for medical expense or wage loss from injuries caused by a particular product or service without regard to fault. Businesses or professionals would have the option of electing all or just selected risks of personal injury typically created by their product or service and would agree to pay for any out-of-pocket losses when injury results from those nonelected risks. To the extent—and only to the extent—that a guarantee of such no-fault payment existed at the time of the accident, no claim based on fault would be allowed. There would be several incentives to substitute no-fault liability in place of traditional liability based on fault. Although businesses or professionals might have to pay more injury victims, they would normally pay each victim less. Moreover, they would not have to pay anything where payment for loss had already been made from collateral sources such as sick leaves; nor would they have to pay for pain and suffering, which now constitute the bulk of personal injury payments. See J. O'CONNELL, *supra* note 23; O'Connell, *Elective No-Fault Liability Insurance for All Kinds of Accidents: A Proposal*, 1973 INS. L.J. 495 (précis of the book); O'Connell, *An Elective No-Fault Liability Statute*, 1975 INS. L.J. 261; O'Connell, *Elective No-Fault Liability by Contract—With or Without an Enabling Statute*, 1975 U. ILL. L.F. 59 (discussion of implementing the proposal by contract, even without an enabling statute, and defending the validity of such contracts). For succinct presentations of this elective no-fault proposal available to the practicing lawyer, see O'Connell, *Products and Services: No-Fault Without Legislation*, 62 A.B.A.J. 343 (1976); O'Connell, *It's Time for No-Fault for All Kinds of Injuries*, 60 A.B.A.J. 1070 (1974).

such benefits as an argument for the feasibility of abolishing tort rights by contract.⁶³ But such benefits are so inadequate for many people that the courts will not likely allow them to serve as the *only* source of compensation after injuries are inflicted by tortfeasors. Even with the enactment of national health insurance, there will be too many losses not covered by first-party or social insurance for the courts to allow tort liability simply to be abolished. For serious injuries—including those stemming from automobile accidents, medical treatment and manufactured products—approximately seventy-five per cent of nonproperty losses are wage losses, and only about twenty-five per cent are due to medical expenses.⁶⁴ No one is seriously suggesting that national health insurance include in the immediate future—or perhaps ever—coverage for middle-class wage loss.⁶⁵ Thus, huge uncompensated losses will remain after private and social insurance payments have been made.

Unlike most traditional insurance schemes, workers' compensation not only covers the full amount of medical expenses but also guarantees recovery of substantial wage losses to accident victims. Accordingly, exclusive reliance on workers' compensation benefits for all industrial accidents might well be feasible. Even so, political reality or the doctrine of unconscionability will probably require supplementation of workers' compensation benefits by the savings produced by the abolition of common-law tort liability.

And yet, proponents of coupling enhanced workers' compensation benefits with contractual waiver of tort rights cannot ignore Professor Gilmore's dour view of the viability of contract.⁶⁶ Labor law, like insurance law (both of which are applicable to collective bargaining over waiver of tort liability rights), is a classic area in which contract is dead, replaced largely by the Byzantine world of statutory and administrative rules under the National Labor Relations

63. Epstein, *supra* note 28, at 149.

64. For serious automobile accidents 74 per cent of injury losses are wage loss, 22 per cent medical loss and 4 per cent other losses. U.S. DEPT. OF TRANSPORTATION, MOTOR VEHICLE CRASH LOSSES AND THEIR COMPENSATION IN THE UNITED STATES: A REPORT TO THE CONGRESS AND THE PRESIDENT 6 (March 1971) (figures computed using the losses listed in the Table 2 for Medical Expense, Wage Loss and Other Expenses). For medical malpractice cases, 74 per cent of injury losses are wage loss, 24 per cent medical loss and 2 per cent other expenses. INSURANCE SERVICES OFFICE, REPORT TO THE ALL-INDUSTRY COMMITTEE, SPECIAL MALPRACTICE REVIEW: 1974 CLOSED CLAIM SURVEY: PRELIMINARY ANALYSIS OF SURVEY RESULTS 35 (Dec. 1975). For product liability cases, 74 per cent of injury losses are wage loss, 21 per cent medical loss, and 5 percent other expenses. INSURANCE SERVICES OFFICE, PRODUCT LIABILITY INSURANCE, 1976 PRODUCT LIABILITY CLOSE-CLAIM SURVEY; PRELIMINARY ANALYSIS OF SURVEY RESULTS 34 (Dec. 1976).

65. See J. O'Connell, *supra* note 23, at 76.

66. See G. GILMORE, *supra* note 1, at 87-99.

Act and its state offshoots.⁶⁷ Very complex issues are involved in the question whether management *can* bargain with unions for the waiver of union members' tort rights.⁶⁸ Intuitively, it seems that this can be done, but legitimate doubts about the validity of such contracts will inhibit their formation. In addition, one union official has voiced other concerns about undertaking and implementing such bargaining:

First, even if we could clarify the complexities of this issue to all our business representatives and local union bargaining committees throughout the United States and Canada, we would still have [problems].

. . . [S]uppose we bargained away our members' [tort] rights through negotiations with Company A—which buys capital equipment from Company B. How much effect would this actually have on insurance rates paid by Company B—if Company B still has third-party liability in relation to all of the other companies with whom it does business? To be effective, waiver of third-party tort claims would have to be almost universal. Bargaining by a few unions in scattered localities would not have any real impact on premium rates and this would not generate a margin convertible into [other benefits]. . . .⁶⁹

On the other hand, workers' compensation does offer a rich area for further exploration of the possibility of substituting no-fault for fault-based coverage.⁷⁰ I have recently suggested that this change be achieved by statute—specifically, that workers' compensation benefits be raised in return for the establishment of workers' compensation as the sole remedy for industrial accident victims as against any third-party employer covered by workers' compensation.⁷¹ In order to avoid excessive externalities, however, this proposal also contemplates that employers paying workers' compensation be allowed a right over against such third parties to the extent of workers' com-

67. The most dramatic changes touching the significance of contract law in modern life . . . came about, not through internal developments in contract law, but through developments in public policy which systematically robbed contract of its subject-matter . . . [such as] labor law [and] . . . insurance law. . . . The growth of these specialized bodies of public policy removed from "contract" . . . transactions and situations formerly governed by it

L. FRIEDMAN, *CONTRACT LAW IN AMERICA* 24 (1965), *quoted in* G. GILMORE, *supra* note 1, at 7.

68. See O'Connell, *Bargaining for Waivers*, *supra* note 59, at 462-67.

69. Private communication to the author.

70. According to one study, about one half of the total liability payments for personal injury goes to employees injured in the course of employment and therefore presumably already covered by workers' compensation. INSURANCE SERVICES OFFICE, *PRODUCT LIABILITY INSURANCE*, *supra* note 64, at 59. For similar estimates of the disproportionate number of product liability claims involving industrial accidents, see O'Connell, *An Immediate Solution to Some Products Liability Problems: Workers' Compensation as a Sole Remedy for Employees, With an Employer's Remedy Against Third Parties*, 1976 *INS. L.J.* 683, 684-85.

71. *Id.*

pensation benefits, perhaps on the basis of comparative fault as between the employer and the third party.⁷² Otherwise, such third parties would cast the entire burden derived from their faulty products onto their purchasers. Although this right over will necessitate the expense of determining issues of fault, the issue will presumably arise between two insurers; accordingly, these claims will probably not be litigated extensively but rather will be handled expeditiously.⁷³

As to the relatively rare situation in which third parties not subject to workers' compensation injure an on-the-job employee (as in the case of a motorist in a pleasure vehicle who runs into an employee driving in the course of employment), there is obviously no reason to extend the tort exemption to such a third party. By definition, he is not paying increased workers' compensations benefits as a *quid pro quo* for relief from tort obligations. But there is, arguably, also no reason to allow the employee injured in these unusual circumstances to have both his fault-based and no-fault claim. The third possibility is novel but not unprecedented: to allow the employer to assert the *entire* tort claim for *all* the proceeds, including damages for pain and suffering, to help reimburse the payment of increased workers' compensation benefits. Similar provisions have a long history of use in Canadian workers' compensation law, under which the workers' compensation fund asserts the employees' third-party tort claim and keeps *all* the proceeds, including amounts paid for the employees' pain and suffering.⁷⁴

72. *Id.* at 685-86.

As to the use of comparative fault, since an employer is obligated to pay for all employee injuries regardless of the employer's lack of fault, it could instead be provided that in such third-party claims to gain funds to help finance no-fault workers' compensation, an employer's fault need not be a factor. In other words, just as the employer's fault—or lack of it—is irrelevant for the purposes of his contribution to the no-fault fund, so too might his fault be considered irrelevant in gaining contribution to the fund from a faulty third party causing a drain on the fund. This indeed is the law today in many states concerning employers' rights of subrogation or indemnity against third parties.

In either case, any right over against the third party might be permitted only on ground of *negligence*—not strict liability—since workers' compensation employers are not necessarily worse risk-bearers than their third-party suppliers or other third parties. It should be kept in mind that it was the tortfeasor's supposedly better risk-bearing capacity vis-à-vis his injured victim that gave rise to the application of the doctrine of strict liability.

73. A precedent for expeditious handling of inter-company claims is the elaborate inter-company arbitration system for dealing with collision insurers' claims against property-damage liability insurers for car damage.

74. See, e.g., N.S. STAT., ch. 65, § 1(1) 14 (1967-68) (Nova Scotia); P.E.I. REV. STAT. ch. W-10, § 11(3) (1974) (Prince Edward Island). Other Canadian statutes with similar provisions have recently been amended to limit the compensa-

For the purpose of this article, it is striking how this statutory device to handle a rather small part of on-the-job accidents opens up much wider possibilities for replacing traditional tort claims with contracts that provide no-fault benefits for off-the-job accidents.⁷⁶ Why not allow, for example, workers' compensation insurers to contract with employees to pay them and their families workers' compensation benefits for off-the-job accidents, in return for an assignment of the entire tort claim of each injured employee or his family member? No one would be compelled to offer such coverage for off-the-job accidents or compelled to buy it. In order to prevent adverse selection, the election by the employee would have to take place prior to the accident—presumably either at the time of employment or at the time the no-fault coverage is offered to the employees as a group. Given the preference of most potential and actual accident victims for certainty of payment for out-of-pocket losses, as opposed to the gamble of tort litigation,⁷⁶ there would almost certainly be a favorable reaction to the offer of such no-fault coverage. This scheme need not be limited to offers by workers' compensation insurers for workers' compensation benefits. For example, auto insurers in Michigan, which has extensive no-fault auto insurance benefits,⁷⁷ could offer the equivalent of no-fault auto benefits to their insureds and families for other than motoring or industrial accidents.⁷⁸ Other casualty or disability insurance carriers could offer similar coverage on the same terms to members of credit unions, or professional and trade associations. In all cases, the coverage would be limited to the following: (1) out-of-pocket loss, and not damages for pain and

tion fund to the amount of compensation paid to the injured worker, with the excess going to the employee. See, e.g., ONT. STAT. ch. 143, § 4(3) (1968).

Similarly, American workers' compensation laws also originally allowed employers to assert the employees' entire tort remedy for the employers' sole benefit (where the employee accepted workers' compensation benefits). See R. KEETON, *INSURANCE LAW: BASIC TEXT* § 3.10(c), at 160-61 (1971).

75. The proposal is offered only in outline form; a forthcoming article in the *University of Illinois Law Forum* will describe it in much greater detail.

76. See U.S. DEPT. OF TRANSPORTATION, *PUBLIC ATTITUDES TOWARD AUTO INSURANCE: A REPORT OF THE SURVEY RESEARCH CENTER, INSTITUTE FOR SOCIAL RESEARCH, UNIVERSITY OF MICHIGAN* 9-10 (1970); J. O'CONNELL & W. WILSON, *CAR INSURANCE AND CONSUMER DESIRES* 9-24 (1969); O'Connell & Simon, *Payment for Pain and Suffering: Who Wants What, When and Why?*, 1972 U. ILL. L.F. 1, 33. For a comprehensive review of the public opinion surveys on no-fault versus tort liability insurance, see O'Connell & Wilson, *Public Opinion on No-Fault Auto Insurance: A Survey of the Surveys*, 1970 U. ILL. L.F. 307. Although these studies only apply to auto accidents, the public's aversion to the tort liability process would seem to apply to other accidents as well. See generally J. O'CONNELL, *supra* note 23, at 112-15.

77. MICH. COMP. LAWS ANN. §§ 500.3101-3179 (Supp. 1976).

78. Concerning the benefits under Michigan's no-fault law, see O'Connell, *supra* note 17, at 39-41 and 164-66 respectively.

suffering; (2) losses above compensation from collateral sources such as Blue Cross and sick leave benefits; and (3) moderate wage loss (up to, say, \$150 or \$200 per week). Deductibles and over-all limits could be used to limit still further the possibility of prohibitive costs.

A first-party insurer offering such no-fault insurance would be in a position to market it subject to a dividend based on the return from the resultant tort suits. It should be noted in this regard that the great virtue of no-fault insurance has not proved to be its lower cost (although it might have this effect) but rather its more efficient use of insurance dollars, particularly for the seriously injured.⁷⁹ Michigan's experience demonstrates that no-fault can provide higher, more predictable benefits to victims of automobile accidents.⁸⁰ In addition, there have been substantial amounts available for victims of catastrophic accidents in which no other vehicle was involved and in which, accordingly, there would have been no payment in a fault-based system.

The device proposed in this article allows the insurance industry to attempt to harness the tort system and make it work for its own and the public's advantage. There seems to be an almost uniform feeling among insurance executives that the present tort system is running amok, not only in auto liability but in product, medical malpractice, municipal, and occupiers' liability as well. But despite such an overwhelming consensus, insurance executives despair of getting courts or legislators to do much about it. Even if the fragmented insurance industry could decide on a course of action, it must then deal with the courts and legislators of fifty states, as well as the federal government.⁸¹

On the other hand, under the proposal made here, insurance companies can begin to experiment with contracts that are much more valuable to the public than tort liability; they can do so without waiting for a legislative intervention and can thereby deal with tort claims among themselves.

In a sense, this proposal allows experimentation with an ingenious idea recently advanced by economist Melvin Reder.⁸² Although even Reder admits that his idea is probably unworkable in its present form, his analysis is nonetheless very illuminating. Reder starts

79. *See id.* at 39-42.

80. *See id.* at 39-41.

81. *The Overload on the Nation's Insurance System*, BUS. WEEK, Sept. 6, 1976, at 46, 48.

82. M. Reder, *Contingent Fees in Litigation with Special Reference to Medical Malpractice* (paper prepared for AEI Conference, *see* note 31 *supra*).

from the premise that plaintiffs' lawyers in personal injury cases have a clear advantage over plaintiffs as far as "portfolio diversification" is concerned. Lawyers handle many different claims, whereas normally a claimant has only one in a lifetime. Thus, lawyers are in a far better position to undertake the risks of pursuing a tort claim. That, at bottom, explains why we allow the claimant to sell a substantial portion—frequently one third—of his claim in the form of the contingent fee contract. In other words, contingent fees, which are well-nigh universal in personal injury claims, reflect the fact that such a claim is a risky asset that is in part transferable. Especially when it is combined with the widespread practice of the plaintiff's lawyer assuming all the costs of preparing the case (including the costs of exhibits, etc.), the contingent fee, as Reder points out, allows the claimant to transfer a portion of his equity in his claim to his lawyer in return for the latter's services.

Logically, argues Reder, we should allow the plaintiffs to transfer the *entire* claim. Being risk averse, the typical injury victim would be willing to sell all or at least most of his "risky asset," and the logical buyer would be his lawyer, who has already bought a portion through the contingent fee. On the other hand, as Reder admits, prohibitions of maintenance and champerty render it unethical for a lawyer to purchase outright for cash his client's entire claim.⁸³ But even if plaintiffs' lawyers were allowed to buy tort claims, they would want to split the risk further by contract. A given case, after all, might require an attorney to invest a significant portion of his annual income in preparation for trial. "Normal desire for portfolio diversification (*i.e.*, risk aversion) would suggest the sale or exchange of shares in large claims, at least among lawyers. And it is quite possible that this actually occurs; the practice of engaging a referring attorney as co-counsel may be one method by which attorneys pool their risks; partnerships may be another."⁸⁴ If one com-

83. *Id.* But given the inapplicability to my proposal of the reasons behind the doctrines of maintenance and champerty, they should pose no barrier. *Cf.* *Grant v. Stecker & Huff*, 300 Mich. 174, 1 N.W.2d 500 (1942).

Reder also maintains that:

even if there were no legal impediments to doing so, often it would be inefficient to eliminate all interest of a claimant in the settlement of his claim. Where he must be available as a witness, or as an exhibit, in the event of a trial; or where his public conduct, prior to settlement, might influence the outcome by providing evidence as to the extent of his injuries, the victim's performance will tend to be more conducive to a successful outcome if he retains a financial stake in the matter.

Reder, *supra* note 82. However, it may well be that the traditional obligation under liability insurance contracts of an insured to cooperate in the defense of an action can be extended to the prosecution of an action. *See* R. KEETON, *INSURANCE LAW: BASIC TEXT* § 7.5, at 458-61 (1971).

84. Reder, *supra* note 82.

compares the distribution of risks on the plaintiffs' side to the defense side in personal injury cases, Reder argues, one immediately perceives how diversified is the risk from the defense side, in contrast to the plaintiffs' side. "[O]n the defense side the principals are, with few exceptions, insured; and the insurers are legally free to reinsure or otherwise engage in mutually advantageous exchanges of risk."⁸⁵ On the plaintiffs' side, apart from selling one third of his claim to his lawyer, the plaintiff is locked into a much less diversified portfolio than he would want.

The proposal described in this article effectively allows pursuit of the goal toward which Reder struggles. Under it, the sale of the victim's highly uncertain tort claim would be to an even better risk-bearer than a lawyer or group of lawyers—an insurance company with all the stability and fairness that the law demands of such an enterprise. In addition, subsistence is guaranteed to the potential accident victim who sells his tort claim. Such a change seems to exemplify Paul Samuelson's comment in another context that "there are some things that are done so stupidly in a society, that everyone can gain [by change]. Once the overall situation is improved, there will be bribes for everybody."⁸⁶ So "stupid" is the lawyers' tort law as it applies to personal injuries that everyone (except trial lawyers, it must be admitted) will benefit if we allow contracts for no-fault coverage to replace tort claims.

V. CONCLUSION

By the devices⁸⁷ described in the previous section, contract law can again be used in place of tort liability, but only within limits—specifically, only where guarantees of substantial payment supplant the vicissitudes of traditional tort liability. In other words, it may not be so much a question of the death of contract or the death of tort. Instead, compensation will entail a cross-fertilization of the two, as it long has. Consider the history of products liability:

First, in 1842, in order to limit payment for personal injury, contract (specifically, the doctrine of privity) was used in a product liability case to get around the inadequacies of tort (specifically, the almost unlimited liability in tort to almost anyone); then, in 1916, in order to ensure more ready payment for personal injury, tort (specifically, liability for negligence regardless of the lack of privity) was used to

85. *Id.*

86. Quoted in L. SILK, *THE ECONOMISTS* 40 (1976).

87. In addition to my proposal for no-fault claims as a "sole remedy" for accident victims both on and off the job, consider also my proposal for elective no-fault insurance by potential tortfeasors. See note 62 *supra*.

get around the inadequacies of contract (namely privity); then, once again in order to ensure more ready payment for personal injury, contract (specifically, the doctrine of warranty) was used increasingly in products liability cases to get around the inadequacies of tort (specifically, such requirements as proof of negligence and the absence of contributory negligence); then, in order to ensure still readier payment, tort (specifically, the doctrine of strict liability) was used to get around the inadequacies of contract (specifically, such requirements as privity and notice under the doctrine of warranty); so now, in turn, to ensure readier payment still, contract (specifically, elective no-fault . . . [insurance]) should be used to get around the inadequacies of tort (specifically, such requirements as proof of defect under the doctrine of strict liability).⁸⁸

Even Professor Gilmore, despite all his talk of the death of contract, would seem to agree:

"Products liability" is a term that has come into use only in recent years. Lawyers used to talk, more clumsily, of liability for breach of warranty, without bothering to make clear whether they were talking about liability in contract or liability in tort. Warranty law indeed has always had one foot in contract and the other foot in tort and this ambiguous straddle over the great legal divide has done a great deal to keep the legal discussion open-ended. Whenever a particular state of doctrine on one side or the other of the divide has seemed to present a roadblock to further progress, it has been possible to get around the obstacle by pointing out that the action is really in tort (if the roadblock is on the contract side) or really in contract (if the roadblock is on the tort side). In days when the courts took the concept of "negligence" more seriously than they do now, the escape from carrying the burden of proof on that issue was to emphasize the absolute promissory nature of contract warranties; in the course of that demonstration there developed the vast and intricate structure of the law of implied warranties. In this century the roadblocks have been located mostly on the contract side—the defenses of privity of contract, of disclaimer, of the plaintiff's failure to give timely notice of the defect—so that we have become accustomed to thinking of tort as providing the escape route. But if the going were to become rough in tort . . . we would no doubt revert almost instinctively to emphasizing the contract nature of the action.⁸⁹

As illustrated by the past one hundred years or so of the interlocking development of tort and contract, it is only for the purpose of achieving progress toward abetting payment—not wholesale denial of it⁹⁰—that we should turn once again from tort to contract.

88. O'Connell, *An Alternative to Abandoning Tort Liability: Elective No-Fault Insurance for Many Kinds of Injuries*, *supra* note 34, at 533-34 (citations omitted). The elective no-fault being discussed was not that explained in notes 75-86 *supra* but the one under which potential tortfeasors could elect to pay on a no-fault basis in return for a tort exemption. *Id.* at 522-23. See note 87 *supra*.

89. Gilmore, *supra* note 40, at 109-10.

90. See notes 28-32 *supra* and accompanying text.

In essence, tort and contract are dying for opposite reasons: contract, in trying to be orderly, is too unjust; tort, in trying to be just, is too disorderly. What is needed is the orderly, if admittedly imperfect, justice of no-fault insurance,⁹¹ with its mixture of contract and tort.

91. See text at notes 18-19, 79-80 *supra*.