IN DEFENSE OF COMPENSATION

Yotam Kaplan

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Yotam Kaplan*

In recent years, tort victims in the U.S. have been finding it increasingly difficult to secure compensation through the legal system. This decline of compensation is the result of a decades-long campaign by corporate defendants to reshape the litigation landscape in their own favor. The most recent volley in this ongoing battle is an unprecedented, forceful attack against compensation launched by the Trump Administration. Regrettably, the inaccessibility of compensation often spells tragedy for tort victims. To justify these attacks, supporters of the anticompensation campaign utilize the economic theory of tort law to formulate forceful arguments against compensation as a general legal principle.

This Article demonstrates that the prevailing economic argument, and the legal order that follows therefrom, is based on a fundamental oversight. In particular, current economic theory fails to consider the possibility of investments by victims to shift harm to others. This Article is the first to examine the possibility of harm-shifting in the context of tort doctrine.

This additional consideration proves to be crucial for the analysis of compensation. Existing economic theory argues that compensation is "inefficient" as it annuls victims' incentive to invest in self-protection. This argument is reversed once we consider the possibility of harm-shifting. When investing to protect themselves, tort victims can pass harms on to others. Such investments are wasteful as they are designed only to redistribute harms, not to eliminate them. Therefore, compensation can actually prove beneficial precisely because it annuls victims' incentive to invest in self-protection.

Once harm-shifting investments are considered, the economic argument against compensation is overturned. The case, therefore, for compensation is stronger than economic theory currently leads us to believe, and action must be taken to reverse the trending decline of compensation.

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INTRODUCTION

An individual wronged by another is entitled to compensation for the harm suffered. This is the general principle of compensation, a self-evident requisite of justice, recognized by moral philosophers at least since Aristotle. Compensation aims to correct a wrong, to the degree possible, when actual repair in kind is unattainable. Thus, if you suffered an injury to yourself or to your property, the least the culpable transgressor can do, morally, is to compensate you for the harm they caused.

Compensation is not only a fundamental moral principle but also an essential element of any legal system. The law defines a set of primary rights; once a primary right has been infringed upon, a secondary right for compensation follows. Absent such compensation, primary rights have no meaning, as their violation bears no consequence. The right for compensation must therefore be considered to underwrite all other rights. From the ancient Code of Hammurabi to the modern administrative state, our societies cannot conceive of a legal system without the institution of compensation.

And yet, despite its crucial importance for both morality and law, the right to compensation has suffered a series of devastating blows in recent years. The structure of private litigation dictates a simple truth: compensa-

1. Compensation is a well-established common-law principle. Livingstone v. Rawyards Coal Co. (1880) 5 App. Cas. 25 (HL) 39 (appeal taken from Scot.) (“I do not think there is any difference of opinion as to its being a general rule that, where any injury is to be compensated by damages, in settling the sum of money to be given for reparation of damages you should as nearly as possible get at that sum of money which will put the party who has been injured, or who has suffered, in the same position as he would have been in if he had not sustained the wrong for which he is now getting his compensation or reparation.”).


3. See Stephen A. Smith, Duties, Liabilities, and Damages, 125 HARV. L. REV. 1727, 1728 (2012) (explaining that compensation operates to correct a wrong by giving legal recognition to the fact a duty towards the victim was violated).


5. O.W. Holmes, The Path of the Law, 10 HARV. L. REV. 457, 461 (1897) (stating that the only meaning of “legal duty” is the prediction that some actions will lead to “disagreeable consequences by way of imprisonment or compulsory payment”).


8. On the contemporary decline of compensation, see infra Part I.
tion is obtained only if the expected compensation amount outweighs the cost of securing it through litigation. Otherwise, victims of harm will simply never sue for compensation. Savvy repeat defendants are aware of this dynamic, and those with the requisite means have been working to systematically increase litigation costs for plaintiffs as well as to limit the compensation amounts plaintiffs can be paid.

Increasing the costs while lowering the rewards imbalances the scale against prospective plaintiffs. This anti-compensation campaign, led by powerful commercial lobbies, has been immensely successful, resulting in prohibitive costliness of lawsuits for many private plaintiffs. Compensation has thus become a rarity instead of the norm: currently, only 2% of Americans injured in an accident find it worthwhile to sue for compensation.

Going forward, compensation is expected to decline even further. The compensation crisis recently made national news following President Trump’s declaration of a new anti-compensation attack. These are not empty threats: the Trump administration is currently working to block compensation suits, for the first time, as a matter of federal law. If such initiatives continue unhindered, the final defeat of compensation will soon be achieved.

To justify the anti-compensation campaign, repeat defendants employ powerful normative arguments that originate in law and economics literature. According to prevailing economic theory, deterrence is the primary goal of tort law. Under this paradigm, compensation carries little inde-
pendent value; any moral justification, for example, is discounted. Furthermore, economic theory emphasizes various inefficiencies generated by compensation. Repeat defendants rely on economic theory to argue that the current compensation crisis is no crisis at all since compensation can be harmful just as much as it can be beneficial. In fact, they argue, it might be appropriate to limit compensation even further. Thus, repeat defendants and their allies justify the compensation deficit on efficiency grounds.

This Article sets out to reject the economic argument against compensation by highlighting the possibility of harm-shifting. This is the first scholarly work to study investments designed to shift harms in the context of tort doctrine.

To illustrate the economic argument against compensation, and this Article’s rebuttal, consider the following stylized example, which follows the classic setting of conflicting land uses by two neighbors, a farmer and a rancher. The farmer and the rancher both know that cattle from the ranch might trample crops in the farm, causing an estimated harm of $10,000. The most practical way to prevent this incident from happening is for the farmer, the potential victim, to invest $1,000 in order to surround the farm with a strong fence.

Under current economic theory, scholars insist that the farmer in the example should not be compensated here if the predicted harm befalls her. The theory dictates that the farmer is the “cheapest cost avoider,” able to prevent the harm at a lower cost than the rancher. It is therefore better if

15. John C.P. Goldberg, Twentieth-Century Tort Theory, 91 GEO. L.J. 513, 545 (2003) (showing that contemporary economic theory focuses exclusively on efficient deterrence as the goal of tort law).

16. See Robert Cooter, Unity in Tort, Contract, and Property: The Model of Precaution, 73 CALIF. L. REV. 1, 3–4 (1985) (showing that compensation distorts incentives to invest in precautions); Steven Shavell, The Fundamental Divergence Between the Private and the Social Motive to Use the Legal System, 26 J. LEGAL STUD. 575 (1997) (showing that compensation creates distorted incentives to engage in litigation). For more details, see infra notes 120–21 and accompanying text.


19. This example is most famously used by Ronald Coase. R.H. Coase, The Problem of Social Cost, 3 J.L. & ECON. 1, 2 (1960).


the farmer cannot secure compensation. If the farmer enjoys no promise of compensation, she will have a strong incentive to invest $1,000 in erecting the fence, thus efficiently preventing a greater harm of $10,000. This would be the most efficient prophylactic measure. Conversely, goes the economic argument, if the farmer can expect compensation, she is made indifferent to the harm and will therefore have no reason to invest efficiently in preventing it.\textsuperscript{22} Thus, compensation creates inefficiencies. Under this view, compensation should never be granted where the victim is the cheapest cost avoider. This conclusion represents a fundamental truth for the economic analysis of tort law,\textsuperscript{23} and it stands regardless of any intuition about justice,\textsuperscript{24} such as the fact the cattle from the ranch trespassed into the farm, violating the farmer’s property right.\textsuperscript{25} Thus, the basic maxim of contemporary economic theory judges compensation to be unwarranted if the victim is the cheapest cost avoider.

This Article will demonstrate that the economic-theory maxim is based on a fundamental oversight and on a misleading assumption regarding the nature of the victim’s investments. In the example above, the farmer is the cheapest cost avoider and can prevent the harm to herself at a low cost by erecting a fence. This cost-efficient measure, however, prevents harm only to the farmer herself. The rancher’s cattle, their progress defeated by the farmer’s new fence, can simply wander off to trample another field. In this way, the farmer’s investment did not minimize the harm but merely passed it on to another victim. Extrapolating this point into a generality, we observe that victims invest to protect themselves, not to minimize harms. In other words, a victim who invests in self-protection can easily shift harms

\textsuperscript{22} This is the now classic “paradox of compensation.” See Cooter, supra note 16, at 6. Compensation makes injurers internalize the harm they cause, thereby optimally deterring them. At the same time, compensation makes victims indifferent to harms, thereby nullifying their incentive to invest in precautions. The term was first coined by Robert Cooter, id. at 3–4, following the work of Coase, Coase, supra note 19, and Calabresi, Calabresi, supra note 20; see also ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 331 (6th ed. 2012). For the same problem in the context of contract law, see Steven Shavell, Damage Measures for Breach of Contract, 11 BELL J. ECON. 466 (1980) (showing that expectation damages can distort the incentives of the promisee).


\textsuperscript{24} Current economic theory insists that intuitions of fairness should never trump the requirements of efficiency. See generally LOUIS KAPLOW & STEVEN SHAVELL, FAIRNESS VERSUS WELFARE (2002); Louis Kaplow & Steven Shavell, Any Non-Welfarist Method of Policy Assessment Violates the Pareto Principle, 109 J. POL. ECON. 281 (2001); Louis Kaplow & Steven Shavell, Fairness Versus Welfare: Notes on the Pareto Principle, Preferences, and Distributive Justice, 32 J. LEGAL STUD. 331 (2003).

\textsuperscript{25} For a critique of this result and more details on its centrality to current economic theory, see Henry E. Smith, Self-Help and the Nature of Property, 1 J.L. ECON. & POL’Y 69, 72 (2005).
to others. Such investments are wasteful because they do not minimize total harm but merely redistribute harms among potential victims.

This point is crucial for the analysis of compensation. Existing economic theory argues that compensation is “inefficient” because it annuls victims’ incentive to invest in efficient precautions. But this argument is erroneous. Given our understanding that investments in self-protection can themselves be wasteful by shifting harms to others rather than preventing them, compensation can, in fact, be beneficial precisely because it annuls victims’ incentive to invest in self-protection.

To illustrate, in the example above of the farmer and the rancher, if compensation is not available, the farmer will indeed invest in erecting a fence. This investment is wasteful; the fence merely works to shift the harm to another victim. Conversely, if compensation is available, the farmer is made indifferent to the harm and will not invest to avoid it. This is a preferable result because the fence serves no useful purpose in preventing harm caused by the wandering cattle. In this way, compensation beneficially eliminates the need for potential victims to protect themselves with wasteful investments that merely shift harms to others.

This analysis reveals that the need for compensation is greater than what prevailing economic theory would have us believe. Under prevailing theory, the justification for compensation is highly contingent. In particular, whenever the victim is the cheapest cost avoider, compensation is seen to create incentives that are actually harmful rather than helpful. From this economic-theory perspective, compensation has no general justification that is compelling, and working to improve access to compensation can create problems as much as or more than it can generate benefits.

My analysis upends the economic argument, demonstrating that compensation can be justified even if the victim is the cheapest cost avoider with the ability to invest in self-protection. In fact, compensation might be justified especially when victims are cheapest cost avoiders. Compensation serves to protect all potential victims from harm, thus freeing individuals of the need to invest in “avoiding” harms to themselves while shifting them, wholly or partly, to others.

By bringing to light this analytical about-face, this Article offers three novel contributions. First, I demonstrate that, contrary to conventional wis-
dom, victims’ investments in self-protection are not aligned with the public policy objective of minimizing harmful effects. Current economic analysis of tort law is premised on a fundamental oversight, erroneously equating harm “avoidance” with actual minimization of harms. I show that when a potential victim invests to “avoid” harm, she is doing exactly that—investing to escape it herself, not to actually minimize or prevent it. This means that victims will generally invest in self-protection according to the effect of such investment on the harms they fear to suffer themselves, not according to its effect on overall levels of harm.

This contribution endeavors primarily to bridge diverse strands of literature. The wasteful nature of harm-shifting investments is a central theme in many areas of study, primarily in the criminal law and criminology literature. This Article is the first to introduce these insights into the tort theory literature and to study the role of harm-shifting investments in the context of tort law.

The second contribution is conceptual. I show that, once one considers the possibility of harm-shifting, the analytical framework of the cheapest cost avoider—the most fundamental maxim of contemporary economic theory of tort law—is inverted. The basic premise of current economic theory is that, if victims are the cheapest cost avoiders, compensation is unnecessary and, in fact, harmful. If victims can cheaply prevent the harm, there is no reason to compensate them because doing so will leave no incentive for them to make efficient investments in precautions. Contrary to this conventional view, this Article demonstrates that the case for compensation can be stronger, not weaker, when victims are cheapest cost avoiders, able to protect themselves from harm. Absent compensation, victims are driven to invest wastefully in attempts to shift harms to others. Compensation, therefore, is appropriate precisely because victims are cheap cost avoiders. This analysis overturns the familiar economic framework.

The third and final contribution is normative. While strong consensus exists regarding the moral justification for compensation, efficiency arguments currently run in the other direction. And, critically, it seems that the

29. See infra notes 156–61 and accompanying text.
30. See infra Part III.
32. See infra notes 175–77 and accompanying text.
efficiency-based anticompensation argument is dominating the debate. Compensation can win this fight according to the economic metric only if it can be shown that it is not only “just” but also efficient. The argument I submit answers this challenge by showing that once we consider the possibility of harm-shifting, the case for compensation becomes far stronger, even on efficiency grounds. This changeover has immediate policy implications; it calls for a concerted effort to reverse the decline of compensation currently favored by economic theory. Without a robust compensation regime, the legal system abandons potential victims of tortious harm to fend for themselves. I show that this generates problems since individuals protecting themselves are not considering the well-being of others and therefore invest wastefully. Compensation mitigates these deficiencies.

The Article proceeds as follows. Part I details the compensation crisis and the general decline in the ability of plaintiffs to vindicate their rights through compensation. Part II reviews the theoretical literature, focusing on the prevailing economic argument against compensation. Part III is the analytical core of the Article; it shows that the conventional economic framework of the cheapest cost avoider is overturned when we consider the harm-shifting nature of investments by potential victims. Part IV expands on the analysis in Part III to argue the normative case for compensation. This Part utilizes examples from the laws of accidents, intentional torts, and nuisance. A short conclusion follows.

I. COMPENSATION UNDER ATTACK

The ability of plaintiffs to secure compensation through the legal system is in decline. Compensation critically depends on the ability of plaintiffs to compete against defendants in court. As well-organized commercial defendants grow ever more powerful, private plaintiffs stand less and less chance to vindicate their right for compensation.

The cost of vindicating legal rights is a familiar theme in legal scholarship. Specifically, scholars highlight the importance of the distribution of

33. See infra notes 146–50 and accompanying text.
34. See infra Part IV.
35. See Gideon Parchomovsky & Alex Stein, The Relational Contingency of Rights, 98 Va. L. Rev. 1313, 1314–21 (2012) showing that the realization of an abstract right depends on the right-holder’s cost of vindicating it and the challenger’s cost of attacking it in court).
legal costs among litigants, while some litigants have easy access to courts and legal services, others face great barriers on their way, financial and otherwise. In the context of tort litigation, the distribution of legal costs systematically favors defendants over plaintiffs. Tort litigation typically pits private plaintiffs against corporate defendants. Corporate defendants, such as insurance companies, hospitals, product manufacturers, or financial institutions, tend to be well-organized, repeat litigants with ready access to litigation resources. By comparison, private plaintiffs are typically one-time litigants without such easy access to the litigation system.

As a general rule, all this means individual plaintiffs find it difficult to vindicate their rights for compensation. What is more, these difficulties have been exacerbated in recent years by the growing wealth gap and by repeat defendants’ concerted efforts to reshape the litigation landscape in their favor. To illustrate this problem in greater detail, consider the following stylistic example, based on the classic polluting factory scenario.

Example 1: Olivia lives in an urban area not far from an industrial complex. One day, following an accident in a nearby factory, toxic waste is released into the air and causes a series of harms to Olivia. Specifically, Olivia suffers a bodily injury ($3,000), significant emotional distress ($2,000), and some damage to her home ($1,000). The total harm to Olivia is thus estimated at $6,000, and the factory, the defendant, is liable for these harms.
In this example, Olivia suffers harm resulting from the factory’s operations. In a perfect world of zero enforcement costs, Olivia will sue the factory and receive full compensation—she will be made whole. In such a world, legal rights are fully manifested in reality, and no gap in legal protection would ever exist. But the analysis changes dramatically once it integrates the cost of enforcing victims’ rights. In the example above, Olivia must incur a total cost of $7,000 to vindicate her right for compensation. In this case, the suit would actually amount to a $1,000 loss for Olivia (compensation of $6,000 minus litigation costs of $7,000). Unless Olivia feels inclined to pursue justice for justice’s sake and is willing to lose money in order to vindicate her rights, she is better off not suing; most plaintiffs in her position would choose this latter option.

Olivia’s example is not only theoretical: it is highly representative. In fact, only 2% of Americans injured in an accident find it worthwhile to sue for compensation. This failure to sue is not irrational; rather, it stems from the prohibitive costs of litigation.

Olivia’s example illustrates a fundamental truth: compensation is obtained only where the expected compensation amounts outweigh the costs of securing them through litigation. This means compensation is less like-
ly to be obtained if (1) plaintiffs’ litigation costs go up or if (2) compensation amounts go down. Unfortunately for victims of tortious conduct, recent years have seen constant trends in both these directions. Well-organized defendants are well aware of this dynamic and, through systematic efforts, are acting both to increase litigation costs for plaintiffs and to limit compensation amounts.

A. Rising Litigation Costs

First, consider Olivia’s cost in litigating the case. In particular, why is it so expensive for Olivia (and many like her) to pursue compensation through the legal system? The answer to this question lies with the incentive of the factory, as a repeat defendant, to invest in its legal defense. Generally, the more the defendant invests in its defense, the costlier it becomes for Olivia to win her case. (The well-invested defendant can appeal decisions, submit multiple motions, etc.) Assume, for instance, that the factory invests $8,000 in a stubborn legal defense, and that is the reason Olivia’s litigation costs are now prohibitively high at $7,000. Of course, this situation hinges on the factory’s willingness to invest the $8,000 on such legal extravagance. In theory, this form of “stubborn defense” would not be worthwhile for the factory because it would cost the factory more than its potential liability of $6,000. Therefore, the factory should be better off just compensating Olivia instead of overinvesting in litigating the case. However, this calculus changes if we consider the position of the factory as a repeat litigant. If the factory invests in a stubborn defense, making a suit unprofitable for Olivia, it signals to other potential plaintiffs that litigation against the factory is not worthwhile. Considering the great number of suits a repeat defendant, like an insurance company, expects to face, its establishing such a reputation is crucially profitable, justifying immense investment in the defense of those few cases that do end up being litigated.

For exactly this reason, repeat defendants actively invest to increase plaintiffs’ litigation costs. As a common practice, commercial defendants employ a variety of tactics designed to drag out trials and increase the cost
of litigation.\footnote{See McClellan, \textit{supra} note 9, at 510–11 (studying litigation tactics by repeat defendants designed to drag plaintiffs into a long and costly litigation process); cf. \textit{AM. BAR ASS’N, PERCEPTIONS OF THE U.S. JUSTICE SYSTEM} 58 (1999) (explaining that 90% of survey respondents “strongly feel that . . . companies often wear down their opponents by dragging out the legal proceedings”).} As defendants advance these tactics further, this directly decreases the incentive of prospective plaintiffs to sue for compensation.

Another reason that the factory will be willing to invest to increase Olivia’s litigation costs relates to economy of scale.\footnote{See Galanter, \textit{supra} note 10, at 98 (noting the economy-of-scale advantage of repeat defendants).} In reality, it may well be that the factory would only have to invest modestly to make Olivia’s suit prohibitively costly for her. For instance, to increase Olivia’s litigation costs to $7,000, the factory may only need to invest $2,000 itself. The reason for this is that the factory, as a repeat litigant, has much better access to legal services.\footnote{See Parchomovsky & Stein, \textit{supra} note 35, at 1344.} For instance, to initiate legal action, Olivia would have to gather information about possible attorneys and meet with them and negotiate the terms of their engagement. The factory, on the other hand, probably employs attorneys in house or has a standing arrangement with a large law firm. Therefore, the factory, as a repeat defendant, does not bear these search costs per case. If Olivia does find an attorney, she will typically be billed on a fixed hourly basis;\footnote{See \textit{id.}.} the factory, on the other hand, most likely pays for legal services on a more lenient retainer fee basis.\footnote{See \textit{id. at} 1344–45.} More generally, volume in litigation, as in many other contexts, translates into a cost advantage. As repeat defendants engage routinely in similar legal procedures, they can use the same legal templates and procedures (letters, briefs, legal research, expert opinions) in multiple cases. As a result, the marginal cost of handling each individual case will steadily decline.\footnote{\textit{Id. at} 1318, 1344.} Private plaintiffs do not enjoy all these advantages. For the foregoing reasons, the factory has both the ability and the incentive to invest to increase Olivia’s litigation costs.

\section*{B. Declining Compensation Amounts}

As previously mentioned, plaintiffs’ incentive to sue for compensation decreases not only as litigation costs rise but also as compensation amounts decline. For instance, assume that Olivia’s litigation costs were “only” $5,000; in this case, she would sue the factory for an expected profit of $1,000 (compensation of $6,000 minus litigation costs of $5,000). This re-
sult changes, however, if compensation amounts are limited. Thus, assume Olivia is entitled to compensation only for pecuniary harms ($3,000 for bodily injury and $1,000 for damage to property), while nonpecuniary harms ($2,000 for emotional distress) are not compensated. Under such circumstances, the suit will constitute a loss of $1,000 for Olivia ($4,000 minus $5,000 in litigation costs), so she will most likely choose not to sue.

This circumstance is highly typical, as compensation amounts are constantly being limited as part of a broader political agenda of tort reform. These reforms aim to cap money damages as means of curbing a perceived overdeterrent effect of litigation.\(^{65}\) The stated goals of this tort reform are to defend crucial industries from excessive liability and to rein in the “out-of-control” tort system.\(^{66}\) Of course, this is a controversial political agenda.\(^{67}\) Tort reform is supported by big business, repeat defendants who lobby legislators to limit compensation amounts with damage caps.\(^{68}\) On the other hand, consumer and employee representatives lobby against these reform efforts, arguing that tort liability is not “excessive”—quite the opposite: tort law is undercompensatory.\(^{70}\) Similarly, various courts have held damage caps unconstitutional, mostly because of concerns of their limiting ef-

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69. See Arbel & Kaplan, supra note 67, at 1210–11; Hubbard, supra note 17, at 480.

70. See, e.g., Abel, supra note 50, at 448–52; Myungho Paik et al., *Will Tort Reform Bend the Cost Curve? Evidence from Texas,* 9 J. EMPIR. LEGAL STUD. 173, 176–81, 209–11 (2012) (reviewing the literature and conducting an empirical analysis of the effect on costs).
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effect on citizens’ due process right to a trial by jury. Yet, despite opposition, tort reform has made significant gains. Currently, twenty-one states have already adopted caps on noneconomic damages, while twenty-two have caps on total compensation.

The debate over tort reform and the desirability of compensation is now more urgent than ever following President Trump’s proposal to expand tort reform aggressively into the federal level. The President’s 2018 health care budget proposal insists not only on repealing Obamacare and slashing Medicaid but also on capping compensation for severely injured tort victims. If implemented, these new caps will decrease compensation amounts even more, further diminishing prospective plaintiffs’ incentive to sue.

C. Growing Wealth Gaps

The decline of compensation has been aggravated by widening wealth gaps between private plaintiffs and corporate defendants. The ratio of the income of an average CEO to that of an average employee illustrates this point. In the United States, this ratio increased from 20:1 in 1965 to 354:1 in 2012. Quite evidently, this indicates that a private plaintiff is no match for a corporate defendant in a civil litigation. The discrepancy in resources is too great. Additionally, as private individuals grow poorer relative to corporate tortfeasors, they become less likely to receive high

74. Compensation is also being blocked by the extensive use of arbitration clauses by potential repeat defendants. In a parallel move to the tort reform efforts, big businesses have successfully established an impressive ability to avoid compensating individual plaintiffs by mandating the use of private decision-making in lieu of adjudication. See Resnik, supra note 45.
77. See Rhode, supra note 36, at 1785–86; Robert J. Rhudy, Comparing Legal Services to the Poor in the United States with Other Western Countries: Some Preliminary Lessons, 5 MD. J. CONTEMP. LEGAL ISSUES 223, 237 (1994).
economic damages.\textsuperscript{78} Again, as compensation amounts decline, it becomes more likely that compensation amounts are actually lower than an individual plaintiff’s litigation costs.\textsuperscript{79} Wealth inequality in the United States today is at historic highs,\textsuperscript{80} with the top 1% of Americans holding nearly 50% of the wealth, the top 20% of households in the United States owning 84% of the wealth, and the bottom 40% owning only 0.3%.\textsuperscript{81} At the same time, national spending on legal aid has been cut by a third over the last three decades.\textsuperscript{82} In addition, the poor are generally not entitled to legal assistance in civil cases.\textsuperscript{83} The aggregate result of these developments is that a private plaintiff’s chance to secure a compensatory payment from a commercial defendant is negligible,\textsuperscript{84} as “millions of Americans are locked out of [legal recourse] entirely.”\textsuperscript{85}

For all these reasons, compensation of victims, although a central principle of our legal system, is largely a phantom. As plaintiffs’ litigation costs go up and compensation amounts go down, the ability of individuals to compete in the legal arena with corporations all but disappears, and compensation of victims becomes a distant dream instead of legal reality.

\section*{II. CURRENT THEORY: WHEN ECONOMICS & MORALITY CLASH}

The compensation crisis is not the result of coincidence but rather a deliberate effort backed by strong theoretical arguments. This Part provides a

\begin{itemize}
\item \textsuperscript{78} For the same reasons, lawyers will not want to take the cases of poor plaintiffs. See Catherine M. Sharkey, \textit{Unintended Consequences of Medical Malpractice Damages Caps}, 80 N.Y.U. L. REV. 391, 489–90 (2005).
\item \textsuperscript{79} Cf. Philip L. Bartlett II, \textit{Disparate Treatment: How Income Can Affect the Level of Employer Compliance with Employment Statutes}, 5 N.Y.U. J. LEGIS. & PUB. POL’Y 419, 430–31 (2002) (explaining that “[f]or a lawsuit to be worthwhile, the cost of litigation must be less than the expected recovery”).
\item \textsuperscript{82} See Deborah L. Rhode, \textit{Access to Justice} 3 (2004).
\item \textsuperscript{84} See Alan W. Houseman, \textit{Civil Legal Assistance for the Twenty-First Century: Achieving Equal Justice for All}, 17 YALE L. & POL’Y REV. 369, 402 (1998) (explaining that the legal services system serves no more than 20% of the needs of the population it is meant to serve).
\item \textsuperscript{85} Rhode, supra note 82, at 13; see also David C. Leven, \textit{Justice for the Forgotten and Despised}, 16 TOURO L. REV. 1, 6–7 (1999) (explaining how the prison population lacks meaningful access to the justice system).
\end{itemize}
short review of this theoretical background and a summary of the prevailing economic argument against compensation.

Contemporary tort theory is divided between philosophic and economic schools of thought.86 While philosophic theories recognize compensation as a necessary element of the tort system,87 economic theories see no difficulty or injustice in the decline of compensation.88 In fact, economic theory presents a forceful attack against the principle of compensation.89 And, importantly, while philosophic theories provide a compelling account of the internal structure of tort law, economic theories—which disfavor compensation—dominate the policy debate.90

A. Economic Deterrence Theory

Contemporary economic theory of tort law focuses on efficient deterrence as the primary goal of the liability system.91 Creating systems of deterrence has long been recognized as one of the central roles of the legal system generally.92 During the second half of the 20th century, scholars

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86. On the gap between functionalist and deontological theories in private law, see John C.P. Goldberg & Benjamin C. Zipursky, Seeing Tort Law from the Internal Point of View: Holmes and Hart on Legal Duties, 75 FORDHAM L. REV. 1563, 1563 (2006) ("[T]he most familiar divide today is that between the law-and-economics camp that focuses on efficient deterrence, and the philosophical camp that tends to focus on corrective justice."); Scott Hershovitz, Harry Potter and the Trouble with Tort Theory, 63 STAN. L. REV. 67, 68 (2011).


88. See infra notes 111–14 and accompanying text.

89. See infra note 132 and accompanying text.

90. See infra notes 146–54 and accompanying text.

91. In the existing economic model of liability, the focus is on deterrence as a primary policy goal. See Howard A. Latin, Problem-Solving Behavior and Theories of Tort Liability, 73 CALIF. L. REV. 677, 677 (1985) ("The most influential mode of torts analysis in recent decades has treated liability as a mechanism for social engineering in the sense that accident losses should be allocated to particular parties in order to induce efficient cost-minimizing behavior by similarly situated actors."); A. Mitchell Polinsky & Steven Shavell, Punitive Damages: An Economic Analysis, 111 HARV. L. REV. 869, 873 (1998) ("[T]o achieve appropriate deterrence, injurers should be made to pay for the harm their conduct generates . . . ."); Gary T. Schwartz, Reality in the Economic Analysis of Tort Law: Does Tort Law Really Deter?, 42 UCLA L. REV. 377, 378 (1994) ("Ever since the 1970s, the modern movement in economic analysis has been in full swing. That analysis has highlighted the deterrence function of tort law. Indeed, even in the works of mainstream scholars, deterrence has now assumed the role of a primary rationale for tort liability rules.") (footnote omitted)). Shavell and David Rosenberg describe the function of litigation as its deterrent effect on the behavior of potential defendants. David Rosenberg & Steven Shavell, A Simple Proposal to Halve Litigation Costs, 91 Va. L. Rev. 1721, 1721 (2005); see also STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW 391 (2004).

92. WILLIAM M. LANDES & RICHARD A. POSNER, THE ECONOMIC STRUCTURE OF TORT LAW 4 (1987) (reviewing the long history of deterrence as a primary goal of the legal system). Deterrence is also central to economic analysis quite generally, beyond the context of the compensation system. See WERNER Z. HIRSCH, LAW AND ECONOMICS: AN INTRODUCTORY ANALYSIS 1 (2d ed. 1988) ("[L]aws are authoritative directives that impose costs and benefits on participants in a transaction and in the process alter incentives."); THOMAS J. MICELI, THE ECONOMIC APPROACH TO LAW 1 (2004) ("The economic approach to law assumes that rational individuals view legal sanctions (monetary damages,
employed the analytical tools of microeconomics to develop deterrence theory into a comprehensive account of tort law. Prominent figures in this strand of scholarship include John Brown, Guido Calabresi, Ronald Coase, Robert Cooter, Mark Grady, William Landes, Richard Posner, and Steven Shavell.

The starting point for economic-deterrence theory is the assumption that actors operate to maximize their own wealth, while possibly neglecting to consider the well-being of others. Thusly, in Example 1 above, the factory may be indifferent to the $6,000 loss it is causing Olivia. Such loss is therefore termed a negative externality: a harmful effect created by the economic operations of the injurer factory but borne by others. If the factory is not held liable for its actions, the losses it causes are external, and the factory will therefore have insufficient incentive to invest in precautionary measures (prison) as implicit prices for certain kinds of behavior, and that these prices can be set to guide these behaviors in a socially desirable direction.

93. See John Prather Brown, Toward an Economic Theory of Liability, 2 J. LEGAL STUD. 323 (1973) (introducing the first formal economic model of tort liability).

94. See CALABRESI, supra note 20 (presenting the analytical framework of the cheapest cost avoider).

95. Coase made seminal contributions to the study of reciprocal causation, fundamental to the economic analysis of tort law. See Coase, supra note 19, at 2.

96. See Cooter, supra note 16, at 1–2 (expanding the basic principles of the economic analysis of tort law to study all areas of private law).


99. See LANDES & POSNER, supra note 92; Posner, supra note 14, at 32 (offering the famous “Hand formula,” which states that the injurer has breached her duty of care if the burden of adequate precautions was lower than the expected loss (PL > B)). For a critique of Posner, and a more traditional legal approach to negligence, see Richard W. Wright, Hand, Posner, and the Myth of the “Hand Formula,” 4 THEORETICAL INQ. L. 145 (2003).

100. See Steven M. Shavell, On Liability and Insurance, 13 BELL J. ECON. 120 (1982) (expanding the existing economic model to study its relation to liability insurance).

101. This is one of the standard assumptions of institutional economics. See WILLIAMSON, supra note 28, at 47; Oliver E. Williamson, Transaction Cost Economics and Organization Theory, 2 INDUS. & CORP. CHANGE 107, 114–16 (1993).

102. An externality is the effect by the action of one party on the well-being of another. See, e.g., COASE, THE FIRM, THE MARKET, AND THE LAW 23 (1988). Coase suggests that the term is inaccurate, as it implies causation to be unidirectional, from an injurer to a victim, thus oversimplifying the problem and the reciprocal nature of causation. See id. at 23–26.

103. Contemporary economic theory of liability is heavily influenced by the study of the problem of externalities. See, e.g., Coase, supra note 19, at 13 (discussing the problem of reciprocal causation); LANDES & POSNER, supra note 98, at 853–55 (surveying contemporary scholarship on the economic theory of liability).
In Defense of Compensation

It may be necessary to penalize the factory to invest appropriately, it may be necessary to penalize it—to force it to internalize the negative externality. One way to penalize the factory—to internalize the negative externality—would be to obligate the factory to compensate Olivia for the harm. However, compensation is not a necessary element of deterrence, and under current economic theory, deterrence is the ultimate normative goal. To create deterrence, any sanction against the factory should suffice, even if not coupled with compensation for Olivia. Injurers would be equally deterred by a regulatory fine paid to the government as by civil compensation paid to victims through the legal system. From a pure economic perspective, and ignoring notions of morality or justice, it should not matter whether the injurer pays the government, the victim, or some other party.

This means that, under economic-deterrence theory, compensation of victims is not an independent goal of the tort system. In this view, compensation is only justified if it serves to appropriately deter the injurer. Considerations relating to the victim’s right for compensation are of secondary importance at most. To determine the desirability of compensation for the purposes of deterrence, economic theory offers the concept of the “cheapest cost avoider.” This concept, first offered by Calabresi, is the cornerstone of economic deterrence theory. Under this analytical

104. SHAVELL, supra note 91, at 93; see also Cooter, supra note 16, at 3–4.
105. See SHAVELL, supra note 91, at 101–09, 177.
106. See Posner, supra note 14, at 32.
108. See Goldberg, supra note 15, at 554 (“All conduct that threatens losses greater than the cost of precaution ought in principle to be deterred. Yet the deterrence machinery of the tort system kicks in only if a private victim chooses to sue. The goal of efficient deterrence might therefore be equally or better served by a system of regulatory fines. In fact, given empirical evidence suggesting that the vast majority of those with valid tort claims never bother to sue, such a system is likely preferable.”).
111. See Goldberg, supra note 15, at 544.
112. See id.
113. CALABRESI, supra note 20, at 244.
114. Discussing Calabresi’s The Cost of Accidents, Keith Hylton writes: “The book has had an enormous influence on the field. It would not be an exaggeration to say that modern law and economics, as we see it practiced today, had its start with Gary Becker’s article on crime and Guido Calabresi’s book, both products of the late 1960s.” Keith N. Hylton, Calabresi and the Intellectual History of Law and Economics, 64 MD. L. REV. 85, 85 (2005) (footnote omitted). Calabresi’s work is closely related to the problem of reciprocal causation presented by Coase. Coase’s paper, The Problem of Social Cost, is still the most cited law review article. Fred R. Shapiro & Michelle Pearse, The Most Cited Law Review Articles of All Time, 110 MICH. L. REV. 1483, 1489 (2012).
framework, compensation should be granted only if the injurer is the cheapest cost avoider, that is, the party most cheaply able to prevent the harm. Obligating injurers who are cheapest cost avoiders to compensate victims will assure minimization of the costs of accidents and of the costs of precautions designed to prevent accidents.

This conceptualization has far-reaching implications for the way economic theories treat the problem of access to compensation. In particular, improving victims’ access to compensation will not necessarily be advantageous because injurers are not always the cheapest cost avoiders. This would mean that the compensation crisis described in Part I may not be a problem at all, and definitely not one that urgently needs a solution. To see the economic argument in more detail, consider Example 2 below, further developing the stylized example presented in the Introduction to this Article.

Example 2: Emma owns a farm and grows wheat for a living. Neighboring Emma’s farm is a large ranch. Cattle from the ranch occasionally wander into Emma’s farm, trampling crops and causing damage to property there. The expected harm from such occurrences is estimated at $5,000. The harm to Emma’s farm can be prevented if Emma invests $1,000 in fencing her farm, or if the rancher invests $1,500 in fencing the ranch. If harm does occur, Emma will have to invest $6,000 in order to sue the rancher.

First, note that the suit is prohibitively costly for Emma: Emma can expect compensation of $5,000 but must incur a cost of $6,000 in order to litigate the case. Now, from an economic perspective, is this barrier to compensation even a disadvantage? In other words, is it important that we work to lower Emma’s litigation costs so that she can sue the rancher?

Economists answer this question with a clear no. In the example, Emma is the cheapest cost avoider and can prevent the harm at a cost of $1,000, while the rancher can prevent it at a higher cost of $1,500. Since Emma cannot profitably sue, compensation is not available, and Emma will invest $1,000 in precautions to prevent the harm. From an economic perspective, this is the optimal result, and there is no need to address Emma’s inability to secure compensation. Since Emma is the cheapest cost avoider, economic theory actually requires that she bear the harm and not be compensated.

In this view, the fact that the rancher’s cattle encroached on

115. See CALABRESI, supra note 20, at 135–40.
116. See id.
117. See Coase, supra note 19, at 2–6.
118. See CALABRESI, supra note 20, at 135; Coase, supra note 19, at 2–6; Cooter, supra note 16, at 3–4.
Emma’s land and harmed her property is almost immaterial and does not independently justify compensation.119

Consider now the possibility that we somehow manage to lower Emma’s litigation costs to a reasonable $500, so that Emma no longer finds it prohibitively costly to sue the rancher after harm has occurred. Supposedly, from an access-to-compensation perspective, that would be a positive change—not so under the economic view. If we do enable Emma to profitably sue the rancher, all this can achieve is to allow Emma to secure $5,000 in compensation for her harms, which, according to economic deterrence theory, is undesirable.120 If Emma can expect to receive this compensation, she will have less reason to invest $1,000 in erecting a fence. Instead, the rancher will be the one investing in precautions. Rather than face liability of $5,000 when harm occurs, the rancher will prefer to invest $1,500 in precautions and prevent the harm. Because the rancher is not the cheapest cost avoider—the harm can be more cheaply prevented by Emma at a cost of $1,000—this is an inefficient result.

In the above example, improving access to compensation actually worsened the situation. From the perspective of overall efficiency, allowing compensation would generate a problem here rather than solve one. Absent compensation, Emma, the cheapest cost avoider, would invest $1,000 in preventing the harm. This is the optimal result. If Emma is allowed better access to compensation, this would actually make things worse because the harm will now be prevented at a higher cost of $1,500 by the rancher. Since the rancher is not the cheapest cost avoider, improving Emma’s access to legal compensation is economically inefficient.121

Example 2 demonstrates a fundamental truth: there is no general economic justification for improving access to compensation.122 Therefore,

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119. For a review and discussion of possible critiques of this result, see Smith, supra note 25, at 71–73.

120. See Calabresi, supra note 20, at 135–40; Shavell, supra note 16, at 579, 582–83.

121. The more general point is, of course, that if victims are compensated for harms, they will have no incentive to invest in preventing them. See Coase, supra note 19, at 2–6; Cooter, supra note 16, at 3–4.

122. This view is highly critical of existing doctrine and greatly differs from the earlier teaching of the economic analysis of tort law. Historically, law and economics drew much of its normative force from justifying existing doctrine as efficient. Early lawyer–economists knew that, in order to convince legal thinkers of the significance of efficiency to legal analysis, it would be helpful to demonstrate that the law already employs this notion. See Richard A. Posner, Economic Analysis of Law 315–16, 713–16 (8th ed. 2011); Isaac Ehrlich & Richard A. Posner, An Economic Analysis of Legal Rulemaking, 3 J. Legal Stud. 257 (1974); George L. Priest, The Common Law Process and the Selection of Efficient Rules, 6 J. Legal Stud. 65 (1977); Paul H. Rubin, Why Is the Common Law Efficient?, 6 J. Legal Stud. 51 (1977). Legal thinkers are accustomed to searching for the normative principles guiding existing rules and to thinking of legal principles as normatively compelling. See generally, e.g., Ronald Dworkin, Law’s Empire (1986). Once law and economics was recognized as a legitimate form of legal argument, the attempt to explain the law based on efficiency was largely abandoned in favor of efforts to criticize and reform. See, e.g., Jules Coleman, The Normative Basis of Economic Analysis: A Critical Review of Richard Posner’s The Economics of Justice, 34 Stan. L. Rev. 1105.
under this view, the compensation crisis is no crisis at all. While it is true that victims are often left with no compensation for their harm, under the economic view, this is not an undesirable result. In fact, even if we are somehow able to reverse this trend, the result may actually harm total social welfare. This general theoretical framework is used to great effect in the campaign against compensation. The core argument is that improving access to compensation is not a viable social goal in itself because compensation can be harmful just as much as it can be beneficial. Since compensation is not required to deter injurers, and more often than not it also distorts the incentives of victims, there is little reason to crusade for the restoration of plaintiffs’ ability to sue for compensation. In fact, it might be appropriate to act to limit compensation even further.

The force of the argument against compensation lies in its simplicity and general applicability. Economists use it to question the overall desirability of improving plaintiffs’ access to compensation. A series of works by Shavell developed the ultimate version of this argument. Shavell offers a formal model in the spirit of the argument outlined above and seeks to show that there is no reason to suppose that improving plaintiffs’ access to compensation is generally desirable. This argument has


123. Based on economic theory, tort reformers argue that “(1) injured persons should be required to have primary responsibility for making decisions about risk, for avoiding injury to themselves, and for insuring against that injury; (2) plaintiffs should not recover damages unless they have satisfied their responsibility to protect themselves and unless the plaintiff has clearly shown that the defendant’s conduct caused the injury.” Hubbard, supra note 17, at 473; see also Studdert et al., supra note 65, at 2617.

124. See Shavell, supra note 16, at 579, 586–88, 592. Shavell writes: “For example, a poor victim of an automobile accident might have a strong incentive to bring suit because of the amount of damages he could collect. In this situation, the contingency fee system furnishes lawyers with a financial reason to take the victim’s case even though he might not be able to afford to pay legal fees in advance. Moreover, because such a suit might have a low social benefit, as I suggested, were the help of legal aid needed to bring the suit, it is hardly clear that the suit would be socially advantageous.” Id. at 592.

125. See Hubbard, supra note 17, at 473–75.
127. See id. at 579, 592.
130. See Shavell, supra note 16, at 579, 582–83, 592 (showing that the social benefit from compensating victims does not bear a necessary connection to the private benefit for victims). Therefore, improving access to compensation is not necessarily socially desirable. This claim explicitly goes against a rich literature advocating access to justice and supporting legal aid initiatives. See id.
achieved consensus in the economic analysis literature and formulates a strong attack against the general idea of compensation for victims.

B. Moral Tort Theory

Tort law scholarship offers a family of closely related moral-based theories. Such theories seek to explain tort law based on notions of justice and deontological right. Naturally, these offer an entirely different view on compensation. The basic premise of deontological right theories is that legal actors owe a duty not to cause certain types of harms to others. For instance, one must not knowingly damage another’s property. When such a duty is breached, the law intervenes by obligating transgressors to repair the resulting losses. Under this view, tort law both delineates the primary duties actors owe one another and provides the legal mechanism by which the secondary duty to repair is enforced. Therefore, the victim’s right to compensation is fundamental to any morality-based theory of tort law.

The chief branch of deontological right theories focuses on corrective justice as the basic principle of tort law. Leading contributors in this branch of the literature include Ernest Weinrib, Jules Coleman, Stephen Per-
Under corrective justice theory, tort law restores the position of the plaintiff to the \textit{status quo ante}. Under this paradigm, tort law is understood as restoring an equilibrium disturbed by the defendant’s wrongful violation of the plaintiff’s right. In particular, the law restores the equilibrium by ordering the defendant to transfer the full value of the loss to the plaintiff. This means that, under corrective justice theory, compensation of victims is a central element of private law, compensation corrects wrongs and brings victims as close as possible to their original position. Under this view, unlike the pure economic perspective, compensation of victims is an independent goal of tort law, not just a methodology for deterrence.

Another main branch of morality-based tort theory, promoted primarily by John Goldberg and Benjamin Zipursky, focuses on concepts of redress and civil recourse. Under civil recourse theory, the quintessence of tort law lies in offering victims the power to seek redress from those who have wronged them. Under this view, of course, compensation for victims is fundamental to the structure of tort law. The \textit{raison d’être} of tort law is to enable the achievement of justice by providing opportunity for victims of a wrong to vindicate their rights.

Although morality-based theories offer unequivocal support for compensation as a general principle, their arguments seem to get lost in translation, as morality-based arguments scantly feature in the raging policy debate regarding the scope and justification for compensation. This is very apparent, for instance, in the celebrated Shavell–Polinsky versus
Goldberg–Zipursky debate on products liability law. From the economic side, Shavell and Polinsky offer a strong series of arguments against the mere existence of compensation for harms caused by defective products. Goldberg and Zipursky, the leading figures of civil recourse theory, set out to provide a rebuttal. However, Goldberg and Zipursky’s main line of defense relies on functionalist or pragmatic arguments, rather than on their own moral theory of tort law. This strongly demonstrates the dominance of functionalist economic arguments—and the relative weakness of philosophical morality—in the policy-making arena. Pure moral arguments simply do not seem to have the same weight as pragmatic ones and are therefore denied the center stage.

A main reason for the absence of morality-based theories from the policy debate is that these theories, for the most part, explicitly reject prescriptive aspirations. Thus, corrective justice theory focuses on understanding tort law “from within” and regardless of its practical consequences. For this theory’s exponents, any investigation into the functions or goals of tort law is deemed “external” and misses the internal coherence of this field of law. In fact, Weinrib goes so far as to assert that any investigation into possible pragmatic advantages of the tort system amounts to a misunderstanding of tort law. For the purposes of this Article, this is a serious limitation, since it denies the usefulness of moral arguments in determining policy. Consequently, corrective justice theory can only describe tort law for what it is, but it does not defend compensation as a socially useful practice.

Against this theoretical background, this Article seeks to highlight the economic advantages of compensation as civil recourse. In other words, it

147. Products liability law is currently one of the frontlines of the anticompensation campaign. See Bogus, supra note 132, at 1; Hylton, supra note 132, at 2457.
150. Thus, Goldberg and Zipursky discuss at length the “empirics of deterrence,” id. at 1927, insurance aims of the liability system, id. at 1935, and the costs of law reform, id. at 1941–42.
151. See, e.g., RIPSTEIN, supra note 139, at 20.
153. Weinrib, supra note 136, at 3–6. Weinrib writes: “In this book, I will argue that, despite its current popularity, the functionalist understanding of private law is mistaken. Private law, I will claim, is to be grasped only from within and not as the juridical manifestation of a set of extrinsic purposes. If we must express this intelligibility in terms of purpose, the only thing to be said is that the purpose of private law is to be private law.” Id. at 5 (emphasis omitted).
seeks to translate into pragmatic language, and therefore into the heart of the policy debate, some of the moral intuitions that stand at the heart of morality-based theories of tort law, and civil recourse theory in particular. The general theme is that it is good and useful, and not just morally right, to allow victims of harm to seek redress from those who have harmed them.

III. THE MISSING PIECE: HARM-SHIFTING

The prevailing attack against the principle of compensation is based on a misconception of the law and a fundamental oversight. This Part demonstrates that, contrary to conventional economic wisdom, compensation for victims can be justified even when victims, rather than injurers, are the cheapest cost avoiders. The reason for this defect in the prevailing theory depends upon the way “cost avoidance” is conceptualized in the economic analysis of tort law.

Economic tort theory focuses on investments designed to minimize harms.155 This focus is common to all major works in the field, including those of Guido Calabresi,156 Richard Posner,157 Mitchell Polinsky,158 Daniel Rubinfeld,159 Robert Cooter,160 Louis Kaplow, and Steven Shavell.161 In this framework, self-protection efforts by potential victims of harm are conceptualized as “precautions,” or investments designed to minimize potential harms. The assumption here is that, when faced with the prospect of danger, the sole possible response by potential victims is to try to minimize

155. To minimize harms, individuals can invest in precautions but can also lower their levels of activity. See Steven Shavell, Strict Liability Versus Negligence, 9 J. LEGAL STUD. 1, 2 (1980). I refer to both as investments to minimize harms, as in both cases individuals incur a cost in order to effectuate lower levels of harm.

156. See Calabresi, supra note 20, at 26 (“I take it as axiomatic that the principal function of accident law is to reduce the sum of the costs of accidents and the costs of avoiding accidents.”).

157. Posner argues that liability is imposed when the actions of the injurer are socially harmful—that is, when the cost of preventing the harm is lower than the harm itself. Posner, supra note 14, at 32.

158. See A. Mitchell Polinsky & Daniel L. Rubinfeld, The Welfare Implications of Costly Litigation for the Level of Liability, 17 J. LEGAL STUD. 151, 151 (1988) (“The central concern of the economic theory of liability is how to induce an injurer to take the socially appropriate level of care—the level that minimizes the sum of the cost of taking care and the losses to victims.”).


160. Cooter offers the “model of precaution,” which focuses on “the direct cost of harm and the cost of precautions against it.” Cooter, supra note 16, at 2. Cooter notes that compensation of victims might also be warranted, but this is only for considerations of equity that are separate from efficiency requirements. See id. at 1.

161. See Louis Kaplow & Steven Shavell, Economic Analysis of Law, in 3 HANDBOOK OF PUBLIC ECONOMICS 1665, 1667 (Alan J. Auerbach & Martin Feldstein eds., 2002) (“We will view the primary social function of the liability system as the provision of incentives to prevent harm.”).
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the harm or prevent it from materializing. This, however, is an unrealistic assumption, and it neglects some important aspects of the issue at hand.

When victims invest to protect themselves from harm, they care little about the total magnitude of that harm. Instead, they worry only about the share of the harm they stand to suffer. This means victims might try to avoid harms by shifting them to others, rather than by preventing them. When making any effort to escape harm, the potential victim tries only to prevent the harm to herself, regardless of whether the harm is actually "minimized" or prevented as opposed to suffered by a third party or borne by the injurer at a later time.

Scholars in many areas of study recognize the fact that defensive practices might shift harms rather than minimize them. In the area of criminal law, scholars devote considerable energy to the study of this possibility. More generally, the notion of wasteful self-protection is central to western political philosophy. Thinkers like Thomas Hobbes, David Hume, William Blackstone, and Jeremy Bentham employ this notion to justify the individual’s relinquishment of personal power to the political order. In the Hobbesian state of nature, individuals enjoy no legal protection of their rights. In such a state, all resources are consumed by individuals’ efforts to protect themselves. Political power is necessary in order to limit this destructive dynamic, and legal protection of private property has a central role in this context.

These fundamental insights are also central to contemporary theory of property rights. Property law scholarship reveals how property-right protection helps lower the costs that individuals would otherwise incur in their wasteful efforts to protect themselves. The main structural features and

162. See, e.g., CALABRESI, supra note 20, at 26–28; COOTER & ULEN, supra note 22, at 202; Kaplow & Shavell, supra note 161, at 1669, 1671.

163. See CRIME SPILOVER, supra note 31; Barr & Pease, supra note 31; Bowers & Johnson, supra note 31.


166. See id.; see also Yoram Barzel, A Theory of the State: Economic Rights, Legal Rights, and the Scope of the State (2002).


168. In the economic literature, the cost of protecting property is sometimes included under the broader term “transaction costs”: Yoram Barzel defines transaction cost broadly as the costs of transfer, capture, and protection of rights. Yoram Barzel, Economic Analysis of Property Rights 4 (2d ed. 1997). Douglass North describes transaction costs as the general costs of doing business. See DOUGLASS C. NORTH, TRANSACTION COSTS, INSTITUTIONS, AND ECONOMIC PERFORMANCE 6–7 (1992). Douglass Allen describes transaction costs as any costs of establishing or maintaining property
doctrinal arrangements of property law are justified based on their ability to achieve this goal. This framework is used to explain such concepts as the *numerus clausus* principle, property rule protection, and the in rem nature of property rights, in addition to the doctrines of first possession, trespass, and protection from theft.

In the context of tort law, however, the possibility of harm-shifting has hitherto never been explored. Instead, a victim’s self-protection efforts are always conceptualized as efforts to minimize harms, not shift them. Considering the possibility of harm-shifting in the tort context carries with it crucial implications for our understanding of efficiency within compensation regimes.
To see the argument, consider again Example 2 above, except this time accounting for the possibility of harm-shifting. Assume again that Emma is the cheapest cost avoider and can protect herself from the harm by investing $1,000 in fencing her farm. Now see, however, that if Emma does protect herself in this way, it does not necessarily mean the harm is minimized. To wit, if the wandering cattle are turned aside by Emma’s fence, they can still wander further and trample a different field. Thus, if Emma chooses to erect her fence, the harm from the cattle does not dissipate—it shifts.

Under these circumstances, compensation for Emma is desirable from an economic perspective. Assume again that a suit will be prohibitively costly for Emma at $6,000. Since compensation is unavailable, Emma will want to prevent the harm of $5,000 to herself, and will therefore invest $1,000 to erect her fence. Although this makes sense from Emma’s private perspective, this investment is socially wasteful because the cattle will simply wander off and trample another farmer’s field, causing the same amount of harm they would have if Emma had taken no action. In this situation, one possibility is that Emma will invest to protect herself, and the harm will be fully shifted to another victim, resulting in a total social cost of $6,000 ($5,000 damage to the field plus Emma’s $1,000 investment). A second possibility is that other potential victims will also invest in protecting themselves, so the total social cost will be, for example, $1,000 per potential victim.

Total social cost is significantly lower if compensation can profitably be obtained. Assume now we can lower Emma’s litigation cost to $500 and so enable her to sue the rancher. If Emma knows she will be compensated for harms, she has no reason to invest wastefully in shifting the harm to others. Instead, the rancher will want to invest $1,500 to fence in his cattle, rather than pay compensation of $5,000 in case harm occurs. This means total social cost will be only $1,500 instead of $6,000, or $1,000 per potential victim.

It is important to note that compensation is desirable here even though Emma, the victim, is nominally the cheapest cost avoider, able to erect her fence for a mere $1,000 (as opposed to the rancher’s $1,500). In fact, compensation is desirable here precisely because Emma is the cheapest cost avoider. Emma can cheaply invest to protect herself and “avoid” or escape the harm. But, as has been shown, such avoidance tactics can be socially wasteful, while compensation can reduce the incentive to invest in them.175

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175. Most investments in self-protection have a mixed effect: part of the harm is minimized, and part is shifted to others. This is the reason compensation is available but also sometimes limited. Absent compensation, victims will invest in protecting themselves; some of these investments will be wasteful, as victims struggle over the distribution of harms and shift parts of the harm to others. Compensation is useful to combat this effect. Once compensation is available, however, victims may have insufficient incentive to invest in precautions that might actually minimize the harm. To combat this problem, com-
This analysis reverses the standard economic maxim. The fact that victims are able to invest to protect themselves is no longer an argument against compensation but instead serves to support it. Therefore, the case for compensation is stronger than what existing economic theory would have us believe.

This conclusion ties the economic perspective back to the fundamental insights offered by civil recourse theory. According to civil recourse theory, compensation is designed to allow victims of harm a way to vindicate their rights. My analysis shows that this arrangement is not only morally justified but also efficient. By denying access to compensation, the state would abandon potential tort victims to fend for themselves. Doing so would be wasteful and problematic, as individuals defending themselves have strong incentive to shift harm, merely competing with other potential victims over the distribution of the harm; in that world, there is no one trying to prevent the social harm from occurring.

IV. THE STRONGER CASE FOR COMPENSATION

The analysis in Part III provides a simple analytical point: compensation is important not only to deter injurers but also to release victims from the destructive struggle over different distributions of harms. Compensation helps relieve potential victims of the need to invest to wastefully shift harms to others. Therefore, the normative value of compensation is greater, not lesser, when victims are able to invest in protecting themselves.

Part IV offers some doctrinal applications of this insight. I begin by studying the cases of road accidents and intentional torts and proceed to give a more in depth account of the law of nuisance. By studying these examples, this Part presents the stronger case for compensation and drives home the theory-based argument offered in Part III.

176. See supra notes 145–46 and accompanying text.

Compensation is helpful in solving quite a prevalent problem, as wasteful investments in self-protection are ubiquitous. To illustrate this, consider the case of road accidents. Potential victims of road accidents (that is, everyone) can invest to protect themselves from expected harm. For instance, it is known that heavier vehicles are generally safer than light ones.\(^{178}\) Thus, to protect themselves from harm, drivers can choose to invest in safety and purchase a bigger vehicle. However, this is not a true investment in safety. By buying a heavier vehicle, a driver can lower her own risk of being harmed; yet, at the same time, a heavier vehicle represents a greater danger to others.\(^{179}\) This means a private investment in safety is not necessarily socially desirable; on the contrary, it may just shift harms to others, or even exacerbate them overall.\(^{180}\)

In a very similar fashion, an individual can decide to drive instead of walk in order to reduce the likelihood of being struck as a vulnerable pedestrian. Again, this private precautionary measure does not actually promote overall safety. By choosing to be a motorist rather than a pedestrian or a cyclist, an individual can significantly reduce the risk to which she is exposed while simultaneously increasing the risk to others.\(^{181}\) Thus, as we have seen in other contexts, an individual protecting herself can shift the harm of accidents to others. More generally, in their efforts to avoid harms, individuals try to improve their position vis-à-vis others; they place themselves as the less vulnerable participant in each possible risky interaction. By doing this, individuals redirect harms towards others. Therefore, indi-
individuals’ efforts to save themselves from the harm of accidents can easily result in harm-shifting. The availability of compensation can help mitigate these effects.

**B. Intentional Torts**

The same dynamic can be identified in the case of intentional torts, such as burglary or theft. Victims of intentional torts invest in order to deflect undesirable activity away from themselves. For instance, to protect themselves from burglars, homeowners contract with security agencies and post warning signs on their property. Yet, these measures may not actually result in the minimization or prevention of home break-ins. Instead, harms may only be shifted, as burglars would simply avoid the signs and relocate their activity to unprotected properties. From a social prospective, this makes the homeowners’ investment a wasteful form of self-help. More generally, individuals invest to make sure they are less attractive targets for tortfeasors. By definition, this means their investments make others (relatively) more attractive victims.

Potential victims can also make wasteful investments in protecting themselves through contracting and bargaining with potential injurers. If victims and injurers are operating in a contractual relationship, they can use this relationship to allocate risk and harms among themselves. While the use of these mechanisms can be efficient, it also creates opportunities for “rent seeking” as different parties compete over the distribution of harms.

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183. For a discussion of this example, see Ayres & Levitt, supra note 31, at 63–65 tbl.IV, 66 tbl.V.

184. See id. at 64.

185. See, e.g., Ernst Fehr, Oliver Hart & Christian Zehnder, How Do Informal Agreements and Revision Shape Contractual Reference Points?, 13 J. EUR. ECON. ASS’N 1 (2015) (comparing the strategy of ex post revision of simple and rigid contracts to that of complex and flexible ex ante contracting designed to anticipate ex post contingencies); Oliver Hart & John Moore, Contracts as Reference Points, 123 Q.J. ECON. 1 (2008).


187. The term rent seeking refers to efforts to secure gains at the expense of others. The rent-seeking literature mainly focuses on individuals’ attempts to manipulate or capture regulatory mechanisms and use them to obtain a competitive advantage in a market environment. See GORDON TULLOCK, THE ECONOMICS OF SPECIAL PRIVILEGE AND RENT SEEKING (1989); Roger D. Congleton, Evaluating Rent-Seeking Losses: Do the Welfare Gains of Lobbyists Count?, 56 PUBLIC CHOICE 181 (1988); Barry J. Nalebuff & Joseph E. Stiglitz, Prizes and Incentives: Towards a General Theory of Compensation and Competition, 14 BELL J. ECON. 21 (1983); Stergios Skaperdas, Restraining the Gen-
In all these diverse contexts, compensation can be useful to reduce the need for victims’ wasteful investments in self-help. Even if it does not eliminate the harm completely, compensation somewhat mitigates it, thus lowering the need for individuals to invest in shifting the harm to others. Quite generally, this means the case for compensation is stronger than what current economic theory suggests. Accordingly, the anticompensation campaign, based on economic theory, is lacking a normative justification.

C. Nuisance

This section returns to the nuisance case of the polluting factory presented in Example 1, only this time considering also the possibility of harm-shifting, here in the form of “Not In My Back Yard” (NIMBY) investments. Before a source of nuisance is constructed, nearby residents typically try to avert the harmful activity through NIMBY objections. Naturally, this does not mean the factory disappears or will not be built. In fact, the factory may simply be moved to a different location. The very nature of NIMBY objections is that residents act selfishly; each group prefers the factory be built somewhere else and “not in my back yard.” Thus, each group of residents in each alternative location will invest to have the factory built near another group. This means that NIMBY investments are, almost by definition, investments by potential victims to shift harms to others.

To see the effect of such investments on the analysis of compensation, consider Example 3 below.

Example 3: Prior to the construction of a factory, nearby residents consider investing in a NIMBY campaign to move the factory away from their houses. The residents can lobby against the construction of the factory, sign petitions, organize rallies, and...
so on. If the factory is eventually built, the expected harm to nearby residents is $2,000. The residents can invest $500 for a 50% chance of ridding themselves of the factory.

Consider first the residents’ investment if compensation is not available. In this case, the residents face the possibility of a harm of $2,000 from the factory. The residents will therefore choose to invest in NIMBY objections. From the private perspective of the residents, this makes sense and will entail an overall lower cost of $1,500 for the residents (an investment of $500 plus a 50% chance of a harm of $2,000).

Indeed, the residents invest to try to banish the factory, but this does not mean the factory will not generate harm. By the nature of NIMBY objections, the residents do not object to the existence of the factory, but only to its specific proximity to them. Thus, the residents are equally happy to invest even if all this will accomplish is that the factory is relocated to harm a different group of residents in a different location. This means that, absent compensation, the total social cost is $2,500 (the harm of $2,000 to the residents in the new location plus the $500 investment by the first group to move the factory away).

Consider now the same situation, but now compensation is available. If compensation is available, the residents will prefer to suffer the harm of $2,000 and be compensated fully for it, entailing no loss to themselves. This situation is therefore better for the residents compared to the option of losing $500 in their NIMBY campaign (and more if their campaign is unsuccessful). Since the residents are not making NIMBY investments, the total social cost is just $2,000 (the cost of the harm) instead of $2,500 (the cost of the harm plus the residents’ NIMBY investment). Compensation is therefore desirable here from an economic perspective.191

Note that compensation is efficient, even though the factory is not the cheapest cost avoider, and even though compensation would not incentivize the factory to increase its investment in precautions. Instead, compensation is required to protect the interests of nearby residents—those who have a property right that has been violated and who can invest to protect that right (in this case, through NIMBY objections). This illustration once again makes clear that the case for compensation is stronger than current economic theory suggests, as compensation is justified here contrary to conventional economic wisdom. This demonstrates the reversal of the familiar

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191. An alternative solution would be to limit the ability of individuals to invest in NIMBY objections (rather than minimizing their incentive to do so). This is not necessarily easy, and despite efforts to minimize NIMBY objections, the cost of NIMBY-style struggles still poses a significant social problem. See Eli Feinerman, Israel Finkelstain & Iddo Kan, On a Political Solution to the NIMBY Conflict, 94 AM. ECON. REV. 369, 369 (2004); Martin P. Sellers, NIMBY: A Case Study in Conflict Politics, 16 PUB. ADMIN. Q. 460 (1993).
economic framework: the case for compensation is stronger, not weaker, when victims are able to invest to protect themselves.

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The examples presented in this Part highlight a simple point: the case for compensation is stronger than what existing economic theory would have us believe. That is, compensation can be justified even if current deterrence theory sees no possible justification for it. Furthermore, and contrary to conventional economic wisdom, compensation actually has a greater normative value when victims are cheap cost avoiders, able to efficiently invest in protecting themselves from harm. This, in turn, means that the normative arguments of the anticompensation campaign stand on shaky grounds.

The economic anticompensation argument is false even if investments in self-protection have a mixed effect: partly minimizing harms and partly shifting them. It is enough that investments in self-protection have some harm-shifting effect to show that the case for compensation is stronger than what current economic theory portrays it to be.

CONCLUSION

The right for compensation is rapidly losing its footing in our legal system. Currently, only an insignificant minority of victims legally entitled to compensation actually sue to vindicate their rights. This new status quo is justified by economic theory that focuses on deterrence and precautions designed to minimize harms. In this framework, compensation is unnecessary for deterring injurers and also harmful in annulling victims’ incentive to invest in precautions. According to this view, a regulatory fine seems an a priori superior legal mechanism, so the case for compensation is not worth pursuing.

My analysis reveals that this analytical position—and the status quo it supports—is unfounded. It is indeed true that compensation lessens the incentive of potential victims to invest in protecting themselves. However, there is no reason to generally assume this is a negative effect. To the contrary, compensation can be useful precisely because it frees potential victims from the need to protect themselves. Efforts of self-protection are often wasteful, as they have no direct connection to the social need for minimizing the overall magnitude of harms and often merely shift or redistribute them.

All this stresses the urgent necessity to reverse the current degeneration of compensation as a legal institution. Compensation serves an important purpose of protecting individuals as fully as practicable, considering the
legal and practical limitations. As such legal protection vanishes, self-protection takes its place. The decline of compensation means our legal system is abandoning some segments of the population to fend for themselves. This is not only morally misguided but also creates inefficiencies and distorted incentives. There is no reason to believe, as does current economic theory, that individuals fending for themselves without legal protection are acting efficiently to “minimize” harms. Instead, the threat of uncompensated harm—the absence of legal protection—can push them to invest selfishly, inefficiently, and in a way that is more harmful to others and to society at large.