

# Indiana Law Review

---

Volume 36

2003

Number 2

---

## ARTICLES

### INTRODUCTION TO THE SYMPOSIUM

WARREN F. SCHWARTZ\*

The terrible events of September 11, 2001 confronted our society with the necessity to fashion an appropriate legal response. Three perspectives competed for dominance in the process through which the legal response was devised and implemented: (1) It was possible to look backward and seek guidance from what had been done in comparable situations. (2) The events of September 11 could be viewed as essentially *sui generis*, requiring decisive, prompt and unprecedented action by public and private institutions. (3) The events of September 11 could be viewed as providing the necessity, but also the opportunity, to determine the principles which would control the public and private responses to terrorist attacks which might occur in the future.

It seems fair to say that the second perspective was dominant, particularly in the days immediately following September 11. Nothing like this had happened before. The focus should be on the uniqueness of the task facing the legal system. But, it is also true, that as public and private agencies struggled to provide the answers to the host of questions, which had to be confronted in deciding exactly what they were to do, that the past and the future emerged as more important determinants of the societal response. Implicit and explicit judgments had to be made about the appropriateness of employing existing institutions to accomplish various objectives or to create new institutions designed to deal with the particular issues implicated by the terrorist attack. A principled approach had to be formulated in order to answer the central question of how much compensation should be paid to different individuals and firms harmed directly or indirectly by the attack. The tort system had long struggled with the problem of devising a coherent theory of compensation, particularly with respect to non-pecuniary harm. The answers provided by tort doctrine remain extremely controversial. Would it be better (1) to utilize the existing tort system, whatever its imperfections, (2) create a new agency which would derive the substantive principles it would apply through (among other things) a selective incorporation of torts jurisprudence or (3) create a new institution which would supply its own substantive principles, unconstrained to any degree by what had been done in the tort system, or any other system providing compensation for

---

\* Professor of Law and Director, the John M. Olin Program in Law and Economics, the Georgetown University Law Center. The Papers in the symposium were presented at a Conference on "The Law and Economics of Providing Compensation for Harm Caused by Terrorism" sponsored by the Olin Program.

various types of harm? In sum then, an evaluation of the historical performance of the tort system and other institutions providing compensation was an essential element in fashioning an appropriate response to the terrorist attack.

The future also had to be considered. This was so for two reasons: (1) Events like those occurring on September 11 might occur again. Terrorism represented a continuing threat. Did it matter whether the principles employed to determine appropriate compensation for harm caused by the September 11 attack could be generalized to govern the compensation provided for harm resulting from future attacks? (2) Decisions with respect to compensation, if they were made applicable to future attacks, or would be viewed as precedent for the legal response to future attacks, would also shape the incentives of actors to take costly steps to reduce the likelihood or severity of harm resulting from future events.

Virtually all of the important decisions with respect to determining the roles of various public and private institutions and the principles which would govern their actions, were implicit. There was little discussion of alternatives which might have been employed. The contributions to this symposium may be fruitfully viewed as making explicit the social choices which underlay the actions which were taken. They capture both what was genuinely “new” and “distinct” about the issues implicated by the events of September 11 and the extent to which these issues were examples of basic questions with which the legal system has struggled for a very long time.

Marshall Shapo’s analysis of the September 11th Victim Compensation Fund of 2001, created by Congress less than two weeks after the attack, elegantly locates the fund in what he calls our “jurisprudence of injury.” He shows that intense political pressures led Congress essentially to reject the customary means employed, most significantly, the tort system, to provide compensation for injury. The result was an unprecedented procedural system conferring enormous power on a Special Master, appointed specifically to administer the fund, and a no-fault substantive regime unlike any which had been seen before.

The creation of the fund, then, represented an extreme example of what I have characterized as the *sui generis* approach. Powerful social forces combined to induce Congress to respond as it did. These forces include: (1) There was an outpouring of compassion by the general public. Providing generous compensation to the victims was seen as an expression of solidarity and an affirmation of the ideals of the American Society. Ironically, perhaps, the act of giving took on a great importance of its own. Much less thought was given to the question of what should determine the amount which a particular victim received. (2) The intentional tortfeasors who had committed the terrorist acts could not be the source of the required compensation. There was great concern about subjecting public and private institutions (principally the airlines), who could be charged with negligence for failing to take adequate precautions to prevent the terrorist attack, to the costliness and uncertain outcomes of the tort system. (3) Existing tort doctrine was thought to be unable to answer the question of what constituted appropriate compensation in these unprecedented circumstances. Perhaps, most significantly, victims were viewed, in varying degrees, as heroes whose survivors should be rewarded for their valor. (4) The airlines presented a

particularly difficult question. On the one hand they might appropriately be required to compensate victims because of their negligence in preventing the attacks. On the other they had experienced serious losses, for which they were not responsible, because of the attacks.

The Shapo essay does a remarkable job of sorting out these complexities and explaining how Congress dealt with them. The story he tells should be particularly fascinating to scholars interested in public choice or torts.

Robert Katz's essay provides a detailed and perceptive account of the large, wholly unprecedented, role played by charitable organizations in distributing to victims the vast sum contributed by the truly astounding total of two-thirds of American households. In one essential respect the problem facing the charities was like that faced by the Victims Compensation Fund. Donors' contributions were an expression of grief, solidarity and patriotism. Their motivation was the felt need to respond to a national tragedy. They did not focus on the complex question of how the funds they were providing should be shared among victims. They were, however, clear that they wanted the money to go to victims. As a result, the charities found themselves under intense pressure to distribute the funds they had received but little guidance as to how to distribute them.

The historical practices of charities in responding to disasters and the legal rules defining what a charity must do to qualify for favorable tax treatment combined to provide a very uncomfortable answer to this question: Charities are not the appropriate institutions to provide compensation to individuals for harm resulting from calamitous events. Charities provide short term disaster relief like medical supplies, food and shelter, and funds for emergency expenditures. Their long term compensatory role is limited to needs based monetary assistance and in kind relief of the poor. As a result, returning to the opening portions of this introduction, the justification for the response of the charities could not be found in what had been done before. Distributing more than a billion dollars to victims, some of whom were very wealthy, was different than providing soup kitchens to feed the destitute or blankets to people driven from their homes by a flood. The focus of the donors was exclusively on the horror of the September 11 attack. Instructed by their donors to fashion a *sui generis* response, not surprisingly, the charities' behavior was, *ad hoc*, inconsistent and uncoordinated.

The most interesting question posed in the Katz essay is whether this *ad hoc* response will provide beginnings for a new, more extensive, conception of what the role of charities, in responding to national tragedies, *should* be.

Hillel Sommer's essay provides an illuminating comparative perspective on the American response to the terrorist attack. He traces the evolution of the very different Israeli approach to the problem of providing compensation for harm caused by terrorism. As it is now constituted, Israeli law grants a wide range of monetary transfers and in kind assistance to victims of terrorist attacks. The legal provisions with respect to harm caused by terrorism are part of the very extensive social welfare regime in place in Israel. Benefits for victims of terrorism are larger than those available to people whose needy condition results from other causes and approximately the same as those furnished to soldiers killed in the ongoing cycle of terrorism and counter terrorism.

The Sommer essay also expresses the reaction of a person familiar with the

Israeli system to what has been done in the United States. The striking aspect of the American system to an Israeli observer is its ad hoc nature. The compensation regimes established for the various terrorist incidents are entirely different. Professor Sommer's reaction implicates fundamental questions concerning compensation for harm caused by terrorism: What are the principled reasons for treating victims of various terrorist attacks differently? Even more generally, what are the principled reasons for treating persons harmed by terrorism differently than persons harmed in other ways?

Margaret Blair's essay shifts the focus of the symposium from the harm to individual victims to the large economic losses experienced by the airlines. The legislation authorizing economic assistance to the airlines was passed very quickly, to a significant degree as part of the outpouring of solidarity and patriotism which underlay the public and private provision of compensation to individuals. The economic assistance took several forms: (1) immunity from tort claims by victims who chose to receive compensation from the Victims' Compensation Fund; (2) a limitation in the liability of victims who choose to forgo payment from the fund and, instead, sue in tort, to the "limits of the liability coverage maintained by the air carrier"; (3) cash payments as compensation for the large losses directly caused by the terrorist attacks; and (4) a subsidy for payment of the high price of liability insurance in the period following the terrorist attack.

The Blair essay focuses on the most extensive and controversial form of assistance authorized by the legislation. The financial situation of several of the airlines was so bad that bankruptcy loomed as a real possibility. Their situation had certainly been materially worsened by the terrorist attacks. But basic economic circumstances, which defined the competitive environment of the industry, also lay at the heart of the difficulties experienced by firms in the industry.

Congress was faced with the difficult and controversial task of fashioning a "bail out" policy for the industry. Of course, this policy could have consisted of providing no financial assistance. However, Congress responded by enacting legislation authorizing large, long term financial aid, in the form of loan guarantees. At the same time, the decision as to how much aid would actually be provided to individual airlines was delegated to an agency created for this purpose. As is often the case in situations of this kind, the vague criteria which were enunciated to control the decisions of this agency indicated that Congress was eager to appear generous. At the same time, however, the "hot potato" of deciding what actually was to be done was thrown to another institution.

At bottom, the implementing agency faced a task which could not coherently be accomplished. It was asked to provide loan guarantees only in those situations in which it was anticipated that the loans would be paid so that the guarantees would not have to be honored. In the words of the Blair essay, the agency was to "pick winners" who would succeed and be able to pay their debts. Achieving coherence was further complicated by two additional factors: First, likely "winners" could obtain financing in the capital market and did not require government assistance and second, the government, like any other supplier of capital, could capture some of the upside potential of likely winners by acquiring

an equity interest in the firm.

As the Blair essay explains, the drama of the implementing agency deciding which firms to help, and on what terms, is not over. So far relatively little assistance has been provided. But the plot is still thickening as the firms in the industry jockey for competitive advantage, and the government officials carefully study the political tea leaves.

The three remaining essays in the symposium focus on the third source of funds for compensating individuals and firms for the harmed caused by the terrorist attack: private and public insurance. Insurance varies from the other two sources, charitable giving and government payments, in a fundamental respect. The relevant decisions with respect to the first two of these sources are primarily made after the fact. Harm has occurred and the question is what to do about it. In the case of insurance, however, the relevant decisions are made before the fact. Individuals and firms decide how much compensation they wish to purchase for harm which might occur in the future. These decisions are disciplined, in the case of private insurance, by the need to pay premiums in sufficient amounts for insurance companies profitably to provide the agreed upon compensation if one of the covered harmful events occur. Government insurance could, in principle, also be provided subject to the profitability constraint. Political pressures, however, often lead to subsidization in the form of premiums which are insufficient to provide the compensation required when a harmful event occurs. Two specific issues relevant to determining the role which privately and publicly supplied insurance should play in determining the compensation which is provided for harm caused by catastrophic events like the September 11 terrorist attack are considered in two of the essays. The third essay comprehensively addresses the general question.

Jeffrey Thomas' essay examines the efforts of the insurance industry to adapt to the uncertainty of future terrorist attacks engendered by the huge, largely unanticipated, liability which the industry faced as a result of the September 11 attack. The industry sought relief from Congress in the form of the federal government bearing a portion of the risk of future harm. The outcome of this effort remains in doubt. The focus of the Thomas essay is on the companion effort to seek state regulatory approval for an exclusion of coverage for losses resulting from terrorist activity. The industry sought the exclusion in part because most insurance carriers, unconstrained by government regulation, had refused, in the renewal of contracts in January 2002, to provide coverage for terrorist caused losses. It was claimed that a \$25 million loss would threaten the solvency of many companies writing commercial property/casualty insurance. State regulators responded by approving an exclusion from terrorist caused harm if the liability of an individual firm exceeded this amount.

The Thomas essay analyzes the complexities involved in framing and implementing such an exclusion. Some of these complexities are similar to issues arising under the Israeli law providing compensation. Essentially, they arise from the necessity of defining exactly what constitutes a "terrorist" event. The second difficulty is, however, unique to the exclusionary clause which was adopted. The difficulty arises because if the threshold \$25 million in losses is exceeded, a company need pay nothing. The threshold thus creates a discontinuity. If the

liability of a company is below the threshold, the company would like losses to be as low as possible, and its insureds, as a group, would like them to be as high as possible. As the threshold is approached, however, the company would prefer that losses be higher in order to gain the benefits of the exclusion. By contrast, its insureds would prefer that it be lower so that they are not deprived of coverage by the exclusionary clause. The Thomas essay contains interesting speculation as to how insurers and insured will behave in these circumstances. The question is a general one applicable to any regulatory solution in which insurers gain beneficial treatment if losses exceed a specified threshold.

The essay by Elizabeth and Terrence Chorvat adopts the innovative perspective of analyzing the federal tax system as a means for providing compensation for losses caused by terrorist activity. In one respect their analysis captures an insurance like function, implicit and unavoidable, in any income tax system. When economic losses are suffered income is reduced and compensation in the form of lower tax liability is provided. More controversially, they argue that special provision should be made in the tax law to reduce the income tax liability of victims of terrorism. Provisions of this kind were enacted for victims of the September 11 attack. The Chorvats argue that they should be made permanent features of the tax code.

This provocative proposal is made for two reasons. (1) If the government bears a portion of the losses resulting from terrorist acts, in the form of reduced revenue, it will provide an incentive for government decision makers to take adequate steps to reduce the likelihood and harmfulness of terrorist activity. (2) Individuals who take precautions which reduce the likelihood or severity of harm resulting from terrorist attacks create benefits for other potential victims. The creation of positive externalities justifies subsidization in the form of favorable tax treatment.

The details of the argument offered in support of these contentions offer interesting insights into the current tax treatment of expenditures designed to lessen or mitigate catastrophic losses. The essay also examines the incentive of government officials and private firms and individuals for taking costly precautions resulting from their anticipating the treatment of these losses after they occur. The essay also weighs in on the side of the before the event comprehensive approach as compared to the ex post ad hoc response.

The final essay in the symposium, by Anne Gron and Alan Sykes, offers a rigorous analysis of the question of whether the government should act as an insurer of losses resulting from terrorism because the private insurance market will fail to provide the required coverage. Although focusing on losses resulting from terrorism, the essay constitutes a major contribution to our understanding of the phenomenon of private insurance markets "failing." It, moreover, considers not only what failures will occur but whether, should they occur, the government can supply the insurance that the private sector will fail to provide.

The analysis is complex and subtle and I will not try to capture it in this brief introduction. In the most general terms, the essay analyzes two phenomena: (1) a short-term inadequacy of supply which may occur after catastrophic events like those occurring on September 11, 2001 and (2) A long term inability of the private market to supply insurance coverage for events like those which occurred

on September 11, 2001. The essay concludes that the private market has self-correcting forces which will lead to a reasonably prompt end to the shortage of coverage in the period immediately following September 11. The answer to the question as to whether a significant, persistent supply shortage may occur is complex and uncertain.

The essay concludes that while it is difficult to conclude with any great confidence what long term shortage of supply, if any, may occur, it is unlikely that the government can effectively diagnose and solve the problem by offering insurance supplementing what is available in the private market. (It appears that the Bush administration has reached a different conclusion in both of these respects.)

I conclude this introduction by reporting the strong sentiment of the contributors that these essays appear together in a single publication. I agree that the sum is greater than the total of the parts. I suggest that the reader will gain many interesting insights if she asks herself how the essay she is reading sheds light on the other contributions to the symposium.