

1-1-1961

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SOME THOUGHTS ON RISK DISTRIBUTION AND THE
LAW OF TORTS

GUIDO GALABRESI†

IN their excellent new casebook on Torts Professors Gregory and Kalven state that "the central policy issue in tort law is whether the principal criterion of liability is to be based on individual fault or on a wide distribution of risk and loss."¹ And so, I suppose, it is. But to say "risk distribution" is really to say very little. Indeed, under the heading "risk distribution" have come the most diverse schemes for allocating losses, schemes that have almost nothing to do with each other.

The reason for the difficulty is, presumably, that while many people have talked about "risk distribution," and some have even used it as a basis for proposed modifications in the law of torts,² few have in recent years attempted to examine in any depth just what it is they are striving for when they say "distribute losses."³ They could mean one of three things. Do they wish as broad a spreading of all losses, both interpersonally and intertemporally, as is possible? Or do they want the burden of losses to be borne by those classes of people "most able" to pay? Or do they seek something entirely different—that those "enterprises" which give rise to a loss "should" bear the burden, whether or not this accomplishes the prior two aims? The answer, I suppose, is that sometimes they mean each of these things, and at other times all of them. Unfortunately, these goals are not always consistent with each other. They are, more-

†Ass't Professor of Law, Yale University Law School. The author wishes to thank Professors Fleming James and Ward Bowman for their helpful criticisms and suggestions. He is also indebted to Abraham Ordover, a student in the Yale Law School, for his help on the research for this article. Neither Mr. Ordover nor Professors James and Bowman are responsible for any errors in the article.

1. GREGORY & KALVEN, *CASES ON TORTS* 689 (1959).

2. So much has been written on the subject of "risk distribution," and so many writers have spent time collecting authorities and opinions on the subject, that it would be both useless and presumptuous of me to attempt to collect all the writings here. Both GREGORY & KALVEN, *op. cit. supra* note 1, at xlvii-lix, and 2 HARPER & JAMES, *TORTS* 759-84, 794-95, 1337-60, 3 *id.* at 1956-58, 1976-79 (1956) [hereinafter cited as HARPER & JAMES] have excellent collections of authorities on the problems involved.

3. Since writing this article I have read Prof. Morris' exceedingly interesting article which appears in this issue of the *Yale Law Journal*. Prof. MORRIS, of course, asks some of the same questions I ask. He sometimes gives answers which agree with mine, and sometimes seems not to. His answers are always thought provoking and, naturally, I am delighted with his questions.

over, supported by quite different ethical and economic postulates—postulates of quite varied acceptability. To decide when and how we wish to distribute losses we must, therefore, examine the theoretical justifications of each of these three positions. This Article takes some first steps in that direction.

In so doing we run into several threshold problems. In the first place, we must ignore altogether the very central issue stated by Gregory and Kalven—that of fault versus nonfault liability. Hence, we must also ignore other factors, like the deterrent effect of fault liability, which are crucial to that discussion. While these factors may be important in choosing a scheme of tort liability they are not relevant to the question of what one means by risk distribution, and to a consideration of the theories by which it may be justified. Put another way, we are interested in seeing how strong the bases are for each of the various things we call risk distribution. If it turns out that these bases are strong, it may be assumed that the policies in favor of other criteria for allocating losses, like fault, are weakened by comparison. It need not follow that these other criteria, even if weakened, should not dominate in all or in some areas where losses occur. That question, however, does not concern us here.

Another, and perhaps more significant, problem which we confront is that the article must deal in theory—often, unfortunately, in that most dismal of theories, economics. Hopefully, it will do so in terms which are intelligible to law teachers, if not to lawyers, and without that suicidal desire of the economist to make his theory so pervasive and detailed that it is rendered utterly useless to the lawyer who lives in the world of men, and even to the law teacher, wherever he lives.⁴

ENTERPRISE LIABILITY—OR THE ALLOCATION OF RESOURCES JUSTIFICATION

Introduction

“Activities should bear the costs they engender”; “it is only fair that an industry should pay for the injuries it causes.” “Enterprise liability”—the notion that losses should be borne by the doer, the enterprise, rather than distributed on the basis of fault—is usually explained in such terms.⁵ A statement of this kind is generally followed by an additional one which implies that the enterprise can pass the loss on to the consumers in price rises, and that therefore enter-

4. An apology is here due to economists, not so much for the gratuitous insult just uttered as for more significant insults which I fear will follow. I have tried throughout this article to write in a way noneconomists can understand. As a result I have let my terms become remarkably sloppy from an economists' standpoint. Misguided though I may be, I feel sure some of this is essential. Therefore, learned brethren, be gentle if at times you see things termed “costs” you would not recognize as “costs,” or as “profits” things you would surely term “costs.”

5. See, e.g., 2 HARPER & JAMES 731 (“The basic philosophy of such legislation is that loss from these accidents is a cost of the enterprises that entail them, and should be borne by the enterprises or their beneficiaries”). C. Morris, Sr., *Hazardous Enterprises and Risk Bearing Capacity*, 61 YALE L.J. 1172, 1173 (1952); Gregory, *Trespass to Negligence to Absolute Liability*, 37 VA. L. REV. 359, 382-83, 386 (1951); James, *Social Insurance and Tort Liability*, 27 N.Y.U.L. REV. 537, 538 (1952).

prise liability is really a form of "risk spreading."⁶ It is, of course, true that enterprise liability sometimes does spread losses; it is equally true, however, that sometimes it does not. In discussing risk spreading at a later point in this Article we will consider when enterprises can in fact, and when they cannot, spread losses.⁷ And since risk spreading is not always a valid justification for enterprise liability we are at the moment less concerned with the risk spreading potential of enterprise liability than with whether another, more general, justification exists for the "should" in the phrase "an enterprise should bear its costs."

The problem of this "should" and what it means is analogous to the problem of why workmen's compensation should be limited to injuries arising out of or in the course of employment, and why master-servant liability should be limited to those acts which are in some sense within the scope of employment. If the "should" were merely a way of saying, "because this is a handy way of spreading losses through the price mechanism to a broad group of people—the consumers," one would wonder why workmen's compensation or master-servant liability should be so limited. And, indeed, writers have long wondered why.⁸ Some have answered directly that there is no logical reason for limiting liability to injuries related to employment.⁹ Others have said about the same thing, but have masked their answer by stating that some "innate sense of fairness" justifies the limitation.¹⁰ What that "fairness" is, unfortunately, is never clearly explained.

But the "should" is used so often that one suspects it must have a more clearly defined justification than some vague sense of fairness.¹¹ And indeed it does; though it is a justification that only some of us would accept, and which, strangely enough, has been all but ignored in tort law in recent years.¹² That

6. See, e.g., Douglas, *Vicarious Liability and Administration of Risk*, 38 YALE L.J. 584, 586 (1929); C. Morris, Sr., *supra* note 5, at 1172, 1176; Gregory, *supra* note 5, at 383; James, *supra* note 5, at 538.

7. See text at notes 48-73 *infra*.

8. See, e.g., Douglas, *supra* note 6, at 590-93; 2 HARPER & JAMES 1376.

9. Douglas, *supra* note 6, at 593.

10. See 2 HARPER & JAMES 1376 (collecting authorities).

11. Some writers have tried to explain the "should" in purely pragmatic risk spreading terms. Their argument can be paraphrased as follows: Accidents related to the work done are not sufficiently costly to destroy an industry, and can, therefore, be spread by that industry through prices. Accidents which are unrelated could put such a heavy burden on the enterprise that it would fold, and losses would be multiplied rather than spread. See, e.g., Douglas, *supra* note 6, at 594. Unfortunately for this explanation there are some industries which cannot bear their own costs without causing a concentration of losses, see text at notes 52-73 *infra*, while there are others which could easily bear and spread many losses totally unrelated to their enterprises. And it would not be impossible to devise a rule of law which would divide one from the other, in a reasonably rough and ready manner. Yet few conceive, let alone advocate, that this be done, because it would in some sense be unfair—which, of course, brings us right back where we started.

12. Smith, in his pioneering work on frolic and detour, comes very close when he states that accident costs not connected with the enterprise should not be placed on it be-

justification can be called the "allocation of resources" justification.¹³ At its base are certain fundamental ethical postulates. One of these, perhaps the most important, is that by and large people know what is best for themselves. If people want television sets, society should produce television sets; if they want licorice drops, then licorice drops should be made. And, the theory continues, in order for people to know what they really want they must know the relative costs of producing different goods. The function of prices is to reflect the actual costs of competing goods, and thus to enable the buyer to cast an informed vote in making his purchases.

An example may help clear the mind a bit. Assume two different societies, Athens and Sparta: in Sparta all accident costs are borne by the state and come out of general taxes; in Athens accident costs are in some way or another charged to the doer. C. J. Taney, a business man in Athens, has one car, but he wants to buy another. The cost of owning a second, used, car would come to about \$200 a year, plus an addition to his insurance bill of another \$200. The cost of train fares, the occasional taxis he would need to use to be as comfortable without the car, and other forms of entertainment which make up for the car, come to about \$250. Contrasting the \$400 additional car cost with the \$250 expense of riding in trains and taxis he decides to forego the car. If C. J. lived in Sparta, on the other hand, he would have to pay a certain sum in taxes to cover the general accident program. He could not avoid this cost whatever he bought. As a result, the comparative cost of buying a car and going by taxi in Sparta would be \$200 per year for the car as contrasted with \$250 for train and taxi fares. Chances are Taney would buy the car. In purchasing a second car the Sparta C. J. is not made to pay the full \$400 that it costs. And in fact, he must pay *part* of that cost whether or not he buys one. He will, therefore, buy a car. If he alone had to carry the full burden of a second car, he would use trains and taxis, spending the money saved on something else—a T.V. set or a rowboat.¹⁴

cause they don't belong there economically. Smith, *Frolic and Detour*, 23 COLUM. L. REV. 444, 461 (1923). Unfortunately, he goes no further and as Douglas, *supra* note 6, at 593, points out, to say only this much is to give a self serving explanation. C. Morris, Sr. and James, as well as some others, seem at times to come close to relying on this justification, though always, it appears, in passing. See C. Morris, Sr., *supra* note 5, at 1172; HARPER & JAMES 1376. See also Leflar, *Negligence in Name Only*, 27 N.Y.U.L. REV. 564, 584 (1952); Laski, *The Basis of Vicarious Liability*, 26 YALE L.J. 105, 126-27 (1916); Comment, 20 U. CHI. L. REV. 667, 669 (1953); Note, 61 HARV. L. REV. 515, 521 (1948).

13. The term "allocation of resources" is, and has long been, current in economics. The foundations and applications of the justification here discussed form that branch of economics usually called Welfare Economics. The classic discussion of Welfare Economics is PIGOU, *ECONOMICS OF WELFARE* (4th ed. 1932). Among more recent valuable and often critical works in the field are LITTLE, *A CRITIQUE OF WELFARE ECONOMICS* (1950) and, for those who find mathematics fun, SAMUELSON, *FOUNDATIONS OF ECONOMIC ANALYSIS* ch. VIII (1958).

14. The Athens effect would, of course, occur in Sparta if "an appropriate" share of the general accident relief program were paid for out of special taxes placed on the owner-

One need not imagine that any of us sit around at home thinking about relative costs of different goods and the relative pleasures derived from them for the theory to make sense. The fact is that if the cost of all auto accidents were suddenly to be paid out of a general government fund the expense of owning a car would be a lot lower than it is now since people would no longer need to worry about buying insurance; the result would be that some people would buy more cars. Perhaps they would be teenagers who can afford \$100 for an old jalopy, but who cannot afford—or whose fathers cannot afford—the insurance.¹⁵ Or they might be people who could buy a second car so long as no added insurance was involved.¹⁶ In any event, the demand for cars would increase, and, therefore, so would the number of cars produced. Indeed, the effect would be the same as if the government suddenly chose to pay the cost of steel used by car makers, and to raise the money out of taxes. In each case the objection would be the same. In each, an economist would say, resources are misallocated in that goods are produced which the purchaser would not want if he really had to pay the full extent of their cost to society—their cost, whether in terms of the physical components of the item or of the expense of accidents associated with its production and use.

The resource-allocation theory is not, however, without its limitations. A primary difficulty with it involves the existence of monopoly power.¹⁷ Under

ship or purchase of automobiles. An "appropriate share," in this context, means an amount sufficient to pay for all accidents covered in the program which resulted from the operation of automobiles. See note 90 *infra*.

15. "Afford" is not, of course, the proper economic term, though it is the one we would normally use. Technically, however, the question is not whether, in absolute terms, the teenager or his father has or can get the insurance money, but whether he thinks it worthwhile to spend that much money on a car rather than on other things. "Other things" includes the leisure the teenager would have to give up to earn the money.

16. An example of this type of effect has apparently occurred in New York recently. For with the coming of compulsory insurance, see N.Y. VEHICLE & TRAFFIC LAW § 312, the bottom has fallen out of the jalopy market in that state.

17. An equally significant limitation, and one which has traditionally troubled economists even more than the monopoly problem, is the problem of income distribution. Unless income—and therefore goods and services—are distributed in the society in some way which that society finds satisfactory, it may be foolish to say that the society is best off if all consumers can choose what they want for themselves after seeing what the true cost of their possible choices are. Instead, a situation which, by falsifying the costs of various items, leads to a more satisfactory income distribution may actually be preferable from the society's point of view. Thus, if a society found that the poor are too poor, and that the poor used widgets in great quantities, it might well be that that society would be made better off if widgets were made cheaper—that is "subsidized"—by not being made to bear their accident costs, than if they actually bore their costs in full. See generally the brilliant treatment of this problem in SAMUELSON, *op. cit. supra* note 13, at 203-28, 249-53.

In our society, however, the prime weapon for redistributing income is taxation. And it is not hard to feel that the most honest way to accomplish a redistribution of income—if any is desired—is through taxes and direct open grants to those whom we wished to help. These might then decide for themselves if they wished to use the grant for widgets or smoked salmon. As a result one could well conclude that the resource allocation justi-

the allocation-of-resources theory, the choice between goods generally depends on the relative prices of goods. But price will be a good reflection of the cost of two competing goods only if the ratio of cost to price is the same in both those goods. This ratio will not be the same, however, where one item is relatively competitive and the other is relatively monopolistic. For, generally, sellers in relatively monopolistic industries sell at higher price to cost ratios than sellers in relatively competitive industries.¹⁸ As a result, fewer goods are demanded from monopolistic industries than is in fact warranted by their true cost.¹⁹ It is this idea that economists and antitrust lawyers have in mind when they speak of the misallocation of resources caused by monopoly.²⁰ If, then, we count on people to choose what they want on the basis of an item's total cost to society, we fool ourselves whenever differing degrees of monopoly power

fication should stand untroubled by dissatisfactions with the given distribution of income. Yet this is not altogether true. In the first place, very few taxes fail to misallocate resources to some extent. See note 26 *infra*. And it is at least theoretically possible, though in fact most unlikely, that a system of allocating tort losses could be found which would accomplish a desired redistribution of income at a cost of less misallocation of resources than taxation, though it might falsify the cost of some goods in so doing. In the second place, it might well be that a redistribution, though desired, could not be accomplished through taxation, for political reasons. In such a case, again, torts or other areas of the law might be called on to accomplish the redistribution *despite* the unfavorable resource allocation effect this might have.

All this is really no more than saying that there are other things which count more in our society than allocation of resources and that we will gladly forego the best allocation of resources if by doing so some more important policy is served. *Cf.* note 28 *infra* and accompanying text. It does not mean, however, that resource allocations should not be an important consideration in deciding what should be done.

For a discussion of other limitations on allocation-of-resources theory, limitations caused by the existence of unemployment and taxation, see generally LITTLE, *op. cit. supra* note 13, ch. xv. These limitations do not destroy the usefulness of the theory. But they do make minor misallocations of resources insignificant. As a result any system of loss distribution which pretends to concern itself with resource allocation can properly ignore minor misallocations and need only worry about major effects on prices.

18. The economist will recognize that I am here weaseling on my use of the term "cost." Thus, if the comparison is between a pure competitor and a pure monopoly, what I say might be true in terms of accounting costs. But if I am comparing a pure competitor and a seller in an industry which has monopolistic competition, what I say will only be true in the sense that the price does not properly reflect the optimum costs which could obtain under conditions of pure competition. See generally STIGLER, *THE THEORY OF PRICE* (1949).

19. To say that fewer goods will be demanded from the monopolistic industry is no more accurate technically than to say that fewer goods will be supplied by that industry. In the relatively monopolistic industry the producer maximizes his profits by selling at a price which is higher than that which would obtain if the industry were competitive. He does so though he will sell fewer goods at that price and produce less than he otherwise would. At the monopolistic price consumers would buy less than they would at a lower price. Whether this means that fewer goods are demanded or that fewer goods are supplied doesn't strike me as a meaningful question. *Cf.* MARSHALL, *PRINCIPLES OF ECONOMICS* 348-50 (6th ed. 1910).

20. See, *e.g.*, *ATT'Y GEN. NAT'L COMM. ANTITRUST REP.* 317 (1955).

exist.²¹ And since monopoly distorts allocation of resources, any system of loss allocation based on this theory must take this possible bias into account.²²

But forgetting for a moment the problems monopoly brings, the most desirable system of loss distribution under a strict resource-allocation theory is one in which the prices of goods accurately reflect their full cost to society. The theory therefore requires, first, that the cost of injuries should be borne by the activities which caused them, whether or not fault is involved, because, either way, the injury is a real cost of those activities. (It is because of this nonfault basis, of course, that "enterprise liability" is often lumped together with other nonfault systems of loss allocation under the general heading, "risk distribution.") Second, the theory requires that among the several parties engaged in an enterprise the loss should be placed on the party which is most likely to cause the burden to be reflected in the price of whatever the enterprise sells.

But which is that party? Is it the worker who has been injured, or his employer; is it the depositor whose check is forged, or the bank; is it the pedestrian, or the driver of the car that hit him? Here, traditional economic *theory* is of little help. For in the economist's world it often makes no difference whether, for example, the cost of an injury is put on a worker or on his employer. In terms of "pure" resource-allocation-loss-distribution theory, if the injury were put on the worker he could insure, and he could demand higher wages to pay the cost of that insurance. Alternatively, although he might not insure, he would still demand higher wages as compensation for the risk. On the other hand, the employer would lower wages if he were suddenly charged with the risk of injury to his workmen. Either way, the theory goes, the cost would find its way into wages and into prices.

21. The same may to some extent be true in competitive industries which are undergoing rapid changes in technology. For here too, at any given period in time, price may not reflect the true cost of the goods. Cf. note 78 *infra*. Over a long period of time, however, it seems safe to say that more harm would come from trying to compensate—through adjustments in tort liability—for temporary misstatements of costs by these industries than by treating such industries in the same way as all other competitive industries. *But cf.* text at notes 43-47 *infra*.

22. The difficulty is that once a misallocation exists due to monopoly power there is no a priori reason to believe that steps which would have improved allocation of resources absent the monopoly power will still do so. See Clark, *Toward a Concept of Workable Competition*, 30 AM. ECON. REV. 241 (1940); SAMUELSON, *op. cit. supra* note 13, at 252-53. Of course, one can take the same attitude toward monopoly that I have taken toward distribution of income, see note 17 *supra*, and argue that there are better ways of solving the monopoly problem than by compensating for its possible misallocations by rearranging the allocation of tort losses, and thereby causing other misallocations. Or one may take the view I have taken of innovations, see note 21 *supra*, and contend that ultimately the monopoly problem itself is one of timing, and that over a long period of time more misallocations are likely to come from taking measures within tort law to compensate for monopoly's misallocations than monopoly caused in the first place. I am rather in sympathy with these views, which in effect boil down to "don't compensate for a wrong by creating another wrong; you only cause trouble for yourself," and think the resource-allocation justification can be supported on that basis alone. If you agree, you may be able to spare yourself the intricacies of the text at notes 31-45 *infra*. If you require more evidence—read on!

This "pure theory" loss-distribution argument, which was used in discussions of workmen's compensation some fifty years ago to explain why compensation would not save workers money, is in fact inaccurate.²³ It presupposes an all knowing, all rational economic world which does not exist. In the first place, even if such a world did exist, *some* risks would still be assignable to the activity which caused them by only one party. Thus, a pedestrian—even if tempted to buy accident insurance because of the risk of being hit by a car—would not be able to make this part of the price of cars. As a result, car buyers would have no reason not to buy cars, even though their purchases raised the cost of pedestrian auto insurance.²⁴ In fact, they would be in the same situation as C. J. Taney in Sparta for whom the real cost of a car is not reflected in its purchase price. Were the risk of accident put instead on the car owner as driver, this added cost would be reflected in the real expense of owning a car and would affect purchases. Secondly, in the real world not all parties evaluate losses equally, or are equally likely to insure. Before workmen's compensation the individual worker simply did not evaluate the risk of injury to be as great as it actually was. He took his chances; and even if he did not wish to take his chances, the fact that other workmen took a chance forced him to do the same, or to starve. The result—apart from some individual tragedies—was that wages and prices in certain industries simply did not reflect the losses those industries caused. Finally, insurance may cost one party less than it costs another. If that is so, the proper party to bear the risk is the party whose insurance costs are lower. For only then are the true costs of injuries, and not some false costs of more expensive insurance, reflected in price.

There are, naturally, some situations where the pure loss-distribution theory applies, and where it actually does not matter who bears the loss initially. Some, though by no means all, independent contractor cases and some product liability cases involving commercial buyers and sellers may be examples.²⁵ But whenever one party is in fact in a better position to allocate the cost of the

23. See TAUSSIG, *PRINCIPLES OF ECONOMICS* 326-27 (1911); Brown, *The Incidence of Compulsory Insurance of Workmen*, 30 J. POL. ECON. 67 (1922).

24. In effect such a result would amount to a decision that automobile accidents are more a true cost of walking and of living generally, than of automobile driving. Actually they are probably a cost of both.

I have not, in this article, attempted to probe what influences our decision that a particular "cost" is caused by one activity rather than another. Clearly this is an important question. Indeed, it is the next step in any thorough analysis of risk distribution. At this stage of analysis, however, when we have not yet examined the need and the effect of charging activities with those costs which all would agree they cause, that step seems somewhat far removed. Cf. text at notes 133-37 *infra*.

25. The traditional theory might today even have some application to the "workmen's compensation" area, given the development of strong labor unions in some industries. It is not fanciful to suppose that if workmen's compensation were suddenly abolished in these industries, unions would demand higher wages for their workers, impose higher dues, and purchase insurance—or provide protection through self insurance—equivalent to that now furnished by workmen's compensation. From the standpoint of resource allocations—though perhaps only from that standpoint—nothing would be changed. Cf. note 128 *infra*.

particular loss to the appropriate activity or merchandise, allocation of resources requires that party to bear the original burden of the loss.

Effect of Monopoly Power on the Allocation of Resources Justification

The foregoing analysis of the resource-allocation and loss-distribution theories is clearly valid only in the absence of monopoly power altogether, or where a similar degree of monopoly power exists in all industries.²⁶ But since in the American economy monopoly power in fact varies enormously from industry to industry, the difficult question of whether these theories are equally justified in the presence of monopolies is crucial. As noted, this is because the relatively monopolistic seller charges a price which is higher in relation to his costs than that charged by the relatively competitive seller; he thereby causes a shift in choices away from monopoly goods, less of which are demanded than would be justified by their true costs.²⁷ It might be argued, therefore, that charging a monopolistic producer with all his accident costs would frequently do nothing to correct the distortion, and where the accident costs of the monopolist were relatively high, might actually increase that distortion. Thus, at first glance at least, it might appear that accident costs should be charged to competitive industries in order to induce them to charge more and produce less, while to counteract the monopolist's relative under-production these costs should not be placed on monopolistic industries. Some of the reasons for the undesirability of such a system will appear later in the discussion of the "deep pocket" or "let the rich man pay" side of what is called risk distribution. For the moment, however, it is enough to note that while the allocation-of-resources theory may be strong enough to justify some modifications in the way losses are allocated, it is not strong enough to justify modifications which run counter to basic political beliefs in our society—like the belief that monopolists should be treated worse than small competitors, or at least not better.²⁸

26. Economists usually suggest that an economy which had monopoly power to the same extent throughout the economy would be less desirable than one which was fully competitive. The reasons for this are too complicated to go into here, but they involve the fact that less would be produced in a monopoly economy than under competition—or, as economists put it, the "work-leisure" conditions for an optimal economic organization would be violated. But similar types of "misallocations" are caused by virtually all forms of taxation. See Ruggles, N., *Developments in Theory of Marginal Cost Pricing*, 17 *REV. ECON. STUDIES* 107, 110-14 (1949); LITTLE, *op. cit. supra* note 13, at 129-65, 294-300. As a result, I am less concerned with them than with misallocations between different goods. That is, I am concerned more with whether too many cars are produced relative to T.V. sets and whether both cars and T.V. sets use too much steel relative to aluminum, than with the total production of steel, cars, T.V. sets, and fruit knives.

27. See Lerner, *The Concept of Monopoly and the Measurement of Monopoly Power*, 1 *REV. ECON. STUDIES* 157, 172 (1934); *cf.* SAMUELSON, *ECONOMICS* 609 (3d ed. 1955).

28. The reader may well wonder why tort law should be used to counteract the monopolist's relative underproduction. And I must say I rather agree with him. See generally notes 17, 21, 22 *supra*. One could, for instance, discourage overproduction in competitive industries by discriminatory taxes. See, *e.g.*, Rolph & Break, *The Welfare Aspects of Excise Taxes*, 57 *J. POL. ECON.* 46, 51 (1949). And the fact that we haven't, and are not

Fortunately for the allocation-of-resources theory, more careful analysis destroys much of the theoretical validity of this "subsidize monopoly" argument. In the first place, the allocation-of-resources theory is of primary importance in situations involving two or more products which can to some significant extent substitute for each other. C. J. Taney is faced with the alternative of using aluminum and steel in making widgets. Suppose that one of these can only be produced with a high accident cost, while the other involves few accidents indeed. Taney's choice between the two metals will be influenced by their relative prices, and these will be influenced by whether or not the accident cost is charged to the metal producing industries.²⁹ From the standpoint of resource allocation the fact that both steel and aluminum have a high degree of monopoly power when compared to corner hash-houses is quite irrelevant. The choice is between steel and aluminum, not between these and fried clams. Putting accident costs on corner hash-houses and not on steel and aluminum plants might help counter a minor misallocation of purchases between metals and clams. But this adjustment would create a major resource misallocation between steel and aluminum, the prices of which would not reflect their relative costs because of the difference in accident rates in the two industries.

In America, industries producing goods which can to some real extent substitute for each other have, by and large, similar degrees of monopoly power.³⁰ Hence, a system of loss allocations which charged all industries with their accident costs would be a pretty good one from the standpoint of resource allocation, even though monopoly power differs greatly in the economy as a whole.

Even in those instances in which the substitute producing industries do not have the same relative degree of monopoly power, quirks in the price setting process may in some cases promote favorable resource allocation. To see this, however, some unfortunately tedious discussion of how added costs get into prices is necessary. These instances of favorable resource allocation as a result of pricing quirks are probably not important enough by themselves to warrant undertaking the task. But an understanding of the pricing concepts involved

about to, is a fair indication that we do not consider the relative underproduction by monopolistic industries sufficiently vital to justify taking measures which seem to us undesirable for other reasons. The same would clearly apply to the use of torts in this way. In contrast, where prevailing social and political ideas do not run counter to the policy which allocation of resources requires toward monopolies, that policy is very likely to become part of the law. The antitrust laws are one example of such an attempt to counter the misallocation of resources caused by monopolistic industries in a manner which does not offend and, indeed, is supported by other social and political notions. See, *e.g.*, ATT'Y GEN. NAT'L COMM. ANTITRUST REP. 1-2 (1955); GRAMPP & WEILER, *ECONOMIC POLICY* 129 (1953).

29. For this point, and throughout this article, it makes no difference whatsoever if the accident cost of widget making is viewed as stemming from injuries to the workers in widget factories, or to consumers of widgets, or to both.

30. See, *e.g.*, Nutter, *The Extent and Growth of Enterprise Monopoly*, in GRAMPP & WEILER, *ECONOMIC POLICY* 141-46 (1953).

will be useful later, in the discussion of loss spreading and they may as well be dealt with here as later.

Two theories of pricing are in vogue among economists. The traditional or "marginal" theory assumes that the seller is less concerned with the average cost of production than with what the last units he produces cost him relative to what they bring in.³¹ So long as it costs him less to produce the last 1, or the last 1,000, widgets than he will make when he sells these additional widgets, he will produce them. If, on the other hand, he believes that the effect of producing more widgets will be to increase his costs more than his revenue, he will not produce them. At this equilibrium point profits would be maximized and losses minimized. Assuming that increases in widget production are accompanied by higher accident costs, a seller who is saddled with accident costs will produce fewer widgets and charge a higher price for each one. He will do this because the point at which producing more widgets will increase his total costs at a higher rate than his total revenues will have been shifted back by the fact that while the additional revenue derived from producing an extra 1,000 widgets is unchanged, it now costs more to produce the last thousand widgets than it did before.

But instead of varying according to output the tort liability costs may be constant regardless of production volume. They may in effect be a tax for entering the industry. An example of such fixed costs would be the lump sum damages awarded to neighboring property owners if a factory creates a nuisance. Once the payment—say \$10,000—is made, it makes no difference whether one makes 1 or 1,000,000 widgets. In this situation, though profits will decrease by the amount of the damages, the placing of accident costs on the industry will not affect price or output at all, unless someone who used to produce widgets decides to produce them no longer. The increase in total cost caused by the production of the last 1,000 widgets will, like the increase in revenue due to their sale, be unchanged by the fact that it cost \$10,000 to get into the business in the first place. Since the equilibrium point at which profits are maximized remains the same, no amount of output changing will tend to mitigate this loss or return profits to their previous levels. In short, Taney may decide that because of the added \$10,000 cost of being in the widget business—a cost he incurs whether he produces one or one million widgets—it is no longer worth his while to manufacture widgets. But if he decides it is still profitable, he will sell as much, and at the same price, as before.

Price and output may be similarly unaffected where accident costs vary with large changes in output, but are constant as to small changes. For example, suppose that it costs \$1,000 in insurance if Taney produces 1 to 100,000 widgets; \$2,000 if 100,000 to 1,000,000, and so forth. Let us assume Taney currently produces 900,000 widgets. Under these circumstances, placing accident costs on Taney will cause no change in price or output unless Taney goes whole

31. A full statement of this theory may be found in STIGLER, *THE THEORY OF PRICE* (1949).

hog and decides that it is now worth his while to produce less than 100,000 widgets in order to save the \$1,000 in extra insurance.

The alleged expense and inconvenience of calculating the marginal theory's maximum profit point is said to explain the popularity of the more empirical, "cost plus" theory of pricing.³² This theory states that producers do not look to the cost of producing their last or "marginal" units, and that whether they would make more money if they did so is irrelevant since in fact they don't. The theory asserts that manufacturers take the average cost of producing their merchandise, add to that cost a fixed or percentage mark up, and then produce what they think they can sell at that price. Under this theory profits are not "maximized" since the computation of per unit price includes the fixed costs of doing business—costs which are irrelevant in determining whether profits will increase with the production of one or more additional units. Cost plus pricing means that accident costs would automatically be reflected in prices, regardless of whether the added accident costs were fixed or variable.³³

How do these pricing theories relate to the argument that resource allocation requires correcting the distortions between monopoly and competitive industry pricing by charging accident costs to competitive enterprises alone? Under the empirical "cost plus" theory, within both competitive and monopolistic industries there will be an immediate effect on prices and output as a result of the added expense of accident costs. This will probably have a favorable effect on allocation of resources wherever industries compete primarily with other industries having about the same degree of monopoly power.³⁴ It will have an

32. See generally Hall & Hitch, *Price Theory and Business Behaviors*, 2 OXFORD ECONOMIC PAPERS 12.

33. Much has been said in criticism and in support of each of these theories. And some have tried to show that they come down to the same thing in certain situations which occur with varying degrees of frequency. See, e.g., Lester, *Shortcomings of Marginal Analysis for Wage-Employment Problems*, 36 AM. ECON. REV. 63 (1946); Machlup, *Marginal Analysis and Empirical Research*, 36 AM. ECON. REV. 519 (1946); Lester, *Marginalism, Minimum Wages, and Labor Markets*, 37 AM. ECON. REV. 135 (1947); Machlup, *Rejoinder to an Antimarginalist*, 37 AM. ECON. REV. 148 (1947); Stigler, *Prof. Lester and the Marginalists*, 37 AM. ECON. REV. 154 (1947); Oliver, *Marginal Theory and Business Behavior*, 37 AM. ECON. REV. 375 (1947). Generally speaking I am not concerned, however, with which of the two is more nearly valid. *But cf.* note 34 *infra*.

34. The statements in this paragraph need some qualification. "Cost plus" pricing necessarily involves some misallocation of resources. Thus, if previous use of cost plus pricing had caused one industry to underproduce substantially, it could well be that the additional cut in output described in the text would perpetuate the misallocation. If cost plus pricing, however, is used by firms only as a rule of thumb within somewhat broad limits of marginal pricing, and if we are concerned with approximations to desirable resource allocations rather than with achievement of perfect allocations, then the statement made in text is fair enough. Since the empirical studies made of pricing do not, in my view, justify more than the rather limited claim for cost plus pricing made in this footnote, see SAMUELSON, *ECONOMICS* 460-64 (3d ed. 1955), and since I am only interested in approximations, I do not think that in practice the text statement could be far wrong.

I also speak, in this paragraph, of cost plus pricing by competitive industries. Perfectly competitive industries could not, of course, employ such a pricing method. But industries

unfavorable effect only where relatively monopolistic industries with high accident costs compete primarily with relatively competitive industries with low accident rates. The reason for the unfavorable effect in this case, as we have said before, is that without the addition of accident costs the prices charged by accident prone monopolies, while inflated because the industries were monopolistic, were at the same time understated since they did not reflect the accident costs of production. Thus the two errors tended to cancel out each other. By adding accident costs in the name of resource allocation we have corrected only one of the countervailing errors, the "understatement," and thereby destroyed this corrective tendency.

If one accepts the traditional "marginal" theory the result will be the same if accident costs vary fairly continuously with output, but will be quite different where they are either fixed or are subject to change in large lumps only. In the latter cases the immediate effect on prices and output will be nil and there will, therefore, be no immediate effect on allocation of resources one way or another. There is, however, a markedly different *secondary* effect in monopolistic and competitive firms under this kind of cost burden. And this secondary effect, without favoring monopolies, promotes a favorable resource allocation in the difficult case where a relatively monopolistic industry competes with an industry that is relatively competitive.

Taney makes widgets. Widget-making is a highly competitive business, and Taney is barely able to make a go of it. Suddenly he is slapped with the requirement that he pay for accidents caused by widget-making. Assume that insurance costs are such that he will be charged the same whatever he produces, so long as he produces at all.³⁵ Insuring will drive him out of business; failure to insure will ultimately drive him, or an unlucky competitor who had accidents, out too. Fewer widget makers will remain, output will be lower, and that output will now sell at a higher price, one sufficient to cover accident as well as other costs. Were Taney in a monopolistic industry he would also have suffered a decrease in profits from the fact that he now had to bear accident costs, and since these accident costs did not vary with output he could not pass any part of them on to the consumers through output and price shifts. But, in all probability, he would still be making enough after his decrease in profits to make staying in the business worthwhile. His extra, or monopoly, profits would have been cut, but he would still be surviving. So would the few others in his industry. Output would therefore remain the same and so would price. In short, if the theory is accurate, competitive industries would ultimately react to increases in fixed costs by losing some firms; monopolistic industries, on the other hand, would be unaffected in their size and output, although their extra profits would decrease. The net result would be a relatively higher price and

which, though not perfect competitors, would still be "relatively competitive" within the terms of this analysis might very well employ cost plus pricing.

35. This example, with insurance as fixed, is probably unrealistic. But the same effect is quite possible in a more realistic situation, where the issue is lump sum damages as against variable damages in nuisances. See notes 108-11 *infra* and accompanying text.

lower output in the competitive industry, a desirable result from the standpoint of allocation of resources. Whether this favorable allocation of resources effect is, in such cases, achieved at the cost of concentrating losses—by driving honest, competitive Taney to the wall—rather than by spreading them will be considered later in a section dealing with loss spreading.³⁶

There is yet another situation in which enterprise liability might promote favorable resource allocation despite the existence of varying degrees of monopoly among industries producing goods which are reasonably close substitutes. This is where the relatively monopolistic industry is made up of a few independent firms—what economists call an oligopoly. In such a situation, economists claim, prices tend to be very “sticky.” Each firm knows that if it cuts prices in an attempt to increase its share of the market all the others will follow, and nothing will have been gained. Similarly, each firm fears that a price rise on its part will not be followed by the other firms, and that this will leave the price-raiser high and dry without a market.³⁷ If this is so, placing accident losses on the industry might well cause no price or output change. And this would be so even if the added costs varied with output. Profits would decline, of course, but no one would leave the industry since, as noted, the oligopoly structure probably guarantees more profits than could be made elsewhere. In contrast, any losses placed on a competitive industry producing goods which were rough substitutes for the products of the oligopolistic industry would result in an output decline and a price rise, whatever method of pricing the competitive industry followed. Thus, the effect of placing losses on both industries would be desirable from the point of view of resource allocation, since the relative over-producer, the competitive industry, would now be selling less.

If the products of the oligopolistic industry had as rough substitutes goods produced by an industry which was close to a true monopoly a different result would ensue. For while the monopoly would restrict output in response to the cost rise,³⁸ the more competitive oligopoly would not. And the already existing relative under-production on the part of the monopoly would be accentuated.

36. The question gets somewhat more complicated if the competitive industry is one in which even firms which lose a great deal of money tend to stay in business, an industry in which for any of several reasons “barriers to exit” exist. The problems involved are discussed in some detail later. For the moment it is enough to say that unless the industry is in a state of expansion, so that the pressure to leave resulting from the added cost is converted into a slower rate of growth, the effect of “barriers to exit” will be to make the competitive industry react to additional costs in about the same way as the monopolistic industry. Such a result would, of course, tend to retain the pre-existing misallocation.

37. See generally Galbraith, *Monopoly and the Concentration of Economic Power*, in AM. ECON. ASS'N, A SURVEY OF CONTEMPORARY ECONOMICS 99, 113 (Ellis ed. 1949); Rothschild, *Price Theory and Oligopoly*, 57 ECON. J. 299 (1947); Sweezy, *Demand Under Conditions of Oligopoly*, 47 J. POL. ECON. 568 (1939). One may wonder, however, how long these conditions, based as they are on lack of mutual information and trust, will last.

38. Unless, of course, the added costs were fixed as to output and the monopoly did not use cost plus pricing.

ated. While true monopolies scarcely exist in our economy, a similar result might occur where an industry composed of a loose knit oligopoly produced substitutes for goods produced by a much more closely organized oligopoly. In the latter there could well be an "understanding" that when costs rose, prices would also be raised, or an "understanding" that if one firm raised prices, the others would follow suit. Such an industry would behave similarly to a pure monopoly, and would raise prices in response to an increase in costs, if these costs varied with output.³⁹ The more loosely organized oligopoly, however, would be unlikely to raise its prices, and its relative over-production would be accentuated.

In sum, there are many situations—probably the most significant ones—where placing losses on the activity which causes them would serve to foster better resource allocation, despite varying degrees of monopoly power, and where failure to do so would cause grave misallocations. This would be particularly true where industries producing rough substitutes have essentially similar degrees of monopoly power. And even in some situations where competitive industries produce goods which are reasonably close substitutes for the products of relatively monopolistic industries, a favorable resource-allocation effect follows from enterprise liability. Undoubtedly, there are also situations where enterprise liability would cause no resource allocation effect at all. Such a situation might be one in which industries producing rough substitutes were each oligopolistic and failed to change price and output as a result of increased costs (or where the added costs were fixed as to output), and in which all firms in the industries involved were making sufficient extra profits to survive the loss in profits entailed by such an unshiftable cost item.⁴⁰

In some cases the introduction of enterprise liability for accident costs will work against the allocation-of-resources theory. These are cases in which two misallocations tended to cancel each other out and the correction of one of these wrongs by adding accident costs would actually accentuate misallocation of resources. Such a situation would exist if a competitive industry produced goods which were rough substitutes for the products of a monopolistic industry, if the monopolistic industry had higher accident costs than the competitive one, and if the monopolistic industry were in a position where its profits would

39. See generally FELLNER, *COMPETITION AMONG THE FEW* ch. VI, at 175-83 (1949); Rothschild, *supra* note 37, at 452-57.

40. Another instance where placing accident costs would have no useful effect on resource allocation is the exceedingly rare case where the products of an industry have no significant substitute at all. In such a case the same amount would be produced by the industry, though at a higher price, whatever costs were placed on it. See BOULDING, *ECONOMIC ANALYSIS* 120-31, 143-44 (3d ed. 1955).

In all these cases a significant resource allocation effect might occur if placing of accident costs on the industry caused it to change the resources used in the production of widgets, even though the added costs made no difference in the price and output at which widgets were sold. Thus an important effect from the standpoint of resource allocations would come about if more aluminum and less steel were now used in widget making because steel had higher accident costs than aluminum.

be affected least by a cost rise if it reacted by raising prices and decreasing output. While such a situation may, and undoubtedly does, occasionally exist, it is fair to say that cases where enterprise liability would enhance proper resource allocation greatly predominate.⁴¹

Some Tentative Conclusions

We are now in a better position to understand what may be meant when it is said that masters "should" be liable for the torts of their servants, but should "only" be liable for them if they occur in the scope of the servants' employment. Similarly, we can now understand the "arising out of or in the course of employment" limitation on workmen's compensation. More detailed analysis of the specific legal doctrines of workmen's compensation, respondeat superior, and independent contractor will have to wait until we have discussed the other elements in what is called risk distribution—the other pieces of our puzzle. But it is not difficult to see that whatever the other elements in risk distribution will show, allocation of resources gives quite substantial support to doctrines which rely essentially on an enterprise concept of scope of liability.⁴²

Proper resource allocation militates strongly against allocating to an enterprise costs not closely associated with it—"liability should be limited to injuries arising out of or in the course of employment." But it also militates for allocating to an enterprise all costs that are within the scope of that enterprise. "The enterprise is held liable for the injuries even though no fault on its part can be shown." Not charging an enterprise with a cost which arises from it leads to an understatement of the true cost of producing its goods; the result is that people purchase more of those goods than they would want if their true cost were reflected in price. On the other hand, placing a cost not related to the scope of an enterprise on that enterprise results in an overstatement of the costs of those goods, and leads to their underproduction. Either way the postulate that people are by and large best off if they can choose what they want, on the basis of what it costs our economy to produce it, would be violated.

In view of the weaknesses of resource allocations as an exact theory there is no need for a rigid relation between losses and the scope of the enterprise. No

41. This is as good a place as any to call attention to another reason why the resource allocation justification cannot be pushed to extremes. Many companies which produce several goods allocate costs to these separate goods somewhat arbitrarily. It could well be that under such a system accident costs caused essentially by one item might be charged to several and reflected in the prices of each. Such a system would result in some misallocation of resources. Much needless time could be spent in analyzing whether placing of accident costs on specific industries helped or hindered this misallocation. The very fact that the firms involved do not find it worth their while to allocate the costs more precisely indicates, however, that the misallocation cannot be too significant. If, then, we are concerned only with avoiding major misallocations in tort law, this imperfection need not trouble us unduly. From this point of view, therefore, the question is not unlike the problem of the misallocations inherent in cost plus pricing. See note 32 *supra*.

42. It does not explain, however, why the master should only be liable for injuries caused by his servant's fault. See generally text at notes 134-35 *infra*.

serious misallocations are likely to occur if the scope of an enterprise is broadly or narrowly interpreted. Reasons for a broad or narrow interpretation will perhaps appear from the other justifications of risk distribution. But insofar as the allocation-of-resources justification is concerned, there are too many minor misallocations for it to matter at all if we don't have a perfect system for deciding what enterprise is exactly responsible for what injury. Nonetheless, it is equally clear that if people are to have any intelligent role in deciding what is to be produced, liability must finally be limited by some criterion connected with the scope of the activity charged.

We can also begin to see why strict fault liability had such a strong vogue from the middle to the end of the 19th century. Many factors were involved, of course. Not the least among them is the fact that the justifications for the risk spreading and "let the rich man pay" elements in risk distribution were not such as would commend themselves to a 19th century Weltanschauung. But, on the other hand, the allocation-of-resources theory would seem to fit in with the 19th century approach to output and production as much, if not more, than with the 20th century one. Why then did it play so small a role in the choice of a system of loss allocation?⁴³

43. One reason why resource allocation may have played so small a role in tort law during the 19th century might be that 19th century thinkers placed too much reliance on the way people theoretically react to having a risk put on them, rather than on the way they react in practice. The 19th century was a time when the "rational," "all-knowing," economic man was in vogue, and in a world populated by such men, proper resource allocation would often result no matter who bore the initial risk of loss. Thus, the "rational" worker in a purely competitive world would demand higher wages if his job involved a substantial risk of accident and the company did not provide him with insurance for it. As a result, putting accident costs on worker or company would not matter. The price of the goods produced by the enterprise would reflect the costs either way. Similarly, the consumer—in this 19th century world of theory—would evaluate the risk of trichinosis in deciding to buy canned meats. And the risk involved would affect the purchases of such meats as much as if the producer had had to pay damages to trichinosis victims and had raised his prices as a result of his added costs. Nor would the 19th century be much concerned with whether the worker or consumer *insured* against the risk, because insurance would be important from the viewpoint of risk *spreading*, not of allocation of resources. So long as the money value of the risk influenced the worker's or consumer's market behavior, it would accomplish the proper resource allocation effect whether loss spreading occurred or not. In the real world, of course, it is most unlikely that workers and consumers would evaluate this risk of injury or of trichinosis as accurately as the producer who is made to pay damages. See text at notes 22-25 *supra*. But that real world seems much more real to us than it did 80 years ago.

While this may explain some of the 19th century approach I do not think it explains all of it. In the first place some instances in which enterprise liability would accomplish better allocation of resources do remain, even if "rational economic men" are assumed throughout society. *Ibid.* In the second place, the whole "rational economic man" approach strikes me as so unreal that I cannot fully believe that men as practical as judges often are could fully buy it. I therefore feel that their reasoning, even when placed on these grounds, must have been bolstered by a feeling that in practice the decisions establishing liability only when there was real fault, actually accomplished an important and very real economic function. What that function might have been is discussed in text.

Perhaps the answer can be found in the rather peculiar state of industry at the time. In the early days of the industrial revolution many industries were operating on a decreasing cost basis. That is, if an industry could expand sufficiently its costs would fall as a result of that expansion. It is an interesting fact that in cases where an industry is operating on a decreasing cost basis a subsidy to that industry will probably help, rather than hinder, proper allocation of resources.⁴⁴

An example may help. Widget-maker Taney has such high costs in making widgets that he must sell them at a price which only the rich can afford. As a result he makes few widgets. If he could sell at a lower price, however, many more people would want to buy widgets. If he could reach this greater level of production his costs would be sufficiently low to enable him, after a time, to meet them all and to sell all the widgets he produced. Taney, however, cannot just start producing at this much higher output, if for no other reason than that he would go broke, selling widgets so cheaply, before his costs would drop. If he had a subsidy, however—if he did not for some years have to meet all his costs—he would be able to establish himself at the higher output, and in the long run all people would be better off. There would be a widget in every pot, as well as in every garage.

If this was the situation of most American industry in the 19th century—and the fact that high tariffs were being justified even by “free trade” economists at the time, on just this ground, indicates that it was—then an argument could be made that proper “long run” allocation of resources required that industry be spared from paying hidden accident costs—at least unless other factors like fault were involved.⁴⁵ I do not suggest, of course, that 19th century judges made the transfer to fault liability on the basis of this rather complicated economic theory. But their statements that nonfault liability would deprive our land of the benefits and promises of industrial expansion may represent a rough and ready, noneconomist’s, way of recognizing the fact that industry was simply not ready to bear all of its costs, and that the country would in the long run be better off if it did not.⁴⁶ To this extent these phrasings are no

44. See, e.g., PIGOU, *ECONOMICS OF WELFARE* 183-95 (4th ed. 1932). My somewhat crude and over simplified statement resembles rather more Pigou’s much criticized earlier version than the more elegant treatment in his later editions. See PIGOU, *op. cit. supra* 189-96 (2d ed. 1920). See generally SAMUELSON, *FOUNDATIONS OF ECONOMIC ANALYSIS* 196 (1953). For the limited purposes of this article, however, either statement seems close enough.

45. If widgets were substitutes for didgets, and didgets also needed a subsidy to reach their best levels of production, any difference in subsidy caused by differing accident costs in the two industries would result in a misallocation of purchases between didgets and widgets. If, however, this misallocation was relatively small compared to the benefits expansion might bring, a society could easily be justified in ignoring it, if ignoring it would help accomplish the desired expansion.

46. See, e.g., *Clifton Iron Co. v. Dye*, 87 Ala. 468, 6 So. 192 (1889); *Madison v. Ducktown Sulphur, Copper & Iron Co.*, 113 Tenn. 331, 83 S.W. 658 (1904); *Losee v. Buchanan*, 51 N.Y. 476, 484 (1873). See also Gregory, *supra* note 5, at 368; Leflar, *supra* note 12, at 579.

different from those of modern writers who, conditions having changed, say without further analysis that enterprises "should" bear all the accident costs they cause, regardless of fault.⁴⁷

Of course, the fact that a subsidy may have made sense does not suggest that the injured worker should have been the one to pay the subsidy. Today we would be inclined to have the subsidy come out of taxes—either a general tax, or one on those who benefit most from the innovation. This is, however, giving a 20th century answer to a 19th century question. For, the reason we quite properly find the idea of workers subsidizing industrial expansion intolerable is because we are wedded to "risk spreading" and "deep pocket" notions, and these are notions which did not appeal especially to the 19th century mind. (In addition, industry itself would have borne a heavy part of the burden of taxes; subsidization through taxation might, therefore, have discouraged industrial expansion in the same way as nonfault liability.)

The fact that the allocation-of-resources theory could in the 19th century justify a result we would deem outrageous today does not, of course, make it valueless now when it supports results which we sometimes—though, by no means always—approve on other grounds. It does suggest, however, that these other grounds are not unimportant. And it is to them that we should now turn.

THE SPREADING OF LOSSES JUSTIFICATION

Introduction

The justification for allocation of losses on a nonfault basis which is found most often among legal writers is that if losses are broadly spread—among people and over time—they are least harmful.⁴⁸ First, the theory runs, the real burden of a loss is smaller the more people share it. Second, the theory argues, the longer the time over which the total money burden of a loss is borne, the smaller its real burden will be.

Analogues to these views can be found in economic theory. The advantages of interpersonal loss spreading would probably be stated in terms of two propositions; (a) that taking a large sum of money from one person is more likely to result in economic dislocation, and therefore in secondary or avoidable losses, than taking a series of small sums from many people,⁴⁹ and (b) that even if the total economic dislocation is the same, many small losses are preferable to one large one, simply because people feel they suffer less if 10,000 of them lost \$1 than if one loses \$10,000.

While the first of these propositions is an empirical generalization not too difficult to accept, the second is in its precise terms a variant of the economist's theory of the diminishing marginal utility of money. This theory has been in

47. See note 5 *supra*.

48. See, *c.g.*, 2 HARPER & JAMES 759-64 (collecting authorities).

49. This statement of the proposition is, of course, not in the least original. See, *e.g.*, Fezer, *Capacity to Bear Loss as a Factor in the Decision of Certain Types of Tort Cases*, 78 U. PA. L. REV. 805, 809-10 (1930).

substantial disfavor among modern economists. The reason for this disfavor is illustrated by recent studies which have indicated, for example, that a loss of a relatively small amount of money, if it results in a change in social status, may be nearly as significant to an individual as a much larger loss which causes an approximately equal change in his social position. On the other hand, a relatively small loss, if it can be borne without giving up certain symbols of social status—be they the house on the right street or the television set—feels infinitely smaller to people than an only slightly larger loss which does involve a change in status.⁵⁰ While this indicates the weaknesses of such a strict utilitarian pain-pleasure analysis as the marginal utility of money theory, with its implication that a loss of \$5 divided among five people necessarily hurts less than \$5 on one person, it does not detract much from the basic justification for loss spreading. We need merely take an additional step and recognize that social dislocations, like economic dislocations, will occur more frequently if one person bears a heavy loss than if many people bear light ones. One can, of course, conceive of situations where the extra \$1 charged to one thousand people would be one thousand straws which would break one thousand backs and ruin one thousand homes or businesses, while \$1,000 charged to one person would only ruin him, albeit thoroughly. But such situations seem mildly unlikely.⁵¹

The economic bases of inter-temporal loss spreading are not dissimilar. There is less danger of economic dislocation, and hence of secondary losses, if losses are spread over time. Social dislocations are also less likely if individuals can buy their risk-of-loss burden on a long term credit plan.

Thus, there are substantial reasons for allocating losses in ways which spread the burden over as many people and over as long a time as is possible. If these were the only aims in allocating losses, however, the most desirable plan would be some sort of governmental accident relief program spread over the population through taxes—Sparta would be better than Athens. But in view of the conflict between this system and the best system from the standpoint of resource allocations—enterprise liability—a government-responsibility plan should not be embraced without some consideration of what loss spreading is in fact accomplished by enterprise liability.

Insofar as enterprise liability places the burden of accidents on the most likely insurer, it accomplishes directly a fair amount of both interpersonal and intertemporal loss spreading. Advocates of enterprise liability argue that it is

50. See generally Friedman & Savage, *The Utility Analysis of Choices Involving Risk*, 56 J. POL. ECON. 279 (1948). Even before the Friedman-Savage approach the notion of diminishing marginal utility of money had fallen in substantial disfavor with economists. Some reasons for this disfavor are given in *ibid.*, and in Blum & Kalven, *The Uneasy Case for Progressive Taxation*, 19 U. CHI. L. REV. 417, 455-79 (1952).

51. The idea that secondary social effects are more likely when losses are concentrated may also derive support from the notion that peoples' wants are substantially dependent on the wants of their neighbors. Thus, C. J. Taney may feel his losses less if C. J. Marshall and C. J. Chase, his neighbors, suffer like losses. See generally DUESENBERY, *INCOME, SAVING AND THE THEORY OF CONSUMER BEHAVIOR* (1952).

yet a better loss spreader because it results in "secondary" loss spreading, that is, it spreads losses beyond enterprises to consumers and resource owners. This is accomplished through the prices enterprises pay for the resources they buy and the prices they get for the goods they sell. But the extent to which enterprise liability in fact succeeds in accomplishing this secondary spreading, without creating significant secondary losses, depends in part on the structure of the industry involved, in part on the nature of the costs charged, and in part on general economic conditions.

Enterprise Liability, Loss Spreading, and Competitive Industries

In industries operating under essentially competitive conditions enterprise liability results in substantial secondary loss spreading through wages and prices; this is true at least when accident costs vary with output or with the use of some specific resource in production. The added cost—if it is significant enough to matter—results in (a) decreased output and higher prices, and (b) lower payments to, and decreased use of, those resources giving rise to the extra cost, assuming that these can be identified. That is, under enterprise liability Taney and his competitors would react to their increased costs by reducing output. (The other alternative, raising prices, is not available to them as small producers in a competitive industry. Soon enough, however, as the output of the industry fell, prices would rise.) Taney would also try to make widgets out of aluminum if steel caused many of the accidents, or out of steel if aluminum caused them. He might bring in machines if he found that accidents resulted from using labor at a particular part of the widget-making process; he would increase the proportion of labor if machines caused injuries. In all these ways Taney would shift some of the accident expense burden forward and some of it backward to the accident prone resource.⁵² Nevertheless, some of it would remain on Taney and his fellow producers in the form of decreased profits.

For example, Taney presumably had some reason for using labor instead of machinery. That reason was, most likely, that labor was cheaper so long as Taney did not have to bear the accident costs it caused. Yet, while machinery is cheaper than labor plus accident costs, it is not as cheap as labor without accident costs. Before the imposition of enterprise liability Taney's labor cost was twenty doubloons, the cost of using machinery instead was twenty-five. After enterprise liability, machinery—which is accident free—still costs twenty-five, while the addition of accident costs to the price of labor has raised the cost of labor to thirty. Taney will not bear the full additional ten doubloon burden from the continued use of labor; he will shift to machinery. But twenty-five, the cost of machinery, is still more expensive than twenty, the cost of labor

52. These changes not only tend to shift the loss, but in themselves are a recognition that at the newer "true" costs Taney feels that some products he used to buy are less good than others he used to shun. In other words, the shift reflects a change to better allocation of resources. See generally text at notes 13-17 *supra*.

without enterprise liability. This difference in cost Taney cannot pass backwards.⁵³ For similar reasons, the increased revenue from lower output at higher prices will probably not absorb the accident costs which remain after the partial backward shifting has occurred. And even after both forward and backward loss shifting, most Taney's will be stuck with part of the burden.⁵⁴ This means that, for a time at least, profits in widget-making would be below those in other, less accident prone, industries. After a while, however, those producers who were just making a go of widget-making before accident costs were placed on the industry would drop out, and the profits of the others would return to normal.

The transition to enterprise liability would place a definite nonshifted burden on all producers in an accident prone industry, but especially on those who were just making a go of it before the shift to enterprise liability. In the long run, however—assuming that those firms which wanted to get out could in fact get out—the system would accomplish nearly complete loss spreading. Those firms which remained in the industry would charge prices sufficiently high to pay for insurance (or self-insurance), and few enough firms would remain in the industry to allow such prices to be charged. The extent of the burden on the producer who was just making a go of it, and the likelihood of secondary economic dislocations, would depend on the suddenness with which enterprise liability were adopted and on whether our economy was expanding, stationary, or contracting at the time.⁵⁵ In a stationary or declining economy, firms would likely be forced out and substantial secondary economic and social effects would probably occur if general nonfault enterprise liability were suddenly to be imposed.⁵⁶ In an expanding economy, however, no such secondary effects

53. This statement is not fully accurate since the price of labor may fall as a result of the shift away from labor induced by the imposition of accident costs. It is, therefore, conceivable that the price of labor in any given industry might fall below twenty-five doubloons (the cost of machines in the text example) and that less than five doubloons would remain unshifted. Indeed there might even be situations where the whole burden of accident costs might be shifted back to labor. But such situations would require a) that the supply of labor be entirely unchanged despite decreased wages and b) that the labor involved be so specialized that it could be used virtually nowhere else, two assumptions which are most unlikely. See notes 59, 61, 62 *infra* and accompanying text. *E.g.*, note 40 *supra*.

54. See note 62 *infra*.

55. The extent of the burden would also depend on how much more a carefully administered program of enterprise liability without fault would cost firms than does the current system. For, while the current system certainly results in less frequent liability damages than would a nonfault arrangement, a nonfault system might result in considerably smaller damage awards. As a result the total cost increase might not be terribly significant.

56. This analysis does not take into account what effect the compensation of accident victims on a nonfault, enterprise liability basis might have on the demand for goods in the economy as a whole, and in the industries most burdened by the change. It does not do so simply because I do not think it is possible to tell. The immediate effect is to shift money from one group of people to another, and just what this will mean in terms of consumer preferences cannot be determined without much more information than is now available.

need occur. For the only effect would then be that the industry would fail to grow as fast as other, less accident prone, industries.⁵⁷

If instead of varying according to production volume or resources used, accident costs were fixed regardless of output and resources, there would be no immediate secondary risk spreading as a result of enterprise liability. The extent to which secondary risk spreading would occur over a longer period of time would depend on how easy it was for firms to leave the industry. If accident costs were constant regardless of output, there would be no incentive on the part of the individual firm to reduce output, since the added fixed cost would not change the equilibrium point of price and output at which profits are maximized. Because output would not change, neither would price, and none of the added burden would be shifted to consumers. Correspondingly, if accident costs did not vary according to the resources used in production, no amount of shifting among resources used would spread the burden back among resource owners. Hence, profits in the industry would be lowered.⁵⁸ Again, producers who were just getting by would feel the pinch, only the pinch would now be greater since no immediate secondary loss spreading would have occurred. In time, however, these high cost firms would drop out, and a price high enough to maintain insurance (or self-insurance) covering the losses charged to the industry would be established. Thus, here too the extent of the

57. The bad effects of the transition might be considerably altered if the change from an absolute fault standard to enterprise liability were gradual instead of sudden. To a large extent that is what has been happening in the last 50 years or so. See generally the brilliant treatment of this whole area by EHRENZWEIG, *NEGLIGENCE WITHOUT FAULT* (1951).

58. Widget maker Taney can make widgets with aluminum or steel. He decides to use steel because steel widgets are as good as aluminum widgets, and are less expensive. He is suddenly charged with the accident costs of widget making. After some study he finds that the accident costs are the same if he uses steel or aluminum. Unless he is completely irrational he will continue to use steel. And if he were to change to aluminum, it would only increase his burden; his accident costs would be unchanged but he would also be bearing the extra cost of aluminum. It is clear that no decrease in his cost burden could be accomplished by shifting among the resources he uses.

The same analysis applies on the price-output side. Taney makes the most money he can when he sells 100,000 widgets at \$1 each. Let us assume that accident costs are placed on him which are constant as to output—that is, they are the same whether he sells 1 or 100,000 widgets. One hundred thousand widgets at a \$1 per widget necessarily remains his most profitable output and price; nothing has happened to change this fact. If Taney changes his output as a result of the new costs, he only adds to the accident costs which he has been forced to bear the costs of producing at an output which is not the most profitable. If he tries to change his price, he loses the benefit of selling his widgets at the best price possible, and therefore adds a decrease in his revenue to the increase in his costs. It follows that Taney is best off bearing his added costs and changing nothing else. Nor does cost plus pricing, see text at notes 32-34 *supra*, help, for all cost plus means is that Taney would automatically react to the new accident costs by raising prices somewhat. But as we have seen, if the accident costs are constant with output, raising prices only adds an unfavorable price to the new cost burden and doesn't help Taney at all.

For reasons given in the text, this analysis applies to the short run only—that is, only until Taney or some of his competitors decide it is no longer worth while making widgets, given the high accident cost burden which widget makers now bear.

unspread burden would in the long run depend on whether the economy was expanding or stationary at the time liability was imposed, and on the abruptness with which the change was made.

The problems of loss distribution would be much greater, however, in industries where exit was difficult—industries with high fixed costs, those using one highly specialized resource, or those in which for other reasons mobility and flexibility of plant and labor was small. For then profits would continue subnormal over a long period of time, and all the undesirable secondary social and economic effects associated with sick industries would manifest themselves. In addition, in such cases the pressure on firms not to insure and to take their chances might become enormous, with the result that even the primary loss spreading potential of enterprise liability would be lost. All these horrors would, of course, be especially likely if the economy were in a general state of decline at the time liability was imposed. For in a rising economy no exit would be necessary, and, in a stationary economy, mobility might well be sufficiently large to get firms out quickly enough to ease most of the burden, at least if the accident costs imposed were not huge. Needless to say, the dangerous effects of difficult exit would be nearly as applicable to situations in which accident costs varied with output or with a specific resource used. In those cases, however, since some immediate secondary loss spreading does occur, the unspread loss burden would be less likely to be as great, with a correspondingly decreased pressure on marginal firms.

If the industry involved did not compete even to a slight degree with other industries having lower accident costs, or if the accident costs arose entirely from the use of a resource which was fixed in supply and which could only be used in that industry, then the entire liability could be shifted immediately—to the consumers in the first case, and to the owners of the accident prone resource in the second. That such a situation would exist for any length of time on the supply side is unlikely. It might well exist on the demand or consumer side for small price increases, but it would be unlikely to exist for major ones. Thus, widgets may be so different from all other goods that people will buy as many widgets at \$1.00 as they did at 80¢. But if the price of widgets rose to \$5.00 some people would make do with one widget instead of two, while others would stretch the use of each widget. More important, gumboes—which serve about the same purposes as widgets, but which cost \$5.10—might now compete with widgets, though they could not do so when widgets cost only \$1.00.⁵⁹

To sum up loss spreading in competitive industries: The amount of immediate secondary loss spreading forward to consumers depends on the degree of

59. A similar situation was said to exist in the cigarette industry at one time. Thus, standard brands suffered virtually no competition from low price brands so long as the price difference between them and the low price brands was less than three cents per pack, but came into severe competition with these brands whenever the differential became more than three cents. See Tennant, *The Cigarette Industry*, in ADAMS, *STRUCTURE OF AMERICAN INDUSTRY* 337 (rev. ed. 1954).

competition between the industry involved and other industries less subject to accident costs.⁶⁰ Similarly, the amount of immediate secondary loss shifting back to the owners of resources used in production depends on the availability of substitute resources whose accident costs are not as high, as well as on the alternative uses available for the resources substituted or discharged.⁶¹ Specifically, the amount of loss spreading forward will depend on how much raising the price of widgets will cut down on the number of widgets sold. In the same way, the amount of loss shifting backward will depend on how good a substitute, both in price and quality, steel is for aluminum in widget-making (assuming aluminum has higher accident costs than steel). But it will also depend on how much aluminum is used outside widget making, for this will affect how far aluminum makers are willing to cut their prices to keep selling aluminum to the widget barons. As we noted before, however, even with backward and forward shifting, some of the loss will not be shifted and will remain on the enterprise.⁶²

Because of the unshifted burden, subnormal profits would occur and would culminate, in a stationary or declining economy, in industry contraction through loss of firms, or in an expanding economy, in industry failure to expand. If contraction occurred reasonably quickly, the prime sufferers would be the high cost firms, and losses that in a more favorable economic climate might have been more widely spread through enterprise liability might well be reconcen-

60. Insofar as an industry competed with industries having higher accident costs, it would benefit from the fact that its competitors would be under even greater pressure to raise prices than it was.

61. The analysis here described is closely analogous to analyses of the incidence of special taxes. See, *e.g.*, Break, *Excise Tax Benefits and Burdens*, 43 AM. ECON. REV. 577, 577-84 (1954) (and authorities there collected); Compare SELIGMAN, *SHIFTING & INCIDENCE OF TAXATION* 217-54 (5th ed. 1932).

62. See text at notes 53, 54 *supra*. Generally, unless losses can be shifted 100% in one direction or the other, there will not be an immediate total shift in losses, since what can be shifted in either direction is always a per cent of any of the cost not otherwise shifted. While this statement is usually accurate it might not work out in specific situations. Roughly, very roughly in fact, the statement posits that if 25% of any burden can be shifted backwards, and 50% can be shifted forward, this does not mean that 75% can be shifted. It only means that 25% can be shifted backwards and that 50% of the remaining unshifted 75% can go forward—*i.e.* a total of 62½% can be shifted (the result is, of course, the same if one starts by shifting 50% forward and 25% of the remaining 50% backwards). Under this analysis a shift of 100% in one direction is needed if the total burden is to be shifted. This result need not occur, however, if competition is virtually nonexistent at one price but becomes acute at a higher level. Assume a widget maker can add 10¢ per widget to his price without feeling any substantial competition from gumboes, but that if he adds more than 10¢, accident free gumboes, which sell for about 15¢ more than widgets, will start cutting heavily into the widget market. Accident costs totaling 15¢ per widget are placed on the widget maker. If he can shift over ½ of the new burden backwards by making widgets with aluminum rather than steel, he can probably shift the whole burden, since price rises up to 10¢ per widget will not affect sales. If he cannot shift more than 2¢ backwards, he probably will not be able to shift more than 10¢ forward and, in the short run at least, will have to bear the difference.

trated on them.⁶³ Once the adjustment was made, either through contraction or failure to expand, no further burden would be borne by the industry, and enterprise liability would accomplish quite complete loss spreading. If exit from the industry were difficult the problem of transition—in a nonexpanding economy—might become chronic, and the burden on high cost firms intolerable. Under these circumstances, the primary loss-spreading effect of enterprise liability might even be lost—firms just barely able to get by might find themselves sorely tempted not to insure. Of course, if the cost burden not directly shifted forward or backward were small, then the whole problem of transition to enterprise liability would be insignificant.

Enterprise Liability, Loss Spreading, and Monopolistic Industries

In industries with a substantial amount of monopoly power enterprise liability would leave at least some of the burden permanently on the industry in the form of decreased profits. On the other hand, in such a situation enterprise liability would be unlikely to create a chronically sick industry or to concentrate losses through the elimination of firms.

If the industry were one in which there was substantial control over price and output—monopoly, close-knit oligopoly, or price-leader industry—and if the added costs varied either with output or with use of a particular resource in production, some of the loss could be shifted forward to consumers or backward to owners of the accident prone resource. Forward shifting, however, would be much less likely to be as complete as in competitive industries. A complete monopoly normally sets its price at a high enough level so that any further price rises would result in a substantial loss of sales. A close-knit oligopoly may not reach the best “monopoly” price, but it is unlikely to be far away. Hence, any price rise contemplated because of the taxing of accident costs on either the monopoly or close-knit oligopoly would be likely to cause a substantial decline in sales, and therefore to result in only slight shifting of the cost burden. Of course, the decrease in the industry’s sales would be lessened to the extent that competing industries with substitute products, also raised prices because of added accident costs.⁶⁴ But the industry with high ac-

63. From the standpoint of allocation of resources this would, of course, be a good thing. But the concentration of losses on the workers in these firms and on those who invested in them might nevertheless offend “risk spreading” notions.

64. It may strike the reader as strange to speak of monopolistic industries competing with other industries or, to use the term employed earlier in the article, producing substitutes for the products of other industries. The concept may be easier to grasp if one imagines an industry which at some prices has relatively few substitutes but which at higher prices has a substantial number of substitutes. Because the industry has very few sellers in it, the price which becomes established is very close to that at which substantial competition arises. Any further price rises in the monopolistic industry will cause a substantial loss of sales. Yet the industry is monopolistic in that it produces less, and at a substantially higher price, than it would were it freely competitive. Cf. Lerner, *Monopoly and the Measurement of Monopoly Power*, 2 REV. ECON. STUDIES 157 (1934); *United States v. Du Pont*, 351 U.S. 377, 414 (1956) (majority and dissenting opinions) (indicating that such a market structure is far from fanciful).

cident costs would probably find great difficulty in shifting to the consumer any part of the differential between its accident costs and those in its competitor industries. Moreover, what cannot be immediately shifted forward or backward will usually not be shifted at all. Since firms in monopolistic industries make more profits than can be made elsewhere, the fact that profits would decline because of the added, unshifted costs would not normally be enough to force exit from the industry. And the decrease in profits would, therefore, remain permanent.⁶⁵

In industries where price changes are difficult, such as loose-knit oligopolies, still less loss spreading would occur. It is self-evident that unless an industry could change prices or output no shifting of costs would occur.⁶⁶ But how likely is it that an industry would not be able to change prices or output? It is probably not too likely to obtain for any long period of time. And the greater the cost burden imposed, the more likely would a firm be to take a chance and raise prices, hoping that the other firms would follow. Indeed, a well advertised cost rise might even be an excuse for a long desired general price rise throughout the industry. And, of course, if a price rise were accomplished the situation would not be dissimilar to that of a close-knit oligopoly.⁶⁷ But if none were possible, all of the added costs would remain on the firms, at least until some "understanding" were to be reached within the industry that prices had to be changed.⁶⁸ Exit from the industry would not be likely because profits, even in loose-knit oligopolies, are probably sufficient to bear extra costs. And in all events, before a firm went under it would in all likelihood try a price rise, a move which would probably be followed by all, if the industry were real-

65. If the accident costs were sufficiently huge, of course, even a monopolist might find that his profits were eaten up and that he could no longer produce. This situation might be more likely in a close knit oligopoly where one of the producers had costs substantially higher than those of his competitors. Such a high cost producer might well find himself forced out by cost rises which hardly bothered his more efficient co-oligopolists. Similarly, it might happen that an essentially monopolistic industry had, at its fringes, a few small producers. These might be tolerated either because they did not rock the boat or because of fear of government action if they were driven out. Were these small producers as efficient as the firms which dominated the industry, the accident cost burden would not be likely to affect them. Were they instead high cost firms, a situation might arise where placing accident costs on the industry would result in their destruction, with the concentration of losses this would imply. Such a result might also cause a strengthening of the monopolistic structure of the industry.

66. An oligopoly might, however, still be able to shift part of the burden backwards to the owners of the resources it employed.

67. This is so except in the case in which the established price is not the most profitable and yet cannot be changed for fear that other firms will not follow. In this case the advent of a well advertised cost rise may be used by the firms as an excuse for changing prices not just enough to take into account the new cost rise but enough to reach the most profitable price. One can even conceive of a situation where the price which had been established was so undesirable that the added costs, by giving the firms in the industry an excuse for making a change, increased rather than decreased profits. *Cf.* note 37 *supra*.

68. See note 39 *supra* on such "quasi agreements" in oligopoly.

ly not making profits.⁶⁹ On the whole, then, immediate secondary loss spreading would be somewhat less likely in loose-knit oligopolies than in tight ones, and long run secondary loss spreading not much more likely.

If the costs allocated were fixed with respect to output and resources used, then no spreading—beyond that achieved by insurance itself—would occur in a monopolistic industry, whether it be a loose or close oligopoly, or a complete monopoly. Any change in price or output would only decrease profits, at least if the firms were producing at the most profitable price and output before the fixed accident costs were charged to them.⁷⁰ This is because accident costs would be the same regardless of output; there would, therefore, be no reason to think a new price-output combination would be better after the imposition of accident costs than before.⁷¹ Again, if firms left the industry as a result of the added, unshifted costs, prices would rise; and in time the burden would go to the consumers. But, again, the presence of excess profits which inhere in monopolistic industries would make exit unlikely. The fact that no exit would be needed while precluding long run loss spreading, of course, also decreases both the chance of any concentration of losses on high cost firms and the likelihood of the industry's undergoing the difficulties which the transition to enterprise liability might cause in competitive industries.⁷²

To say, however, that in a substantial number of cases some or all of the costs placed on monopolistic industries would not be spread forward to the consumer or backwards among the resource owners is not to end the matter of loss spreading. Decreased profits themselves, for instance, are often spread—through decreased dividends—if the firm owners are at all numerous. But a special problem would arise if the firm whose profits declined were singly owned or family owned. Would we not have just taken from one guiltless party to give to another? And why should we do this?⁷³ A reason might be the allocation-of-resources justification. But as we saw, that justification is

69. Once again, a single high cost firm in a relatively wealthy oligopoly industry might find that an attempted price rise on its part was not followed. Such a firm might very well be forced out.

70. Again, in a loose knit oligopoly the cost rise might be an excuse for dropping a previously undesirable price; higher profits might then result. *Cf.* note 67 *supra*.

71. And cost plus pricing could not help. See note 58 *supra*.

72. This article has nowhere treated the case of regulated industries. The extent of risk spreading and the importance of resource-allocation effects in these industries would depend in large part on the nature of the regulation to which they were subject and the degree of competition between them and other industries. General statements are difficult to make. As a rule of thumb, however, one would expect that prices and outputs in regulated industries would be closer to competitive prices than monopolistic ones, and that the risk-spreading and resource-allocation analysis of competitive industries would probably be a good starting point, except, of course, that exit from the industry or abandonment of services previously rendered might prove difficult.

73. One can even conceive of a somewhat weird situation in which enterprise liability would concentrate losses. Assume that an industry consisted of one firm owned by one man. His company suffered 20 "fault free" accidents in an average year. A fault system would burden the 20 injured workers and their families. An enterprise liability system

weakest, though probably still valid, when monopolistic industries are involved. Perhaps another scheme for allocating losses, also termed risk distribution, will aid us in understanding why we are not too concerned with the sole proprietor in a monopolistic industry who is unable to shift the burden of accident costs which are placed on his firm.

THE DEEP POCKET JUSTIFICATION

An Economic Meaning and a Political Meaning

At one time a substantial body of economists felt, on the basis of economic theory, that a dollar removed from a rich man caused the rich man less pain than a dollar removed from a poor man, and that, therefore, shifting losses from the poor to the rich was in itself a good thing. As noted, this theory—the theory of the diminishing marginal utility of money—is currently out of favor.⁷⁴ By itself, therefore, it is not adequate support for the notion that where enterprise liability leaves losses unspread it is still justified if it places them on the rich rather than on the poor. But in terms of the aims of loss spreading—the avoidance of secondary economic and social losses—rather than the fact of spreading itself, some support for enterprise liability in these cases may nevertheless be found. For while the inability of a monopolist to shift accident losses might well cause him decreased profits and a lowered social status, secondary *economic* effects would still be unlikely to occur. This is because once the transition to enterprise liability is accomplished accident costs will be unshifted only if an industry is making more than can be made elsewhere, a situation which negates the very possibility of any secondary economic effects.

Moreover, even though we cannot say as a matter of economic theory that a dollar taken from a rich man hurts him less than a dollar taken from a poor man, we as voters are accustomed to operating under this assumption all the time. For even if the economist refuses to say that the last \$1,000 of a millionaire's income is worth less to him than the last \$1,000 of a poor man's income is worth to the poor man, the Bureau of Internal Revenue, on instructions from the people, says just that. An argument can be made for letting our system of loss allocations work the same way as our tax code—and, like Robin Hood, take from the rich, by and large, to give to the poor, more or less. This could be done either by a general government accident program paid out of progressive taxes, or through a system of liability which tended to put the burden of accidents on rich classes of litigants rather than on the poor.⁷⁵ Enterprise liability would seem likely to do just this, at least absent problems of sick industries and difficulties of transition to nonfault liability. Needless to say,

would, let us assume, allow him to pass on to consumers or back to the workers the equivalent of the cost of 10 of the accidents. The rest would remain on him; he would bear about 10 times the losses any single worker did before. Though this may be desirable, it is hardly risk spreading.

74. See note 50 *supra*.

75. Cf. MORRIS, TORTS 248-49 (1953).

whether one buys this position depends on whether one agrees with the voters' choice in favor of highly graduated taxes. And even if one does, one might still wonder whether it would not be fairer, and more honest, to do this bit of Robin-Hooding openly through social insurance and taxation. These systems seem more likely than a haphazard system of enterprise liability to work fairly and consistently—and make those whom the voters wants to have pay, in fact pay.

The Tax on Monopoly

One further aspect of the theory of enterprise liability may give that method certain advantages over social insurance backed by taxes on the relatively wealthy.⁷⁶ Once the initial, possibly painful, adjustments were made, and absent long range barriers to exit from an industry,⁷⁷ the only major case where the burden of loss due to enterprise liability would not get shifted from the primary risk bearer and broadly spread is the case of industries that enjoy extra, monopoly, profits.⁷⁸ A tax whose proceeds went to pay for accident injuries, and whose incidence was either spread very broadly or—by and large—put on monopoly profits, may well be supported.⁷⁹ Indeed, in view of our strong policy against monopoly—expressed in much legislation with deep common law roots—one might think that such a tax on monopoly profits would be the best way to pay for the unspread cost of accidents, better even than a broad system of social insurance. If one does find this essentially political argument appealing, one has substantial reason for supporting an enterprise liability scheme of loss allocation in an area where its “loss spreading” justification is perhaps weakest, and where even its “allocation of resources” support is not as strong as it is elsewhere.⁸⁰

SOME GENERAL OBSERVATIONS

At the end of this rather long analysis we might well consider some of the consequences of the different justifications for nonfault distribution of losses,

76. Such a system might, of course, have an important allocation of resources effect apart from any “deep pocket” advantages.

77. Permanent barriers to exit cannot exist. Sooner or later people will get out of a business or just stop entering it, and it will die out. This does not mean that it may not be quite a long while before this comes about.

78. Unfortunately, another area where the loss burden might not be spread is the area of rapidly growing industry. For here, too, “extra” profits may be made. And it is rather difficult to view a tax on growing industry as especially desirable.

79. Of course, the actual owners of the company at the time the burden was imposed might very well not be those who had organized the monopoly and reaped the extra profits. As a result, the tax would have to be justified as being on the monopoly business rather than as cutting down on the extra profits of “rich” monopolists.

80. For the reasons given in notes 78-79 *supra*, and also because I happen to like my Robin Hooding done more openly, I do not find the tax-on-monopoly notion too appealing politically. But I think that the combination of loss spreading in some areas, and resource allocation in most areas, presents an adequate justification for enterprise liability apart from a tax-on-monopoly notion.

and some inconsistent results these theories would seem to require. Perhaps the most dramatic inconsistencies exist between some of the requirements of the allocation-of-resources justification and the loss-spreading justification. The treatment of losses which are definitely caused by enterprises, but which could not be foreseen by those enterprises—and which are therefore probably not insured against—is a strong example. Unless they were covered by a general state social-insurance program, such losses would be unlikely to be thoroughly spread. They would be left either on the injured parties or on the enterprises which engendered them. It is because of this absence of spreading through insurance that Professor Ehrenzweig, in his thought-provoking treatment of the problem, suggests that in these situations enterprise liability should not apply.⁸¹ But the allocation-of-resources justification would require the enterprises to bear these costs as much as foreseeable ones.

Insofar as resource allocation is concerned, such losses are just as truly costs of producing particular goods as are more foreseeable risks. Lack of foreseeability makes it somewhat more difficult to include these costs in the price of the item produced, but does not make it impossible. Industries with more than their share of unforeseeable losses—and, as a result, more than their share of bad years or failures—get reputations for being risky. Fewer firms enter such industries and, over time, higher prices prevail. Thus, the desired allocation effect is accomplished. Higher prices do not mean, however, that any substantial loss spreading occurs. They only mean that entrepreneurs in such industries make greater profits, subject to the danger that, when the risk strikes, one of them may be so severely damaged that he will never recover his losses, or that he may be wiped out altogether. In such cases undesirable secondary social and economic losses would, of course, follow.

None of this would occur if instead of being handled by a system of enterprise liability risks of all injuries were covered by a general state accident program. But neither would these losses be reflected in prices under such a scheme. Advocates of allocation-of-resources enterprise liability would argue further that though such secondary losses seem harsh, they are a necessary part of any free enterprise system. Entrepreneurs always take “uninsurable risks”—indeed, the danger of going into business, which, many economists say, is the very source of “profits” in business, as distinguished from mere payments for labor or for use of capital, is just such a risk.⁸² And advocates of enterprise liability would say that this is merely another indication of how enterprise liability is really the “free enterprise” way of allocating losses, as against more collectivist social insurance plans.

Of course, it is true that enterprise liability must ultimately be supported primarily on a free enterprise argument. Though as a system of loss-spreading enterprise liability has some merits, it is still relatively inefficient. In the first

81. EHRENZWEIG, NEGLIGENCE WITHOUT FAULT 58, 60, 66, 72-73 (1951); see Note, 8 U. CHI. L. REV. 729, 736 (1941).

82. Knight, *Profit*, in AM. ECON. ASS'N, READINGS IN THE THEORY OF INCOME DISTRIBUTION 539-41 (1946).

place, we are not prepared to charge enterprises with losses which are not readily assignable to some specific activity. And, of course, many such losses do exist. If risk spreading is really important, these general losses of living would in themselves require some kind of social insurance. Enterprise liability may be similarly inefficient where the cost of collecting the loss from the enterprise is very large—either in terms of court costs, or lawyers' fees. (In such situations, neither would there be an allocation-of-resources justification for placing these losses on any activity. Indeed, the justification would run the other way. A greater misallocation is caused by incurring the avoidable costs of trying to allocate the loss than by leaving it where it falls and letting the price of the product involved understate its true costs.) At best, then, if risk spreading is deemed crucial, enterprise liability could do only part of the job; the other part would have to be filled in by some social insurance scheme.

In the second place, even in the area where enterprise liability does play its part, it would in all probability be a far less thorough risk spreader than a social insurance plan. We have seen that the danger of creating sick industries and the possibility of driving out small competitors—at least during a transition period to enterprise liability—indicate that harmful secondary economic and social effects may well occur with enterprise liability, while they could be avoided under general social insurance. This is not to say that enterprise liability would do a bad job of spreading losses; it is only to say that social insurance probably would do a better one.

Similarly, from the point of view of the "deep pocket" justification, social insurance would probably be preferable to enterprise liability. It is true that in the long run enterprise liability promises either wide loss spreading or—by and large—a tax on monopoly. But it does not tax all monopolies equally; nor does it tax wealthy men who are not monopolists. The taxing system—with all its weaknesses—is far more refined in taking from the rich and giving to the poor than enterprise liability could ever be. For all these reasons, many writers who have been concerned primarily with risk spreading or "deep pocket" have tended to view enterprise liability as, at best, a half way house on the road to social insurance.⁸³

One can argue with this position by raising questions about the actual costs of running a program of social insurance, and by suggesting that, in view of those costs, enterprise liability does what it does in the way of risk spreading pretty cheaply. Or one can go back to questions of deterrence, and to some of the other justifications for fault liability, and see whether they do not form some justification for enterprise liability as against social insurance. But the first of these approaches is not really subject to proof, and the second, though potentially fruitful, is really outside the scope of this Article, since it would involve a thorough discussion of the role fault plays in our system of loss allocation.

On the basis of the discussion in this Article, however, enterprise liability is superior to social insurance in that it promotes proper allocation of resources.

83. See, *e.g.*, 2 HARPER & JAMES 1370-74 (and authorities cited therein).

And the importance of allocation of resources increases to the extent that we value free enterprise.⁸⁴ Therefore, so long as our society remains committed to free enterprise, enterprise liability is unlikely to be relegated to the role of a stop-gap measure on the road to social insurance.

The reason that the allocation-of-resources justification is tied to free enterprise—a system of production choices based on individual decisions to buy—is that it is in just such a system that it matters most whether prices reflect all the costs of production, including accident costs. The more we deviate from such a system—the more we believe that people do *not* know what is best for them—the more we undermine the foundation of enterprise liability, the resource-allocation theory. There is no question that in recent years increasing doubt has been cast in our society on the value of a system of choices based on free prices. In an increasing number of areas it has been said that people do not appreciate the importance of certain commodities to them and to society, and that these commodities should be made available to them whether they want them or not. Housing and medical expenses are but two examples. To some extent, subsidization in this area is merely a recognition of allocation-of-resources theory. The argument for subsidized housing, for example, is in part the correlative of the argument for enterprise liability: hidden benefits must be made part of price as must hidden costs. Housing must be helped because people must be made aware of the fact that if there is good housing many costs—those of fire and police protection for instance—decrease.

But the trend toward subsidization cannot be totally explained on the basis of resource-allocation theory; it is also in partial conflict with that theory. For underlying subsidization is the feeling that people themselves do not understand how much they should spend, “for their own good,” on housing and medical care as against such goods as television sets.⁸⁵ To this extent, of course, the basis of the allocation-of-resources justification is weakened. If because of advertising, for example, people buy cars or T.V. sets which they do not “really” want, and if they are unhappy with the things they have bought once they have them, then, perhaps, the postulate that people know better than

84. For some discussion of the not negligible inherent-accident-prevention potential of the allocation-of-resources justification, see note 88 *infra*.

85. To some extent, of course, subsidization is merely the other side of taxation as a device for redistributing income. Thus, money may be given for housing because basically those who will benefit from it are poor people while those who pay for it (out of taxes) are rich. And therefore income is redistributed. But while this element may explain subsidization, it does not explain the kind of subsidization we have. Why should a person—who is admittedly poor—be given a subsidy *only* if he chooses to live in a decent house, rather than be given his share of the money and allowed to choose for himself whether he wishes to spend it on housing or drink. The answer brings us right back where we started—either because there are hidden savings to society, not reflected in the cost of housing, from having people live decently, or because we feel that we—as a society—know better than the individual involved that he would be better off in good housing than in a drunken stupor. For either of these grounds we may—and do in fact—offer him the subsidy *only* in terms of cheaper housing and not in cash to spend as he wishes,

anyone else what is best for themselves ought to be abandoned. Perhaps some central agency should control the production of cars, television sets, and widgets, as is done in war time, when individual desires are subordinated to group needs—when, in effect, we all agree that individual buying choices would not reflect what is really best for the buyers.

Despite some undermining of the postulates of free enterprise, however, we are still remarkably wedded to the price system and to individual choice as the proper basis for determining what should be produced. For the mass of goods is still produced in response to individual choices rather than to executive fiat. Indeed, the practical difficulties of having production choices determined in any other way are such that even socialist writers have on occasion sought to adapt the price system as a means for making public choice as to desired production known to producers.⁸⁶ Moreover, if we move from the realm of individual purchasing decisions by consumers—where such phenomena as advertising are most likely to cast doubt on how much people know what they “really” want—to the area of purchases by producers, the validity of a system of free choice based on prices is accentuated. The firm deciding whether it wishes to use steel or aluminum in widgets is likely to choose on the basis of relative costs, advertising or no. If one of these metals causes more accidents than the other, that firm should somehow or other be made aware of the difference in real cost at the time it chooses between them. And the best way to create that awareness and to make it effective is by charging to the firm which uses a metal the accident costs which that metal causes.⁸⁷ Similarly, if the costs of accidents vary not only from industry to industry, but among firms within an industry, and if the difference is substantial enough to be reflected in different insurance premiums charged to each firm, there is every reason to have these accident costs placed on each firm. Thus, the product of the low cost more efficient firm will be favored, enabling that firm to expand at the expense of its guiltless, but more accident prone, competitor.⁸⁸

Have we not, however, proved too much? If hidden costs should be made a part of prices in order to ensure informed choices by buyers, should not all

86. LANGE & TAYLOR, *ON THE THEORY OF SOCIALISM* 57-142 (1952).

87. To the extent, then, that we are concerned with *how* things are produced, as against *what* is produced, the allocation-of-resources justification may apply as well to the Soviet Union as to the United States.

88. It is in this area of “how” things are produced and “by whom” that one sees most closely the accident preventing potential inherent in allocation of resources. By urging the producer, on the basis of costs to him, to use the resources which have lower accident costs—accidents are reduced. By urging the consumer, on the basis of prices facing him, to buy from the firm which has lowest accident rates, accidents are reduced. And even if one discusses “what” is to be produced, the same potential is shown. For again, on the basis of prices, consumers, under enterprise liability, are urged to buy those products which are less accident prone, rather than those which are more accident prone. All this says no more than that the good which is cheaper in terms of steel or labor costs, but is more expensive in terms of accident costs, loses its advantage once accident costs are made a part of prices,

other hidden costs be included too; why stop at "tort" costs when there are such other hidden costs as traffic congestion, water pollution, and resource exhaustion?⁸⁹ The answer, I suppose, is that while in theory we should take each of these into account too, it may just not be worthwhile in practice. The cost of determining and allocating these other costs may be too great, and, as has been said before, if that cost is too large, a greater misallocation may result from trying to include it in price than from allowing originally hidden costs to remain hidden.

In this regard, at least, "tort" costs are substantially different from most other hidden costs. Our society is so organized that much of the expense involved in evaluating and assessing "tort" costs tends to be borne even without enterprise liability. Under a fault system people are always ready to try and prove fault, and the expense of the attempt is not too different if they prove liability or if they fail to do so. Our increasing concern with loss spreading, moreover, has resulted in an increasing number of nonfault losses being given monetary value and being assigned to a particular party. Once this is done there seems to be no financial reason for not assigning the loss in a way which fosters proper allocation of resources.

Hence, "tort" costs should be borne by the activity which causes them even if other hidden costs cannot be allocated, and even if other methods of allocating losses do a better job of loss spreading. We have not yet abandoned the basic economic structure which requires prices of goods to reflect all the costs which producing or using them entail—far from it. At most we have combined our concern with production of what people want in the most efficient manner, with an increasing insistence on other values. Among these is a desire to mitigate the effect of losses by spreading them broadly. A system of loss allocation that does an adequate job from the standpoint of each of these different values is more likely to remain established than a system which emphasizes one set of values to the exclusion of others. Since social insurance ignores allocation of resources to achieve optimum loss spreading it is hard to conclude that enterprise liability is just a temporary measure, doomed to be overcome by its neater and perhaps more efficient rival.⁹⁰

Of course, if the costs of administering enterprise liability prove exorbitant, or if damages rise out of all proportion to the injuries sustained—if, in other words, the amount charged to the industry becomes much greater than the loss caused—it will be difficult to make out a case for enterprise liability on

89. See generally KAPP, *THE SOCIAL COSTS OF PRIVATE ENTERPRISE* (1950).

90. Of course, the same resource allocation effect accomplished by enterprise liability could be accomplished by social insurance if the insurance were paid for out of special taxes imposed on each activity which caused the loss. To do the job as well as enterprise liability, however, each firm's and each industry's loss record would have to be reevaluated frequently, and the special taxes changed accordingly. At this point we may well start to wonder if enterprise liability coupled with private, and perhaps some public, insurance would not be cheaper and much more feasible administratively. This position would be strengthened by the fact that all of the undesirable "concentration of losses effects" of enterprise liability would be equally present in a special tax system of social insurance.

resource-allocation grounds. And we may look for an increased trend toward social insurance. Similarly, if we become more concerned with the elimination of any possible economic dislocation, and if at the same time—for the two are quite consistent—we become increasingly disenchanted with production in accordance with the apparent desires of consumers, then social insurance is bound to increase in importance. But if these things don't happen there is every reason to think that we shall try to combine broader enterprise liability—in which risk spreading, loss allocation, and deep pocket values are synthesized—with limited social insurance programs, paid out of progressive taxes, to cover those losses which are too general to be assigned to any single activity or group of activities.

THE LEGAL CONTEXT

The theories analyzed in the previous sections have broad applicability in many fields of law. A thorough study of even one of the areas in which they might be significant would require far too great an addition to an already lengthy article. It may be worthwhile, however, to examine a few areas in which these theories are relevant in order to indicate in a preliminary way how the theories might help in an analysis of some of the legal problems that arise in each area. I shall make no effort to interrelate the nonfault theories of liability which I have discussed with fault theories. Such a task, though crucial, is far too broad for any preliminary study.

Nuisance

Our discussion of nuisance is necessarily restricted to activities with some social utility. Other nuisances should, clearly, be abated; in those cases damages are only incidental to the abating,⁹¹ and are not really relevant either to questions of allocation of resources or to spreading of losses.

The first question in the law of nuisance is whether the alleged nuisance should be enjoined.⁹² In the modern view enjoinability depends on the damage the nuisance causes compared to the cost of eliminating the nuisance, taking into account, however, the social benefits of the activity which causes the nuisance.⁹³ Were courts to apply a pure "economist's" allocation-of-resources

91. A house of prostitution might easily be able to pay for the nuisance damages it causes, and yet it will not ordinarily be given a chance to do so; for in such instances courts are not really interested in compensation or in allocation of resources but in abolishing what they deem an evil. See generally *Tedeschi v. Berger*, 150 Ala. 649, 43 So. 960 (1907); *Crawford v. Tyrrell*, 128 N.Y. 341, 28 N.E. 514 (1891); *Marsan v. French*, 61 Tex. 173 (1884).

92. *Fox v. Ewers*, 195 Md. 650, 75 A.2d 357 (1950); *Sarraillon v. Stevenson*, 153 Neb. 182, 43 N.W.2d 509 (1950); *Johnson v. Drysdale*, 66 S.D. 436, 285 N.W. 301 (1939); *Kramer v. Sweet*, 179 Ore. 324, 169 P.2d 892 (1946).

93. *Monroe Carp Pond Co. v. River Raisin Paper Co.*, 240 Mich. 279, 215 N.W. 325 (1927); *Clifton Iron Co. v. Dye*, 87 Ala. 468, 6 So. 192 (1889); *De Blois v. Bowers*, 44 F.2d 621 (D. Mass. 1930); *Paramount-Richards Theatres, Inc. v. City of Hattiesburg*,

theory they would not go through all this rigamarole. They would charge the nuisance with the damages it caused and, if the nuisance could pay them and still stay in business, they would take this as a good "market place" indication that the benefits to be derived from the activity were sufficiently great to justify its existence. If it could not sustain these damages and stay in business the same effect would be achieved as when a nuisance is enjoined. This is like saying that if widgets can pay for the accidents they cause and still sell it means that people want widgets even though they cause accidents.

There are, however, practical reasons why the pure allocation theory is not fully adequate in discussing nuisance. When nuisance damage is widely spread the company causing the harm is unlikely to be made to answer for all the damage it causes. For nowhere near everyone who is injured is likely to pursue his claim. Moreover, even if the injured parties all did sue, the expense of bringing so many scattered suits might easily be great enough to negate any resource allocation benefits which successful prosecution of the suits could theoretically achieve. If, then, it is perfectly clear that a nuisance could not pay for all the damage it causes, why wait for a thousand law suits to prove it?⁹⁴ Even on the basis of resource-allocation theory, therefore, a case can be made for enjoining some nuisances which have some social utility, at least as a matter of convenience.⁹⁵

Resource allocation, however, probably cannot justify many of the injunctions actually issued in nuisance cases. Nor can a general justification for injunctions be found in loss-spreading theory. If a nuisance affected a relatively wide area it would be hard to see how enjoining that nuisance could have a beneficial loss spreading effect. Indeed, in most cases injunction would seem to invite relative concentration of losses and, hence, undesirable secondary effects. If a nuisance affected only a limited number of people—and risk spreading was, therefore, indifferent to, or possibly even favored protecting

210 Miss. 271, 49 So. 2d 574 (1950); *East St. Johns Shingle Co. v. City of Portland*, 195 Ore. 505, 246 P.2d 554 (1952); *Rose v. Socony-Vacuum Corp.*, 54 R.I. 411, 173 Atl. 627 (1934). Compare *Powell v. Superior Portland Cement, Inc.*, 15 Wash. 2d 14, 129 P.2d 536 (1942), with *Rible v. Spokane-Portland Cement Co.*, 41 Wash. 2d 249, 248 P.2d 380 (1952).

94. An injunction may not, of course, put a company out of business. It might just force the end of a particular process or method of production, and in some cases might even spur the firm to discover a new and better method. If the damages caused by the old method were sufficiently large, damages would have the same effect. The firm would presumably compare the likely cost of developing the new method with the cost of damages under the old, and choose to pay one or the other. A court which felt that an alternate method of production might be found, but that the firms involved either overestimated the cost of developing it, or were too stodgy to try to find it, might well be tempted to enjoin the old method of production. Such a move would be justified in economic terms if developing the new method turned out to cost less than the injuries caused by the old method. It would, however, represent an evaluation of the costs of the business on the part of the court rather than on the part of the firms involved. In effect, it would be a statement by the learned judge that he is a better man at widgets than the widget makers.

95. *But see* note 105 *infra* on consumer surplus.

the injured few—damages would be quite adequate to achieve the desired result with less risk of avoidable secondary effects. For damages would be less likely to force a company out of business; then too, they could, in part, be spread to consumers through price changes. All in all, the loss-spreading theory would tend against injunctions even in these cases in which allocation of resources might justify an injunction, and would scarcely ever require an injunction where resource-allocation notions would be opposed.

Ultimately, I suppose, this analysis suggests that while all of the various "loss distribution" theories certainly have relevance to the question of enjoining nuisances, other important factors may require injunctions in cases in which "loss distribution" theories would not. Thus, many cases granting injunctions, and the doctrine that "injunction will issue if the nuisance is voluntary,"⁹⁶ though they cannot be explained in terms of loss-distribution theories, can be readily understood in terms of other concepts. For example, the concept that private property is sacred and that the right to expropriate with compensation is a right that ought normally to be given only to the state and not be made available to any neighbor who wishes to manufacture rubber tires.⁹⁷

There is another side to the nuisance coin. Assuming an alleged nuisance is deemed nonenjoinable, is there any justification for the following notions: (a) that there must be *substantial* injury to the plaintiff to give rise to a nuisance, and to justify damages at all;⁹⁸ (b) that the "usefulness" of the enterprise which causes the "nuisance" must be weighed in deciding whether any nui-

96. Compare *Racich v. Mastrovich*, 65 S.D. 321, 273 N.W. 660 (1937), with *White v. Bernhart*, 41 Idaho 665, 241 Pac. 367 (1925). See discussion in Ames, *How Far an Act May Be a Tort Because of the Wrongful Motive of the Actor*, 18 HARV. L. REV. 411 (1905); Drukker, *Spite Fences and Spite Wells: Relevancy of Motive in the Relations of Adjoining Landowners*, 26 CALIF. L. REV. 691 (1938). See also PROSSER, TORTS 413 n.49 (2d ed. 1955) (collecting cases); 1 HARPER & JAMES § 1.26; Note, 11 VA. L. REV. 122 (1924); Note, 9 WYO. L.J. 74 (1954).

97. *Cumberland Torpedo Co. v. Gaines*, 201 Ky. 88, 255 S.W. 1046 (1923); *Helms v. Eastern Kansas Oil Co.*, 102 Kan. 164, 169 Pac. 208 (1917); *Kennedy v. Frechette*, 45 R.I. 399, 123 Atl. 146 (1924); *Krocker v. Westmoreland Planing Mill Co.*, 274 Pa. 143, 117 Atl. 669 (1922); *Sarraillon v. Stevenson*, 153 Neb. 182, 43 N.W.2d 509 (1950); *Jack v. Torrant*, 136 Conn. 414, 71 A.2d 705 (1950); *Cities Service Oil Co. v. Roberts*, 62 F.2d 579 (10th Cir. 1933); *Brede v. Minnesota Crushed Stone Co.*, 143 Minn. 374, 173 N.W. 805 (1919). On the other hand, if the neighbor were performing a function of great social utility, or had a contract with the government, he might be allowed to expropriate with compensation. This might be a rough analogy to the requirement of a public use in eminent domain, or even to the granting of eminent domain privileges to certain industries such as railroads. The failure to allow compensation for nuisance in some cases of great public utility, or in the case of activities tied closely to the government, however, is more difficult to explain in terms of eminent domain analogies. See notes 99, 103 *infra*.

98. *Maddox v. International Paper Co.*, 47 F. Supp. 829 (W.D. La. 1942); *Kepler v. Industrial Disposal Co.*, 84 Ohio App. 80, 85 N.E.2d 308 (1948); *Rhodes v. Dunbar*, 57 Pa. 274 (1868); *Hampton v. North Carolina Pulp Co.*, 223 N.C. 535, 27 S.E.2d 538 (1943); *International Shoe Co. v. Heatwole*, 126 W. Va. 888, 30 S.E.2d 537 (1944).

sance exists—even if the question is one of damages and not of injunction;⁹⁹ (c) that damages, when awarded, should generally be in the form of a lump sum payment.

° The requirement of substantial injury is, of course, justified in terms of loss spreading. If the costs of a nuisance are spread quite thin, by hypothesis excellent loss spreading is achieved, and secondary effects are much less likely than where a firm is required to pay damages. “Substantial injury” is also justified by resource-allocation theory because of the high cost of justice. Again, pure theory, it is true, would require even slight costs to be charged to a firm. But if the cost of requiring payments for small damages were greater than the benefits strict allocation of resources would bring, there would be no advantage in forcing such payments.¹⁰⁰ In any event, since more substantial misallocations of resources exist in our society, court time would be better employed in making major improvements than in trifling with minor ones. Of course, if an enterprise caused a great many minor injuries the aggregate misallocation might be substantial even though no one claim for damages was worth bothering about. In such a case it would be difficult to see what courts could usefully do to improve allocation of resources unless the harm were clearly large enough to justify an injunction. A better solution might be special taxation of the enterprise or its product.

It is a little more difficult to find a justification for weighing the social utility of an activity before determining whether it should pay “nuisance” damages in those cases in which the harm caused by the nuisance was substantial. One might well wonder why this should be the function of courts, assuming that a decision against an injunction had already been made. For under the allocation-of-resources approach, if an activity caused injury the cost of that injury should be made a part of the price of the goods that activity produced. And if the product were sufficiently useful socially, it would be able to make a go of it even though it had to bear the injury costs. If it could not do so there would be a market indication that it was not sufficiently useful to be worth producing. Of course, at times the “relative utility” test, while expressed as “the law,” is not applied at all in the decision as to whether damages should be paid. Thus, courts sometimes say that the utility of an enterprise is not sufficiently great to bar an injunction, but that if damages are paid no injunction will issue.¹⁰¹ This language may well mask a tendency to make damages, with-

99. *De Blois v. Bowers*, 44 F.2d 621 (D. Mass. 1930), 29 MICH. L. REV. 790 (1931); see note 86 *supra* (citing cases). See also 1 HARPER & JAMES § 1.30.

100. Thus, if a system of general nonfault recovery for automobile damages were ever to be established, it seems very reasonable to suppose that damages of less than a certain sum—whether the sum were \$50, \$100 or more does not really matter—would be excluded from the program. The cost of handling such small claims would not be worth the advantage in terms of resource allocations and would have no support in terms of risk spreading. See generally note 121 *infra*.

101. *Spaulding v. Cameron*, 38 Cal. 2d 265, 239 P.2d 625 (1952).

out injunction, the usual solution in cases where substantial injury exists, whatever the real usefulness of the activity.¹⁰²

On the other hand, there are clearly cases in which obvious damages are not paid, and in which the only reason given is that the utility of the enterprise is too great.¹⁰³ Such language is a little reminiscent of the 19th century when "fault" liability was justified in terms of the usefulness of industry generally. As we have seen, that language may well have expressed a hidden feeling that subsidy to industry was somehow socially desirable.¹⁰⁴ Perhaps, a similar kind of reasoning justifies the immunity of some highly useful activities from nuisance claims.¹⁰⁵ But even assuming that it does, which is doubtful, the question of why injured neighbors should subsidize an activity would still remain. If a subsidy is needed why not have it come out of taxes? Of course, our feeling about who should pay the subsidy when nuisance is involved is less strong than in the case of nineteenth century industrial accidents, because nuisance injuries are likely to be reasonably well spread anyway. This is especially so since in nuisance courts fail to award damages only after contrasting the *size*

102. *Kentucky W. Va. Gas Co. v. Lafferty*, 174 F.2d 848 (6th Cir. 1949); *Central Georgia Power Co. v. Pope*, 141 Ga. 186, 80 S.E. 642 (1913); *Town of Braggs v. Slape*, 207 Okla. 420, 250 P.2d 214 (1952); *Nailor v. C. W. Blakeslee & Sons, Inc.*, 117 Conn. 241, 167 Atl. 548 (1933); *United Verde Copper Co. v. Ralston*, 46 F.2d 1 (9th Cir. 1931); *California Orange Co. v. Riverside Portland Cement Co.*, 50 Cal. App. 522, 195 Pac. 694 (1920); *Vann v. Bowie Sewerage Co.*, 127 Tex. 97, 90 S.W.2d 561 (1936).

103. *East St. Johns Shingle Co. v. City of Portland*, 195 Ore. 505, 246 P.2d 554 (1952); *Rose v. Socony-Vacuum Corp.*, 54 R.I. 411, 173 Atl. 627 (1934); *Powell v. Superior Portland Cement, Inc.*, 15 Wash. 2d 14, 129 P.2d 536 (1942).

104. See notes 44-47 *supra* and accompanying text. See also *Clifton Iron Co. v. Dye*, 87 Ala. 468, 6 So. 192 (1889); *Madison v. Ducktown Sulphur, Copper & Iron Co.*, 113 Tenn. 331, 83 S.W. 658 (1904).

105. While the specific reasoning which applied to the 19th century situation is probably not applicable, another exception to the normal rule of resource allocation might apply. This is the concept economists call "consumer surplus." There is no need to get into the highly involved technicalities of that theory. Roughly, the idea is that if an activity with few substitutes will be forced out of business altogether if it has to bear all of its costs, and if the activity can survive if it is able to charge a high price to those who really want its product, and a much lower price to others, then it is worthwhile keeping the activity alive even though for certain reasons the charging of different—discriminatory—prices is not feasible. The common sense of the theory is simply that if most people want telephones but only at a reasonable price, while some people want them so badly that rather than lose phone service altogether they are willing to pay a higher price than all the others, there is no earthly reason for shutting down phone service as a business that is unable to pay its way just because two prices for the same product are not feasible in the industry. If activities exempted from nuisance damages are essentially public utility type enterprises—enterprises most subject to the consumer surplus requirements—this analysis may serve as a partial explanation. In view of the strong criticism that the concept has received, however, even such a partial explanation gives little comfort. See generally LITTLE, *A CRITIQUE OF WELFARE ECONOMICS* 166-84 (2d ed. 1950) for a lucid analysis and criticism of the concept. See also SAMUELSON, *FOUNDATIONS OF ECONOMIC ANALYSIS* 195-97 (1958). In all events the concept, even if valid, is far too limited in applicability to be a good theoretical justification for exemption from nuisance damages of enterprises with a high social utility.

of an injury with the social utility of an activity.¹⁰⁶ Indeed, it is probably in loss-spreading theory that one can find the best justification for the no-damage doctrine. Unless the injuries to any individual were extremely large, courts might well hesitate to saddle an important enterprise with heavy damages. For damages might cause disruption in the industry, or perhaps even a closing down, with disastrous secondary consequences.¹⁰⁷ Such an approach would merely reflect the judgment that although allocation of resources might require the closing down of a firm, ensuing disruptions would be too great to justify the change. My own inclination, however, is that there are still many cases in which no really good reason exists for not charging an enterprise with "nuisance" injuries even though the enterprise is highly useful socially—cases in which the effect of charging such costs would not be disaster to the industry, but only higher prices in the long run.

The desirability of "lump sum"¹⁰⁸ damages as against "time-to-time"¹⁰⁹ damages, in cases where the nuisance injuries were industry wide, would depend entirely on the structure of the industry involved and on the structure of competing industries. Lump sum damages, it will be remembered, are fixed and do not vary with output, whereas "time-to-time" damages presumably will reflect differences in the volume of production.¹¹⁰ If the industry were a purely competitive one, either type of damages would result in a curtailment of output and a favorable resource-allocation effect. This result would be achieved more quickly if "time-to-time" damages were charged, for then the effect would be felt without a change in the number of firms in the industry. Moreover, the chance of secondary dislocations would be less than with "lump sum" damages. But in time the same result would be accomplished whichever type of damages were charged.

If the industry involved were a relatively monopolistic industry, and competed with more competitive industries the monopoly's output would already be too low as compared with the output of the competing competitive industry, because the prices of the monopolistic industry's goods are higher in relation to their costs than those of the competitive industry. As a result any damages which would diminish the monopoly's already too low output would be undesirable.

By assessing damages in "lump sum," however, it may be possible to take advantage of one of the previously discussed pricing quirks and allow us to charge the accident costs to the monopolist without inducing him to raise his

106. See cases cited note 98 *supra*.

107. Compare *Madison v. Ducktown Sulphur, Copper & Iron Co.*, *supra* note 104, with *McCarthy v. Natural Carbonic Gas Co.*, 189 N.Y. 40, 81 N.E. 549 (1907).

108. *Kentucky W. Va. Gas Co. v. Lafferty*, 174 F.2d 848 (6th Cir. 1949); *Nailor v. C. W. Blakeslee & Sons, Inc.*, 117 Conn. 241, 167 Atl. 548 (1933); cf. *Cumberland Torpedo Co. v. Gaines*, 201 Ky. 88, 255 S.W. 1046 (1923).

109. *Akers v. Ashland Oil & Ref. Co.*, 139 W. Va. 682, 80 S.E.2d 884 (1954).

110. If the injuries caused were constant as to output, then even though damages were charged from "time to time," the resource-allocation effect would be identical to that caused by lump sum damages. See notes 31-36 *supra* and accompanying text.

price and lower his output.¹¹¹ This would only be possible if the monopoly used marginal cost pricing rather than "cost plus" pricing. Of course the same level of price and output would not be maintained if total nuisance damages were so great that they exceeded the profits of the monopolistic industry. But in this case the monopolist would be producing too much, for the expansive effect of not meeting hidden costs would have more than overcome the contracting effect of monopoly pricing and a reduction would be justified.

If, instead, the industry involved were monopolistic, but competed with other monopolistic industries, "time-to-time" payments would be preferable. For these would be more likely to cause the differences in the hidden costs of the two competing monopolistic industries to be reflected in their prices.

Lump sum payments are, of course, a more effective tax on monopoly, while "time-to-time" payments, both because of their intertemporal spread and because they allow more loss shifting, even in cases of monopoly industries, are better loss spreaders.

Clearly, then, arguments in favor of either method can be made, depending on the structure of the particular industry and the emphasis one wishes to place on each of the risk-distribution theories. Under the circumstances the best result might be for courts to have discretion between granting "lump sum" or "time-to-time" damages. Discretion would, of course, require consideration of many things other than the theories discussed—the inconvenience and expense of many suits, and the chance that, if continuing payments were required, the nuisance might in time be eliminated through better technology, are only two of the other factors to be considered—but the risk-distribution theories we have discussed should certainly play some role in the final decision.¹¹²

111. See text at notes 31-36 *supra*.

112. Where only one firm in an industry is a nuisance, the allocation-of-resources problem is mainly a question of allocations between this firm and its competitors. This could occur where a firm produced in a city near the market for its product, while its competitors produced on the outskirts of town where no nuisance would be created. Since the city firm did not have to bear all of its costs, it would presumably produce more than it should relative to its competitors. The best way to make the firm produce what it should, given its true—albeit hidden—costs, would be to place "time to time" damages on it. Then the decision on how much to produce would most accurately reflect the cost, including nuisance costs, of producing. It may be that if such costs are charged, the firm would decide, in time, to move to the outskirts. This decision would only reflect the fact that the added cost of transporting goods to the market incurred by moving to the outskirts was less than the cost the firm was causing others when it produced in the city. Or it might be that even having to pay nuisance costs the firm would still be able to compete, in which case pretty good market evidence would exist that having a firm in the city was desired. Even such a firm would probably produce less, however, than before it was charged with its nuisance costs. Lump sum damage assessments would be as likely to force the firm to move to the outskirts. But they would be less likely to cause it to reduce production—in accordance with its true costs—if it found it worthwhile to stay in the city. In addition, lump sum damages might tend to make the move to the country immediate, which might be desirable from the standpoint of resource allocation, but devastating from the standpoint of risk spreading.

Extra-Hazardous Activities

Current legal doctrine requires strict, or nonfault, liability for injuries resulting from certain types of activities labelled "extra-hazardous."¹¹³ Much confusion existed in the past between liability for extra-hazardous activities and nuisance.¹¹⁴ Such confusion is not surprising in view of the substantial similarity in the economics of the two doctrines. In each case we have, in effect, a charge being put on a useful activity which involves a certainty of a significant number of injuries. The allocation-of-resources consequences of the charge are about the same, as are the monopoly tax consequences. The loss spreading reasons for placing injury costs on extra-hazardous activities seem, however, much greater than the equivalent reasons for charging nuisances. This fact may explain why commentators who have been mostly concerned with loss spreading as a justification for nonfault liability have emphasized "risk distribution" in the field of extra-hazardous activities much more than in the field of nuisance.¹¹⁵

Significant differences in legal doctrines applicable to the two fields do exist, however. In nuisance, for instance, the particular damage must be significant,¹¹⁶ while in extra-hazardous activities liability exists whether the particular damage is great or small—so long as it arises from the risk which made the activity extra-hazardous.¹¹⁷ Allocation-of-resources theory and risk-spreading notions may both serve to explain the difference. On the basis of strict resource-allocation theory, industries should be liable for all their costs, large or small. Convenience, however, requires an exception in nuisance cases; the expense of meeting small damages is too great for the benefits derived. Besides, risk spreading is favored by letting small losses lie where they fall. This exception seems much less necessary in extra-hazardous activity cases, since a series of costly suits for minor damages is quite unlikely in these situations. The typical extra-hazardous activity is one in which a substantial chance of substantial damage exists.¹¹⁸ Indeed, if many minor damages were the likely

113. *Sullivan v. Dunham*, 161 N.Y. 290, 55 N.E. 923 (1900); *Dixon v. New York Trap Rock Corp.*, 293 N.Y. 509, 58 N.E.2d 517 (1944); *Alonso v. Hills*, 95 Cal. App. 2d 778, 214 P.2d 50 (1950); *Exner v. Sherman Power Constr. Co.*, 54 F.2d 510 (2d Cir. 1931); see *Fletcher v. Rylands*, 159 Eng. Rep. 737, 3 Hurl. & C. 774 (1865) (for early developments); 20 A.L.R.2d 1372 (1951) (listing states and collecting cases which allow recovery without fault); 2 HARPER & JAMES § 14 (collecting authority).

114. *Coley v. Cohen*, 289 N.Y. 365, 45 N.E.2d 913 (1942); *Vincent v. Hercules Powder Co.*, 228 App. Div. 118, 239 N.Y. Supp. 47 (1930). See also 2 HARPER & JAMES § 14.8; PROSSER, *SELECTED TOPICS IN THE LAW OF TORTS* 159-77 (1953).

115. Compare 1 HARPER & JAMES 64-92 (1956), with 2 *id.* at 794-95.

116. *McCarty v. National Carbonic Gas Co.*, 189 N.Y. 40, 81 N.E. 549 (1907); *Riblet v. Spokane Portland Cement Co.*, 41 Wash. 2d 249, 248 P.2d 380 (1952); *Brede v. Minnesota Crushed Stone Co.*, 143 Minn. 374, 173 N.W. 805 (1919).

117. *Sullivan v. Dunham*, 161 N.Y. 290, 55 N.E. 923 (1900) (dicta); see 20 A.L.R.2d 1372 (1951) (collecting cases).

118. RESTATEMENT, TORTS §§ 519-20 (1938); see *Asheville Constr. Co. v. Southern R.R.*, 19 F.2d 32 (4th Cir. 1927); *Federoff v. Harrison Constr. Co.*, 362 Pa. 181, 66 A.2d 817 (1949); *Rainham Chem. Works v. Belvedere Fish Guano Co.*, [1921] 2 A.C. 465.

result of an activity, it seems probable that a nuisance label with nuisance restrictions would be used.¹¹⁹ The usual extra-hazardous case being sizeable, there is no need for a special rule of convenience to rule out petty harms. Those few minor injuries that do occur incidentally are paid for and are sufficiently rare not to be worth the trouble of creating a special exception which courts would have to consider in deciding each case. If, however, activities such as driving were suddenly termed extra-hazardous activities,¹²⁰ it would be highly likely that a requirement of substantial damage—similar to that existing in nuisances—would be required.¹²¹ Otherwise the game would not be worth the candle.

A more troublesome problem arises from the fact that in order to be "extra-hazardous" an activity requires more than the mathematical certainty that harm will occasionally occur.¹²² It is necessary that there be great likelihood that the harm will occur *frequently* as a result of that activity.¹²³ And, according to the *Restatement of Torts*, it is also necessary that the activity not be a matter of "common usage."¹²⁴

Thus, the extra-hazardous category excludes such cases as grade crossing accidents¹²⁵ which, inevitably, harm a few each year. Presumably, this is either because not enough people are harmed in any one year, or because the activity is "common usage," whatever that means. It is somewhat difficult to reconcile these rules with the theories we have discussed. The "frequency" rule may find some support in allocation-of-resources theory, but it runs quite counter to loss-spreading notions. And the "common usage" notion runs counter to both. Thus, the argument can be made that if the expected loss, though significant to the party injured, occurs relatively infrequently, any readjustment of resources which would result from allocation of the loss to the industry which caused it would be minimal. And no substantial allocation-of-resources ground for liability would exist. On the other hand, the very fact that little readjustment would be required to meet the loss if it were placed on the enterprise

119. *Cumberland Torpedo Co. v. Gaines*, 201 Ky. 88, 255 S.W. 1046 (1923); *Whittemore v. Baxter Foundry Co.*, 181 Mich. 564, 148 N.W. 437 (1914); *Dixon v. New York Trap Rock Corp.*, 293 N.Y. 509, 58 N.E.2d 517 (1944); *Landau v. City of New York*, 180 N.Y. 48, 72 N.E. 631 (1904); *Pennsylvania R.R. v. Sagamore Coal Co.*, 281 Pa. 233, 126 Atl. 386 (1924). See also PROSSER, *TORTS* 336-38, 399 (2d ed. 1955); 2 HARPER & JAMES § 14.

120. See *Wing v. London Gen. Omnibus Co.*, [1909] 2 K.B. 652; *Phillips v. Britannia Hygienic Laundry Co.*, [1923] 1 K.B. 539; *Steffen v. McNaughton*, 142 Wis. 49, 124 N.W. 1016 (1910) (automobile not dangerous contrivance).

121. See PROSSER, *TORTS* 336-38 (2d ed. 1955). See also, Note, 29 ILL. L. REV. 372 (1934); Note, 95 U. PA. L. REV. 781 (1947); note 100 *supra*.

122. RESTATEMENT, *TORTS* § 520 & comment *g* (1938); 2 HARPER & JAMES §§ 14.1-14.5; PROSSER, *TORTS* 315-18 (2d ed. 1955).

123. *Id.* at § 520.

124. See *id.* at § 520, comment *b* (1938).

125. See *Baltimore & O.R.R. v. Goodman*, 275 U.S. 66 (1927) (contributory negligence indicated).

suggests the very strongest loss-spreading reason for liability since, by hypothesis, the loss was quite heavy when placed on the person injured.

It is clear, then, that the notion of extra-hazardous activities has not been brought to its logical conclusion in terms of risk-distribution theories. If only allocation of resources is considered, some justification may be found for limiting the label "extra-hazardous" to activities involving frequent, substantial, harm. Even so limited, however, the doctrine would seem to require inclusion of many activities not now subject to strict liability.¹²⁶ If one also considers the other grounds for risk distribution—particularly loss spreading—enormous broadening of the extra-hazardous activities doctrine would seem indicated. All in all, one cannot help thinking that it is a bit incongruous that those very activities which cause most of our injuries are not deemed extra-hazardous, even though substantial resource readjustments could occur if they were included, and although loss spreading would certainly favor their inclusion. Continuation of a narrow definition of extra-hazardous activities must necessarily find what justification it has in factors outside the scope of this Article.

Respondeat Superior

In General. Respondeat superior—like workmen's compensation, to which it has often been analogized—was the forerunner of modern enterprise liability. As a result, both have been written about extensively, though usually with emphasis only on their "loss spreading" or "deep pocket" potentials.¹²⁷ Both are based on the notion that no single employee deems the risk of injury arising out of his employment to be great enough to justify him either in insuring or in asking substantially higher wages because of it. The proposition is an empirical one which can be fairly readily accepted.¹²⁸ Respondeat superior applies it to injuries to third parties, while workmen's compensation applies it to the worker himself.

The effect of this proposition in terms of the justifications for enterprise liability is clear. The master is the best insurer, both in the sense of being able to obtain insurance at the lower rates and in the sense of being most aware of the risk.¹²⁹ Consequently, he is the best primary risk spreader. The cost of insurance is normally allocated in part to the cost of labor, and thereby spread

126. Thus, it is difficult to understand why from the standpoint of resource allocation the utility of an enterprise should be relevant to the question of whether it is ultra-hazardous. Compare the analysis of a similar doctrine in nuisance cases, text at notes 103-07 *supra*.

127. See, *e.g.*, GREGORY & KALVEN, CASES ON TORTS 703-25 (1959) (collecting authorities).

128. To some extent unions may have changed this. See note 25 *supra*. Indeed, in some industries where management is small, poor, and disorganized, while the union is strong, wealthy, and large, the union may be more aware of the risks and in a better position to spread them and to make them a part of the appropriate prices.

129. Rankin v. Western Union Tel. Co., 147 Neb. 411, 23 N.W.2d 676 (1946). See also note 131 *infra*.

backwards. It is in part spread forward to consumers, through adjustments of price and output. The remainder is—after a transition period now long past in every industry—spread forward in all industries except monopolistic ones. Thus, very broad spreading, both primary and secondary, is achieved. In addition, of course, what is not spread can be justified both on monopoly tax grounds and on the broader deep-pocket notions which emphasize the generally stronger financial position of masters than of servants.

Equally strong allocation-of-resources arguments can be made. Unless wages reflect the risk of injuries the true cost of labor in an industry is not shown. Similarly, the failure to show injury costs means that the prices of the goods the industry sells understate their true costs, and that too much is produced in that industry compared to those which are less accident prone. On the other hand, if workers were to insure themselves and to demand higher wages to pay for the insurance, the fact that insurance would probably cost them more than their employers would mean that injury costs in the industry would be overstated. Either way, workmen's compensation and respondeat superior would tend toward a better allocation of resources. Needless to say, contribution between master and servant, or reimbursement of the master by the servant tortfeasor—though possibly supported on "fault" grounds—runs directly counter to all the "risk distribution" justifications. As a result, one can understand the tendency of some courts to avoid such contributions and even to let a verdict against the master—based on the servant's negligence—stand together with a finding of no negligence in the suit against the servant.¹³⁰

The similarities between workmen's compensation and respondeat superior have led some writers to urge that the "scope of employment" rule of respondeat superior be read as broadly as the "arising out of and in the course of employment" test of workmen's compensation.¹³¹ On the basis of the theories analyzed here this is, of course, justified. These theories would suggest that *all* injuries caused by workmen which arise out of and in the course of their employment should result in the master's liability—whether or not the injury resulted from some activity which benefited the employer or was authorized by him, and whether it occurred through the servant's willfulness or through his negligence.¹³² Since insurance is probably available in each case, and since secondary risk spreading is certainly the same in each, there seems no reason

130. See Note, 8 U. CHI. L. REV. 729, 734 n.26 (1941) (collecting cases).

131. RESTATEMENT, AGENCY § 228 (1958); 2 HARPER & JAMES § 26.7; PROSSER, TORTS 352 (2d ed. 1955); 6 LABATT, MASTER & SERVANT §§ 2224-83 (1913).

132. See *Sears, Roebuck & Co. v. Creekmore*, 199 Miss. 48, 23 So. 2d 250 (1945); *Limpus v. London Gen. Omnibus Co.*, 1 H. & C. 526, 158 Eng. Rep. 993 (1862); *Mautino v. Piercedale Supply Co.*, 338 Pa. 435, 13 A.2d 51 (1940); *Great Atl. & Pac. Tea Co. v. Noppenberger*, 171 Md. 378, 189 Atl. 434 (1937); *White v. Pacific Tel. & Tel. Co.*, 24 F. Supp. 871 (D. Ore. 1938); *Hubbard v. Lock Joint Pipe Co.*, 70 F. Supp. 589 (E.D. Mo. 1947); *Forsberg v. Tevis*, 191 Wash. 355, 71 P.2d 358 (1937). Compare *Joel v. Morrison*, 6 C. & P. 501 (1834), with *Nelson v. American-West African Line*, 86 F.2d 730 (2d Cir. 1936). There may of course be reasons based on fault for not doing this. All such reasons are outside the scope of this article.

for the distinctions on risk-spreading or "deep pocket" grounds. Similarly, allocation of resources would tend to support liability. For a cost of an activity is not any the less real because the employee was not authorized to undertake it, or because he acted willfully.¹³³ If it arose out of an enterprise it should be just as chargeable to that enterprise as negligent torts; both should be reflected in prices. Of course, allocation of resources is not so exact or powerful a justification that it really matters too much where the line is drawn between activities arising, and those not arising, out of an enterprise; so long as it is in the general area. But since the other justifications are in accord with what formally seems the most "correct" line from the standpoint of resources it seems fair to say that allocation of resources also supports equating "scope of employment" and "arising out of or in the course of employment." To this extent courts like those in California, which have taken the lead in moving in this direction, have properly applied risk-distribution theories.¹³⁴

This discussion, however, does not tell us why respondeat superior is in fact limited to injuries caused through the servant's *fault*. There is, of course, no answer to this question in terms of the theories analyzed in this Article, any more than there is an answer to why extra-hazardous activities are limited as they are, or to why tort liability generally retains a semi-fault basis. The answer must be found in the broad justifications for the fault requirement. The inconsistency between these limitations based on fault and the philosophy of workmen's compensation was long ago noted.¹³⁵ It still remains.

Independent Contractor. An employer is not liable for the torts committed by independent contractors in his hire.¹³⁶ This doctrine is justified in terms of our analysis if an independent contractor is defined as a party who would, *a priori*, be more likely to consider the risk in his market decisions than would his employer. Thus, a taxi driver is better suited to bear the risk of taxi accidents than the man who hires a cab. For the rider will almost certainly not carry insurance; and even if he does, he will not be influenced in his use of taxis by the fact that part of the cost of his general liability insurance stems from taking taxis. The taxi driver, on the other hand, will make his insurance cost part of the cost of riding cabs. Similarly, though a home owner who hires a tree surgeon to chop down a tree is about as good a risk spreader as his independent contractor, he is less good at allocating costs. The owner probably carries general home owner's liability insurance, and this policy probably covers injuries caused if the tree falls on his neighbor's head. Thus, the danger

133. See 2 HARPER & JAMES § 26.7, at 1379.

134. See, e.g., 2 HARPER & JAMES § 26.7, at 1377 n.13 (collecting cases).

135. Smith, *Sequel to Workmen's Compensation Acts*, 27 HARV. L. REV. 235, 344 (1914).

136. See Harper, *The Basis of the Immunity of an Employer of an Independent Contractor*, 10 IND. L.J. 494 (1935); PROSSER, TORTS § 64, at 357 (2d ed. 1955); HARPER & JAMES § 26.11, at 1395. See also *Davis v. Cam-Wyman Lumber Co.*, 126 Tenn. 576 (1912) (collecting authority); *Laugher v. Pointer*, 11 Eng. C.L. 579, 5 B. & C. 547 (1826); *Painter v. City of Pittsburgh*, 46 Pa. 213 (1863).

of these accidents will be properly allocated as a cost of home ownership. But unless the tree surgeon bears the initial cost, and makes his insurance a part of his price for chopping trees, the injury will not be counted as a cost of *that* activity. The independent contractor makes the danger a cost of both the tree business and the house business, while the owner can not; therefore, the contractor is in a more crucial position to accomplish proper resource allocation.

Of course, if both parties are equally likely to consider the true cost of liability in making their market decisions, allocation of resources is indifferent as to who should be liable; and if both parties are equally likely to insure, or to bear the loss without causing harmful secondary effects, loss spreading is indifferent as to who should bear the loss. In such cases initial liability will not matter at all since the ultimate burden will generally rest on exactly the same persons no matter who is initially liable.

While originally the independent contractor exception to respondeat superior was considerably broader than would be justified by risk-distribution theories, its scope has been considerably narrowed in recent times.¹³⁷ Employees who used to be considered independent contractors are now treated as servants for the purposes of respondeat superior.¹³⁸ Thus, newspaper boys, local service stations—if sufficiently controlled by their parent oil companies—and others who are inadequate risk bearers have been excluded from the category of independent contractors.¹³⁹ The technical definitions of independent contractors have remained about the same, but courts have tended to apply the definitions in ways more consonant with risk-distribution theories than they did in the past.¹⁴⁰ Despite this narrowing a substantial number of cases remain in which independent status is given, but in which the independent contractor has failed to insure and cannot compensate the injured without substantial secondary effects, if he can compensate them at all.¹⁴¹ It is hard to say, however, how many of these are cases in which courts did not choose the best risk taker, and how many are cases in which, though they chose correctly, the particular party involved did not insure simply because he was ornery, and preferred instead to take his chances.¹⁴² Nevertheless, some narrowing in the

137. See *Murray's Case*, 130 Me. 181, 154 Atl. 352 (1931). See also the development of concepts in Harper, *supra* note 136; Steffen, *Independent Contractor and the Good Life*, 2 U. CHI. L. REV. 501 (1935); Morris, *The Torts of an Independent Contractor*, 29 ILL. L. REV. 339 (1935).

138. *Murray's Case*, *supra* note 137; *Pacific Fire Ins. Co. v. Kenny Boiler & Mfg. Co.*, 201 Minn. 500, 277 N.W. 226 (1937).

139. See *Humble Oil & Ref. Co. v. Martin*, 148 Tex. 175, 222 S.W.2d 995 (1949); *Warren v. Hale*, 203 Ark. 608, 158 S.W.2d 51 (1942); *Robinson v. George*, 16 Cal. 2d 238, 105 P.2d 914 (1940).

140. See notes 137-39 *supra* (citing cases); Chapman, *Liability for the Negligence of Independent Contractors*, 50 L.Q. REV. 71 (1934); CHARLESWORTH, *LAW OF NEGLIGENCE* 58-66 (1938).

141. See notes 137-40 *supra* (citing cases); Comment, 39 YALE L.J. 861, 872 (1930); 2 HARPER & JAMES § 26.11.

142. Examples of this are not limited to the independent contractor area. Thus, while auto drivers are better risk bearers than pedestrians, uninsured auto drivers are hardly a rarity.

doctrine would probably still be desirable on the basis of risk-distribution theories. But the doctrine itself, if properly limited, is clearly justified by these theories.

Nondelegable Duties. A second narrowing in the doctrine has been through the development of exceptions. Just what these exceptions—and the exceptions to the exceptions—do, is hard to say. Some have argued, however, that they are essentially ways of charging the party who is most aware of the risk.¹⁴³ And the argument is certainly plausible. The principal exception to the doctrine is the rule that certain duties are not delegable, and that liability for them cannot be avoided even though independent contractors are hired to perform them.¹⁴⁴ These duties are usually described as statutory duties,¹⁴⁵ or as duties involving some special risk which depends on their proper performance.¹⁴⁶ To go into the various meanings given these “black letter” definitions would require a substantial digression. In theory, however, it is just these duties about which the employer is likely to be fully aware. Hence, he is more likely to insure against the risk they involve, and be the better risk spreader.¹⁴⁷

Whether the employer is also in a better position to make the cost a part of the price of the particular goods or services rendered is more problematical. In a sense, the issue here is not so much one of whether the injured party should have recovery against the employer, as of whether the employer—once held liable—should be allowed recovery against the contractor. Often, however, the two come down to the same thing because, if insurance is prevalent, recovery over won't have much effect.

In all events, it seems likely that “nondelegable” duties involve situations in which the employer is in a pretty good position to make the risk he bears a part of his buying decisions. The risk is either extra-hazardous¹⁴⁸ or statutory.¹⁴⁹ Either way, it is probable that the employer will carry special insurance for the risk or that the risk will be the crucial part of his general insurance, and that its cost will, therefore, affect his decision to enter into the activity which involved his taking the risk. To this extent the employer is a more suitable risk bearer—from a resource-allocation viewpoint—than he would be in a normal independent contractor situation.

143. See note 137 *supra* (citing articles).

144. *Dixie Stage Lines v. Anderson*, 222 Ala. 673, 134 So. 23 (1931); *Corrigan v. Elsinger*, 81 Minn. 42, 83 N.W. 492 (1900); *Murray v. Lehigh Valley R.R.*, 66 Conn. 512, 34 Atl. 506 (1895).

145. *Blount v. Tow Fong*, 48 R.I. 453, 138 Atl. 52 (1927); *Weber v. Buffalo Ry.*, 20 App. Div. 292, 47 N.Y. Supp. 7 (1897); *Colegrove v. Smith*, 102 Cal. 220, 36 Pac. 411 (1894); *Luce v. Holloway*, 156 Cal. 162, 103 Pac. 886 (1909).

146. See Annot., 23 A.L.R. 984 (1923); PROSSER, *TORTS* § 64, at 359 (2d ed. 1955); 2 HARPER & JAMES § 26.11.

147. See generally NEW YORK LAW REVISION COMMISSION REPORT, *RECOMMENDATIONS & STUDIES* 411-688 (1939); *Morris*, *supra* note 137; *Steffen*, *supra* note 137; *Harper*, *supra* note 136.

148. *Bower v. Peate*, 1 Q.B.D. 321, 45 L.J.Q.B. 446 (1876); *RESTATEMENT, TORTS* §§ 416, 423 (1938).

149. *Blount v. Tow Fong*, 48 R.I. 453, 138 Atl. 52 (1927).

The collateral negligence exception can be taken as no more than the usual "arising out of" limitation, applied to nondelegable duties. That is, once it is decided that independent contractors are generally better risk bearers on both resource-allocations and risk-spreading grounds, but that employers are preferable in certain special cases which involve what we call nondelegable duties, the question arises as to what is and what is not properly a part of this duty. In a sense, the question involves no more than a decision as to whether certain accidents are so much more a risk of the general job of the independent contractor than of the specific nondelegable duty which he was hired to perform on the particular occasion, that they are better charged to his prices generally than to his prices for undertaking this particular type of job. If the risk is "general" the contractor is not only best suited to allocate the cost to prices, but, because he is more likely to foresee the risk than the employer, he is also the best risk spreader. Of course, this broad approach to collateral negligence cannot account for the many minute distinctions which that doctrine has spawned.¹⁵⁰ But those distinctions are more the natural incident of the drawing of any line than the result of a reasoned approach to the problems involved.

Charitable Immunities. There are jurisdictions which grant to nonprofit institutions some form of immunity from respondeat superior.¹⁵¹ The scope and extent of this immunity varies greatly from state to state.¹⁵² As the original justifications for the charitable exemptions have been strongly criticized¹⁵³ many jurisdictions have tended to narrow or to abolish the immunity.¹⁵⁴ We must, however, ask if the loss-spreading and allocation-of-resources justifications support liability for nonprofit institutions. Presumably, the "tax on monopoly" or "deep pocket" notions do not.

Loss spreading is just as applicable to charitable institutions as to profit making ones.¹⁵⁵ Insofar as charities are the most likely insurers, primary loss spreading occurs. Moreover, secondary spreading can also occur through re-allocation of resources used, through higher prices to those who can pay for the nonprofit institution's services, through more pressing demand on donors, and through somewhat less "charity" to the, usually numerous, beneficiaries of the charity's bounty. In all events, secondary *effects* are certainly less likely if the charity bears the loss than if the injured party does.

Similarly, resource allocation applies equally well to charitable institutions as to profit making enterprises. A charity sells itself just as any other service

150. See note 147 *supra*.

151. See HARPER & JAMES § 29.17; Annot., 25 A.L.R.2d 29, 79-84 (1952).

152. See Annot., 25 A.L.R.2d 29, 143-200 (1952).

153. See Appleman, *The Tort Liability of Charitable Institutions*, 22 A.B.A.J. 48 (1936); Feezer, *The Tort Liability of Charities*, 77 U. PA. L. REV. 191 (1928); Note, 34 YALE L.J. 316 (1925); Note, 48 YALE L.J. 81 (1938); Note, 32 N.C.L. REV. 129 (1953). But see Zollman, *Damage Liability of Charitable Institutions*, 19 MICH. L. REV. 395 (1921).

154. See notes 151-53 *supra*.

155. See, *e.g.*, 2 HARPER & JAMES §§ 29.16-29.18.

does. What it accomplishes in good works is its production. Its success depends on the desirability of those works, in the eyes of donors and others who pay for the charity's services, in comparison with the costs the works entail. A rational choice among charities, and between charities and other services, requires that all the costs be before the public. This necessarily implies that the cost of injuries caused by employees of the charity be included. To say that people do not fully appreciate the value of a charity, or that the results accomplished are much greater once expenditures have exceeded costs by a sufficient amount, is merely to say that the charity creates hidden benefits, as well as hidden costs, or that the charity is a decreasing cost industry. As we have seen, such a situation is not unique to charities, and it may be proper ground for subsidization.¹⁵⁶ But there is no more reason for injured parties to pay the subsidy in the case of charities than there would be in other, similarly situated industries.

There are other bases, of course, for criticizing charitable immunities.¹⁵⁷ The fickleness of a law which grants relief to a person injured by a private laundry truck, but which denies it to a person hurt by a hospital laundry truck, should be enough to damn it. From the point of view of this Article, however, it is enough to say that no grounds exist on the basis of loss spreading or resource allocations for exempting charities from respondeat superior.

Negotiable Instruments

The applicability of loss distribution theories is not, of course, limited to the field of torts. To indicate how these theories may apply in nontort areas a few words on negotiable instruments are included here. Forgery, which has often been examined by commentators concerned mostly with risk spreading,¹⁵⁸ is considered primarily because the discussion and conclusions reached there contrast strongly with the conclusions that will be reached in considering stop orders. Apart from this contrast, a superficial discussion of allocation of resources and forgery, such as the one I can undertake here, does little to modify the general conclusions reached by those who have studied the field from the standpoint of risk spreading alone. A more thorough analysis might nevertheless prove fruitful, since in forgeries, as in negotiable instruments generally, one deals with a specific economic structure—the banking system. As a result, questions about the effect which ease of exit or monopoly power would have on resource allocations could perhaps be answered in more specific terms than they can in the less homogeneous torts area.

Forgeries. Leaving aside any consideration of what system of loss allocation serves best to decrease the risk of forgeries, it is hard to escape the con-

156. See text at notes 43-47 *supra*.

157. See note 153 *supra*.

158. See, e.g., Corker, *Risk of Loss from Forged Indorsements*, 4 *STAN. L. REV.* 24, 30-31 (1951); Comment, 18 *U. CHI. L. REV.* 281, 287-88 (1951); Note, 14 *U. CHI. L. REV.* 705, 708 (1947); Comment, 65 *YALE L.J.* 807, 810 (1956).

clusion reached by most commentators that in general the risk of forgeries should be put on the drawee bank.¹⁵⁹ A possible exception to this might be the case of business-fraud forgeries.¹⁶⁰ Except in this case the risk spreading argument is obvious. The bank is the party most aware of the dangers of forgery. Insofar as it is concerned, the danger takes on an almost mathematical certainty. It is, therefore, the party most likely to insure, as well as the one for whom insurance is cheapest. The bank is also in a crucial position to achieve substantial, if not complete, secondary risk spreading through manipulation of the price of checks. Clearly then, if the bank bears the loss the danger of undesirable secondary effects is minimized.

The resource-allocation justification, moreover, does not really detract from the best risk-spreading conclusion. In theory, resource allocation here takes the form of a comparison of different ways of making payments. Since forgery is an inherent cost of payment by check it should be made a part of the visible cost of checks, so that people may have the proper data in deciding whether to use "cash" or "checks." People, the theoretical argument would run, are aware of the real costs of using cash—such as inconvenience and the danger of loss, but unless banks bear the risk of forgery check users will not be aware of the full cost of using checks, and will tend to use more checks than they would if they were fully informed. In fact, the theory is of doubtful validity. For it seems probable that the cost of forgery is so slight, when divided up among all check users, that it would make no difference at all in the number of checks employed. But if this is so it follows that banks can pass all of the cost of forgery to check users, and the risk-spreading argument takes on added force. If this is *not* so, and if adding the cost of forgery to the price of checks were actually sufficient to cause some significant number of people to use checks less often, an improvement in resource allocations would be achieved. Either way, placing the initial loss on banks accomplishes a desirable result. As a practical matter, the importance of choosing a system of loss allocation which significantly helps to prevent forgeries may be so great that any discussion of forgery which leaves out deterrence is hardly worthwhile. Nevertheless, even as sketchy a discussion as this indicates that risk-spreading and resource-allocation notions have a place in the formulation of a sensible rule on forgery losses.

The case of business fraud forgery is rather different. The risk here might properly be assignable to either one of two enterprises, each of which seems equally suited to insure and to act as a secondary risk spreader. Risk spreading being indifferent, reasons for choosing one enterprise rather than the other must be derived from the resource-allocation theory. If the risk, when put on the bank, were a significant addition to the normal forgery cost, making it worthwhile for banks to segregate corporation accounts and to charge different

159. See, *e.g.*, Comment, 62 YALE L.J. 417, 435-38 (1953); Corker, *supra* note 158, at 31. See also 4 WILLISTON, CONTRACTS § 1160, at 3345 n.10 (collecting cases); 5 *id.* at § 1572; National Bank of Sanford v. Marshburn, 229 N.C. 104, 47 S.E.2d 793 (1948).

160. See UNIFORM COMMERCIAL CODE § 3-405 comment 4 (1952).

checking fees for them, resource allocation would be indifferent as to whether banks or businesses bear the risk initially.¹⁶¹ Either way, the cost would become part of both banking and business enterprises. And the division of the ultimate burden will be unaffected by who bears the initial burden. Whether banking or business bore most of it would—according to strict economics—depend on whether businesses tended to use substantially fewer checks, because of the risk there involved, than they would if the use of checks entailed no risk. Of course, since businesses would not in fact use fewer checks, they would end up bearing pretty much the whole burden.

If the cost of segregating business checking accounts were too great to be worth the bank's while, a different result would be indicated. For then banks would be faced with the choice of passing the burden to all check users, of incurring the loss themselves, or of segregating corporation accounts anyway and passing the costs of the segregation, as well as the costs of forgery, to business check users. Any of these would tend to misallocate resources somewhat. The first, because nonbusiness check users would face a cost which they do not cause, the second, because businesses would be insulated from a cost which is properly theirs, and the third, because businesses would face a cost which better loss allocation could have prevented. Of course, if the cost of business forgeries is so small that the misallocation is insignificant—and this is not at all unlikely—the whole question is interesting only as a dubious intellectual exercise. Since, however, the entire problem can be avoided by putting the initial risk on businesses rather than on banks, it would seem wise to do so. Should the cost of forgery insurance or of bonding employees be substantially higher for businesses than banks, or should it be shown that businesses are substantially less likely to insure than banks, there would be reasons for a different result. For then adequate risk-spreading, and possibly even resource-allocation, grounds would exist for countering the not overly strong resource-allocation argument for business rather than bank liability which we have just considered.

Stop Orders. Arguments in favor of initial bank liability for stop orders, though on their face based on allocation of resources, are not in fact justified by that theory. Commentators have stated that the risk of failing to observe stop orders is best put on the drawee bank.¹⁶² Only the bank, it is said, can contrast the cost of preventing failures to honor stop orders with the cost of paying for mistakes. Only the bank, therefore, can properly allocate its resources between prevention and compensation. While this is true, assuming the existence of stop orders, the argument fails to face the problem of whether, on the basis of resource allocation, banks should be made to accept stop orders

161. The same is true if for other reasons banks wish to segregate corporate from individual accounts, or if the combination of other reasons plus the risk of business forgeries suffices to justify the cost of separate corporate accounts.

162. Comment, 20 U. CHI. L. REV. 667 (1953); *Kentucky-Farmers Bank v. Staton*, 314 Ky. 313, 235 S.W.2d 767 (1951); *Calamita v. Tradesman's Nat'l Bank*, 135 Conn. 326, 64 A.2d 46 (1949). *But see* Comment, 65 YALE L.J. 807, 819-21 (1956).

at all. In fact, the indications are that in general the right to stop checks is not desired enough to warrant the cost it engenders. If check users really care enough about stop orders to pay without irritation the higher price of checks they entail, one wonders why banks are so unhappy about having to observe stop orders. For if customers wanted stop orders banks could easily pass on the added costs without a decline in check use or an increase in consumer dissatisfaction.¹⁶³

The fact that some check users desire the right to place stop orders, and that some would be willing to pay a substantially higher price for this service, does not support current rules making stop orders generally applicable.¹⁶⁴ Currently, everyone who uses checks enjoys the right to stop a check, and everyone pays for it, whether he wants to or not.¹⁶⁵ As a result those who do not want the right and scarcely use it, subsidize those who do. On the other hand, those who now like the right to use stop orders may well do so because the service carries a price tag lower than its real cost. It is, therefore, impossible to tell if unsubsidized stop orders could pay their way.¹⁶⁶

The proper solution would be to allow stop orders for those who want them and are willing to pay more for the right to have them; but stop orders should not be made a part of normal checking services. If separate stop order accounts could pay their way there would be a good "economic" indication that the cost of keeping them is worth while. And they would be kept only for those who wanted them and were willing to pay for them. If stop order accounts were not a self-sustaining business service then from the standpoint of resource allocation it would be shown that stop orders are just a waste of resources. Of course, in those special accounts which had the stop order privilege banks would be liable, regardless of fault, for any failure to act upon a stop order. The reason is that as to these accounts banks would, in fact, be in the best position to allocate resources between prevention and compensation.

A somewhat stronger argument for stop orders can be based on risk-spreading notions. Stop orders enable a purchaser to change his mind in mid-pur-

163. See note 166 *infra*.

164. *Second Nat'l Bank v. Meek Appliance Co.*, 244 S.W.2d 769 (Ky. 1951); *Calamita v. Tradesman's Nat'l Bank*, 135 Conn. 326, 64 A.2d 46 (1949); *Bohlig v. First Nat'l Bank*, 233 Minn. 523, 48 N.W.2d 445 (1951); *Reinhardt v. Passaic-Clifton Nat'l Bank & Trust Co.*, 16 N.J. Super. 430, 84 A.2d 741, *aff'd*, 9 N.J. 607, 89 A.2d 242 (1952).

165. *Ibid.* Some states allow banks to contract out of stop order liability. See *Gaita v. Windsor Bank*, 251 N.Y. 152, 167 N.E. 203 (1929); *Chase Nat'l Bank v. Battat*, 297 N.Y. 185, 78 N.E.2d 465 (1948); *Tremont Trust Co. v. Burack*, 235 Mass. 398, 126 N.E. 782 (1920); *Hodnick v. Fidelity Trust Co.*, 96 Ind. App. 342, 183 N.E. 488 (1933). For additional limitations, see generally Note, *Exculpation Clauses in Stop-Payment Orders*, 6 RUTGERS L. REV. 577 (1952); *Martinez v. National City Bank of N.Y.*, 80 F. Supp. 545 (D.P.R. 1948).

166. Many banks do charge a small fee to those who have a check stopped. But, apparently, the fee is in no way commensurate with the liability to which the bank is exposed by the stop order rules. See letter to the author from G. Harold Welch, Jr., Asst. Vice President of the First New Haven National Bank, New Haven, Conn., on file in the Yale Law Library.

chase and to spread the risk of his about face on all check users. All check users have, and pay for, this privilege.

In effect, then, the general stop order system is nothing but a short term insurance which is compulsory on check users, and which lumps together good and bad risks. This undoubtedly does spread the risk of some losses and, therefore, finds support in risk-spreading notions. But it seems rather strange that the particular type of loss involved in stop orders should be picked out and made not only insurable, but necessarily insurable. In the first place, this loss is more readily avoidable than most losses. In the second, it is much less likely to be catastrophic and to cause undesirable secondary effects. In the third place, it prevents the risk of loss from falling on the buyer for a very short period of time. If he does not realize his mistake while the check is being cleared, the loss, heavy or slight, falls on him despite stop orders. For all these reasons I conclude that while stop orders do seem to find some justification in risk spreading, their relation to risk spreading is so erratic, and the risk spreading involved so far beyond what is normal in our society, that no real justification exists. Only if we required everyone to insure or if we spread every conceivable type of risk would stop orders be supported by risk spreading notions.

Under these circumstances it seems hard to understand why some courts refuse to allow banks to contract out of stop order responsibility,¹⁶⁷ except, of course, when such "contracts" are only ex post facto attempts by banks to avoid a loss already incurred. A more desirable solution, at least from the standpoint of the theories discussed in this Article, would be a general rule insulating banks from stop order liability unless they contract for it.

167. *Thomas v. First Nat'l Bank*, 376 Pa. 181, 101 A.2d 910 (1954); *Speroff v. First-Cent. Trust Co.*, 149 Ohio St. 415, 79 N.E.2d 119 (1948). Of course it is easy to understand why stop orders exist in terms of their history. And it may well be that there are reasons outside the scope of this article which justify a general stop-order rule. But it is hard to see any valid reasons for such a rule in terms of the "risk distribution" concepts here discussed.