Insurance as Safety Regulator

Author : Catherine Sharkey

Date : October 9, 2012

Omri Ben-Shahar & Kyle D. Logue, *Outsourcing Regulation: How Insurance Reduces Moral Hazard,* 111 **Mich. L. Rev.** (forthcoming 2012) *available at* SSRN.

In *Outsourcing Regulation: How Insurance Reduces Moral Hazard*, Omri Ben-Shahar and Kyle Logue make a pitch for the underappreciated role of insurance as manager and minimizer of safety risks.

The study of tort law in the modern administrative state increasingly entails a comparative institutional account of private common law versus public agency control in terms of satisfying the goals of compensation and regulation of safety risks. I would go so far as to say that the future of tort law and scholarship belongs to those who tackle complex health and safety issues by integrating concepts and doctrines drawn from public administrative law and private tort law. Ben-Shahar and Logue make a major contribution by adding the third dimension of insurance: "Choosing the ideal regulatory role of these two institutions—agencies versus courts—depends on how well insurance arrangements support the regulatory function of tort and agency law." (P.20)

In the contest between institutions, Ben-Shahar and Logue boldly pronounce insurance the winner: "[I]n a variety of areas private insurance companies can, and already do, *replace or augment* the standard-setting and safety-monitoring currently performed by government, and they do so in ways that increase overall social welfare." (P.1) As their title suggests, they are ready to "outsource" to the private insurance market regulatory functions now performed by the government.

Why? According to Ben-Shahar and Logue, private insurance companies enjoy two main comparative advantages: superior information and competition. In terms of informational advantages, insurance companies have "expertise in acquiring and sorting sophisticated information." (P.12) Central to their business is the assembly of large actuarial databases used to classify and price risks in the underwriting process. Moreover, unlike government regulators, insurance companies are subject to competition, which is key to their motivation to reduce risks.

Ben-Shahar and Logue want to upend conventional thinking about insurance as merely providing indemnity for losses. They stand on the shoulders of several insurance law scholars (notably Ken Abraham, Ronen Avraham, Tom Baker, and Steven Shavell) to present an overarching view of insurance as a pervasive form of regulation in the modern economy. They present a detailed, clear picture of insurers engaging in various forms of ex ante and ex post regulation. Unlike most government regulators, insurers present actors with a menu of safety options, not simply an either-or choice. Insurers tailor and adjust insurance premiums according to policyholders' risk characteristics and loss experiences over time, setting prices for actors' choices or levels of care much like government-set Pigouvian taxes. Employing a centralized network of agents who administer claims, insurance transforms vague safety standards into bright-line rules. And finally, insurers monitor the conduct of their policyholders on an ongoing basis. Ben-Shahar and Logue give myriad examples of how insurance supplies "both the incentive and the know-how that actors often lack, to administer a more efficient level of accidents" (p. 2), moving seamlessly from the world of "what is"—with examples of risk management in the homeowners, auto, and products liability insurance contexts—to the world of "what could be"—imagining insurance as a substitute for government regulation in consumer protection, food

and import safety, and financial markets.

Ben-Shahar and Logue's article bursts with fresh insights. One of their most fascinating ideas is a kind of "law of conservation of regulation." Namely, if tort-based liability is eliminated in a certain area and the government has yet to step in, then private insurance markets will spring up. For example, they predict: "It is possible . . . that the trend in American law, of businesses immunizing against court-imposed liability for breach of consumer product contracts, through their use of mandatory arbitration clauses, may dramatically increase the demand for first-party insurance coverage as a substitute for legal control of consumer product quality." (P.48) Another provocative idea is that subrogation claims brought by first-party insurers can substitute for class-action lawsuits as a means of regulating bad behavior where individualized lawsuits are not cost effective. (P.46)

In a recent article, Ken Abraham divided the field of insurance law into "Four Conceptions of Insurance," each of which "paints a different view of the cathedral." (P.56) Ben-Shahar and Logue's work falls squarely within the "governance" conception, which Abraham describes with the catchphrase "insurance as 'surrogate' for government." (P.5) (The competing conceptions are insurance as contract, public utility, or product.) Reading Ben-Shahar and Logue's article against the backdrop of Abraham's typology, the reader may wonder, "Where are we most likely to see insurance wear its risk manager hat?" "Where not?" The risk management role played by insurance is likely to vary significantly by insurance line and by market conditions. Ben-Shahar and Logue offer a formidable start down this path. To their credit, the authors make bold predictions and do not shy away from claims that still await empirical testing. But, for the time being, if their conceptual claims hold sway, then we might welcome, rather than fear, insurers' larger role in the health and safety contexts of the modern administrative state.

Cite as: Catherine Sharkey, *Insurance as Safety Regulator*, JOTWELL (October 9, 2012) (reviewing Omri Ben-Shahar & Kyle D. Logue, *Outsourcing Regulation: How Insurance Reduces Moral Hazard,* 111 **Mich. L. Rev.** (forthcoming 2012) *available at* SSRN), https://torts.jotwell.com/insurance-as-safety-regulator/.