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ESSAYS

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The imposition of strict liability and the simultaneous application of the collateral source rule to innocent defendants represent unfair and unsound public policy. Strict liability and the collateral source rule should not be mixed; nevertheless, our courts inadvertently blend them. A fundamental reform that would help stabilize the American tort law system is to abolish the collateral source rule *in toto* whenever a claimant relies on a strict liability theory. The collateral source rule is appropriate only when a claimant proves that the defendant was at fault in causing an injury.

There is a broad view in the United States that the American tort system has become unwieldly and too expensive.[1] Many blame

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1. The current liability insurance crisis has reached enormous proportions. Insurance is unavailable or unaffordable for many municipalities. Both small and large businesses find product liability insurance either unavailable or unaffordable. Restrictions on coverage mean that insurance may not be predicted against claims that arise in a certain year but that do not manifest themselves until later.

This Essay is not intended to suggest that a modification of the collateral source rule is all that is necessary to "fix the system." Limits also must be placed on damages for pain and suffering, which may be wholly inappropriate when a claim is based on strict liability. The

the advent of strict liability theories. Where American tort law went awry may be not so much in its adoption of strict liability when *appropriate*, but rather in converting from a fault-based system to a strict liability system without any adjustment of its damage rules. Under traditional tort law, an injured claimant may receive damages that are many times his actual out-of-pocket losses. For example, the claimant may receive damages for pain and suffering that are nine to ten times out-of-pocket costs plus double recovery for out-of-pocket costs because of the collateral source rule. On the other hand, when an individual suffers an insured loss for which no legal recourse is available, his "expectation" is to recover only actual out-of-pocket losses or maybe only a portion of them. If the courts had made appropriate adjustments in the tort damage rules when they spawned strict liability, our tort system would be far less wounded than it is today.[2]

I. THE COLLATERAL SOURCE RULE—A RULE EMBRACED IN FAULT

The collateral source rule "ordains that, in computing damages against a tortfeasor, no reduction be allowed on account of benefits received by the plaintiff from other sources, even though they have partially or wholly mitigated his loss."[3] The first application of the collateral source rule in the United States occurred in 1854.[4] It has been a part of tort law ever since. The rule grew out of the premise "that the *wrongdoer* ought not to benefit—in having what he owes diminished—by the fact that the victim was prudent enough to have other sources of compensation, which he was

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history of tort law shows that damages for pain and suffering were rooted in fault, not compensation. *See* O'Connell and Carpenter, *Payment for Pain and Suffering Through History*, 50 INS. COUNSEL J. 411 (1983). Another fundamental reform goes to the type of harm for which compensation is appropriate. Traditionally tort law was limited to physical harm to persons and damaged property. Insurance crises of major proportions did not arise while these limits were maintained.

2. Reform of tort damage rules is needed in several areas to accompany the development of strict liability. For example, when liability is imposed without regard to fault, it may be appropriate to limit the types of harm for which claimants may receive compensation (*e.g.*, to limit recovery for mental anguish to that which is caused by actual physical harm). It also may be appropriate to set a limit on the total amount of pain and suffering damages that may be recovered in strict liability cases.

3. Fleming, *The Collateral Source Rule and Loss Allocation in Tort Law*, 54 CALIF. L. REV. 1478 (1966).

4. *See* Note, *Unreason in the Law of Damages: The Collateral Source Rule*, 77 HARV. L. REV. 741, 741 & n.3 (1964) (citing The Propeller Monticello v. Mollison, 58 U.S. (17 How.) 152 (1854); Maxwell, *The Collateral Source Rule in the American Law of Damages*, 46 MINN. L. REV. 669 (1962)).

probably paying for."[5]

Under the rule, an injured party who recovers his salary, pension, or medical expenses from an insurer or other third party may still recover full damages for all these items from the person who is liable for the injury.[6] To this extent the claimant will receive double payment. Although courts openly have recognized this fact, they stand by the principle that the defendant "wrongdoer" should not benefit from payments that come to the claimant from a collateral source—a source deemed legally separate from the defendant. Professor Fleming observed many years ago that "[t]o anyone a little troubled by the notion that this might mean double recovery for the plaintiff, the stereotyped response has been that this is still better than letting the defendant profit."[7]

The critics of the collateral source rule have pointed out the weaknesses of this argument by stressing the compensatory goal of the tort system. As Professors Harper and James have suggested:

> It may be said that the defendant deserves being made to pay in full because of the *moral quality* of his act. Now there can be no question here of who should fairly bear a loss, as between an innocent and a guilty party, for by hypothesis the innocent man's loss has been made whole and we are discussing a further payment beyond that. There may be mixed with this feeling of desert a desire to deter dangerous conduct, but that merits separate treatment. What is left under this head, then, springs from a feeling of indignation or resentment and a desire to punish as such. Surely, there is no place for such a notion in any philosophy of social insurance. It has no acknowledged place even in tort liability based on fault, for the theory of damages here is purely compensatory.[8]

Nonetheless, once courts have characterized the tort system as one based on fault, they have found a certain symmetry to the application of a rule that prevents the defendant from benefiting in any way from his wrong. For example, the Supreme Court of New Mexico has stated:

> The right of redress for wrong is fundamental. Charity cannot be made a substitute for such right, nor can benevolence be made a set-off against the acts of a tort-feasor.[9]

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5. J. O'CONNELL & R. HENDERSON, TORT LAW, NO-FAULT AND BEYOND, 114 (1975) (emphasis added).

6. 2 F. HARPER & F. JAMES, THE LAW OF TORTS § 25.22, at 1343-44 (1957). By contract, many insurers will become subrogated to the plaintiff's rights against the tortfeasor, but the collateral source rule does not depend on the insurance contract provisions.

7. Fleming, *supra* note 3, at 1483 (footnote omitted).

8. 2 F. HARPER & F. JAMES, *supra* note 6, § 25.22, at 1345 (emphasis changed) (footnote omitted).

9. Mohley v. Garcia, 54 N.M. 175, 177, 217 P.2d 256, 257 (1950).

The Supreme Court of Texas has observed:

> The theory behind the collateral source rule is that a wrongdoer should not have the benefit of insurance independently procured by the injured party.[10]

A New Jersey court has observed:

> All the collateral source rule does is to preclude a tortfeasor, that is, one whose fault caused the injury, from setting up in mitigation of damages, benefits derived from the injured person from some collateral source.[11]

Lest the reader feel there is an overemphasis on quotes from judicial opinions, they are put forth *in hac verba* because courts forgot this *fundamental*—that the collateral source rule is a fault-based concept—when they developed the theory of strict liability.

II. The Engine Behind Strict Liability: Risk Distribution

Strict liability, by definition, is distinct from fault. The *Restatement (Second) of Torts* in section 402A states, in part, that liability can be imposed even though "the seller has exercised all possible care in the preparation and sale of his product."

While the application of strict liability in the design and duty to warn areas sometimes has become muddled with fault in that a defendant may be able to escape liability by showing that he neither knew nor could have known of the risk,[12] recently the highest courts in Arizona, Massachusetts, Missouri, New Jersey, and Oregon have indicated that liability should be imposed in this precise situation and that a totally innocent manufacturer may be subject to liability.[13] As the Supreme Court of New Jersey explained:

> One of the most important arguments generally advanced for imposing strict liability is that the manufacturers and distributors of defective products can best allocate the costs of the injuries resulting from those products. The premise is that the price of a product should reflect all of its costs, including the

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10. Brown v. American Transfer and Storage Co., 601 S.W.2d 931, 934 (Tex.), *cert denied*, 449 U.S. 1015 (1980).

11. Cozzi v. Government Employees Ins. Co., 154 N.J. Super. 519, 528, 381 A.2d 1235, 1240 (App. Div. 1977); *see also* Quinones v. Passaic Boys Club, 183 N.J. Super. 531, 535, 444 A.2d 630, 632 (Law Div. 1982) ("It is axiomatic that a party who becomes obligated to pay damages because of a wrong done may not benefit by payments or medical services rendered to the injured party from collateral sources."), *overruled on other grounds*, 199 N.J. Super. 127, 488 A.2d 1032 (App. Div. 1985).

12. *See* Powers, *The Persistence of Fault in Products Liability*, 61 Tex. L. Rev. 777 (1983).

13. *See* Dart v. Wiebe Mfg., No. 17766-PR (Ariz. Nov. 14, 1985); Heyes v. Ariens Co., 391 Mass. 407, 462 N.E.2d 273 (1984); Elmore v. Owens-Illinois, Inc., 673 S.W.2d 434 (Mo. 1984); Beshada v. Johns-Manville Prods. Corp., 90 N.J. 191, 447 A.2d 539 (1982); Phillips v. Kimwood Mach. Co., 269 Or. 485, 525 P.2d 1033 (1974).

cost of injuries caused by the product. This can best be accomplished by imposing liability on the manufacturer and distributors. These persons can insure against liability and incorporate the cost of insurance in the price of the product. In this way, the costs of the product will be borne by those who profit from it: the manufacturers and distributors who profit from its sale and the buyers who profit from its use.[14]

The notion of risk distribution, first articulated by Justice Traynor,[15] has permeated other areas of tort law.[16] Again and again courts have stressed that the reason the innocent defendant should pay the price is that the defendant is in a better position to distribute the risk. Thus, placing the risk on the defendant is considered "far preferable to imposing it on the innocent victims who suffer illnesses and disability from defective products."[17]

III. The Collateral Source Rule and Strict Liability—The Improper Mixture

It should be clear to the reader that by justifying strict liability in terms of risk distribution the courts have surgically removed from strict liability the very basis on which the collateral source rule is premised. In terms of fundamentals, when courts remove the basis of a rule, the rule itself should be abandoned. Apart from this logical syllogism, however, sound economics also demands the abolition of the collateral source rule when a defendant has been found strictly liable. Given that risk distribution is the nub of strict liability, it is foolish to distribute a risk for which the victim already has been compensated. When the tort system distributes a previously compensated-for risk, it, in effect, *redistributes* the risk to a different insurance system. This redistribution makes poor economic sense.

In that regard, the insurance system represents a more efficient means of compensating injured parties to the extent of coverage. The percentage of each premium dollar paid to claimants as damages or benefits for health insurance, disability insurance, and

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14. *Beshada*, 90 N.J. at 205, 447 A.2d at 547.

15. Greenman v. Yuba Power Prods., Inc., 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1962).

16. *See, e.g.*, Bigbee v. Pacific Tel. and Tel. Co., 34 Cal. 3d 49, 59 n.14, 665 P.2d 947, 953 n.14, 192 Cal. Rptr. 857, 863 n.14 (1983) (in suit against defendant who was responsible for location, installation, and maintenance of telephone booth in which plaintiff was standing when struck by an automobile, court noted that "imposition of liability would not be unduly burdensome to defendants given the probable availability of insurance for these types of accidents which defendants themselves maintain do not recur with great frequency").

17. *Beshada*, 90 N.J. at 206, 447 A.2d at 547.

pensions is quite high. For example, for group health insurance coverage in 1982, payments reached eighty-eight percent of premiums.[18] By way of contrast, the percentage of each premium dollar paid out to injured parties under casualty property lines of insurance is substantially less. On average, between the years 1977 and 1981, the casualty insurance payout rate was only sixty-five percent of premiums.[19] This statistic does not mean that the sixty-five cents "paid" as a claim reaches an injured person's bank account. In asbestos litigation, for example, plaintiff's fees and expenses for tried and settled claims averaged forty-one percent of the payout.[20] The net compensation received by claimants was thirty-eight percent of the premium dollar.

Thus, not only does compensating the victim twice make poor economic sense, but also the secondary compensation system—the tort system—represents a relatively inefficient insurance mechanism. One does not have to be an actuary to appreciate that it is far easier to return premium dollars to injured parties through accident and health insurance. One knows who the insured person is and an insurer can assess that risk (as contrasted with liability insurance where the "potential" victim is unknown). Cost savings also arise because lawyers and the judicial system do not need to involve themselves whenever an injury occurs.

Mixing the collateral source rule with strict liability also represents a fundamentally unsound public policy. The "mix" treats innocent manufacturers, or other classes of innocent defendants, the same as negligent manufacturers. This treatment is indefensible public policy. As New Jersey Senator Frank R. Lautenberg has observed:

> [W]e need a system that rewards the prudent product maker, and penalizes the imprudent. The courts in some cases have approached a system of absolute liability where a manufacturer can be found liable no mater how careful, or how circumspect it was when it designed a product. The careful manufacturer can be found as liable as if it were negligent. I think that is wrong. If we are to encourage prudent behavior, we have to reward it, hy distinguishing between the prudent and the imprudent.[21]

Unfortunately, the simultaneous application of the collateral

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18. *See* HEALTH INSURANCE ASSOCIATION OF AMERICA, SOURCE BOOK OF HEALTH INSURANCE DATA 12, 14 (1984 Update).

19. *See* NATIONAL ASSOCIATION OF INDEPENDENT INSURERS, GREENBOOK 1983; A COMPILATION OF PROPERTY-CASUALTY INSURANCE STATISTICS 20.

20. *See* J. KAKALIK, P. EBENER, W. FELSTINER & M. SHANLEY, COSTS OF ASBESTOS LITIGATION 36 (Institute for Civil Justice 1983).

21. S. REP. No. 476, 98th Cong., 2d Sess. 109 (1984).

source rule and strict liability commits the very sin Senator Lautenberg chastizes.

IV. Conclusion

The time has come for American tort law and American judges to stop thinking in boxes, one box for the collateral source rule and another box for strict liability. Rather, the courts should synthesize the rationale underlying each rule. Once the policies underlying each rule are examined carefully, they will be found to be totally inconsistent. The collateral source rule is based on fault; strict liability is based on risk distribution. If a defendant is not deemed at fault, courts should not require him to reimburse a plaintiff who has *already been paid* by another source. Such payment represents unsound economic thinking, and it places an unnecessary cost on an ever weakening tort system.

Finally, and most importantly, it is unsound public policy to treat negligent and innocent defendants alike. If courts are to use the tort system to impose strict liability, they should limit the financial burdens imposed on defendants to losses that the claimant actually has incurred.