Washington University Law Quarterly

VOLUME 1977 NUMBER 4 FALL

THIRD PARTY CLAIMS IN WORKERS' COMPENSATION: A PROPOSAL TO DO MORE WITH LESS†

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INTRODUCTION—A PROPOSAL TO SUPPLANT THIRD PARTY LIABILITY ARRANGEMENTS

In a typical year American enterprises expend a substantial amount of money—possibly in excess of $1.5 billion—as a result of "third party" claims deriving from a relative handful of workers' compensation cases.[1] In comparison, the workers' compensation system dispenses $5.5 bil-

† This article is part of a larger study, *Disability in the United States*, pursued by the author under a grant from the Social Security Administration-Social and Rehabilitation Services of the Department of Health, Education, and Welfare and administered and supported by the Ohio State University Research Foundation. SSA-SRS gave permission for the publication of this segment. The Washington University School of Law also facilitated pursuit of the study.

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1. *See* Appendix *infra*, which presents the basis for this estimate.

lion[2] in benefits to fifty times as many claimants. This article proposes the abolition of third party suits and suggests a new system to obtain supplementation from third parties without suit (discussed in Parts VII and VIII) with which to pay improved workers' compensation. This system would reduce employer and third party costs and increase employee compensation benefits, spread those benefits more equitably, and better serve the goal of allocating cost according to degree of risk, without sacrificing either safety incentives or moral values which arguably the present arrangements serve. Under this proposal, third party liability would be extinguished in return for which third parties engaged in activities which usually produce compensable injury would contribute to a supplementary workers' compensation fund at rates related to their injury-causing history. The savings effectuated by eliminating the considerable costs of processing third party claims would enable third parties to reduce their insurance costs. The proceeds of this fund would be used to increase workers' compensation benefits, especially to those sustaining more serious injuries (who tend to obtain proportionally less compensation than the less seriously injured) and, if sufficient, would fuel cost-of-living adjustments.

I. DESCRIPTION OF THIRD PARTY LIABILITY[3]

Each year an estimated 31,500 injuries compensable under workers' compensation involve formal claims against someone other than the employer (a third party) seeking damages based upon negligence or products liability doctrines. Although a small fraction of the total caseload, these claims constitute a significant portion of compensation payout and produce dramatically larger recoveries than normal workers' compensation claims.

The workers' compensation laws of every state require employers to pay an employee who sustains an injury "arising out of and in the course of his employment" specified amounts in weekly benefits and for needed

2. Price, *Workers' Compensation: Coverage, Payments and Costs, 1975*, 40 SOC. SECURITY BULL. 31, 33 (Jan. 1977). This figure excludes black lung program payments. It includes "regular" compensation and medical/hospital payments.

3. This article does not concern itself with the niceties or even garden-variety complexities of third party law. Rather, it focuses upon the general nature of third party claims under workers' compensation laws (other than the Longshoremen's and Harbor Workers' Compensation Act), what they total, who pays them, the advantages and disadvantages of such arrangements, and the advantages and disadvantages of the alternative proposed. This section, which sketches only the essentials, derives primarily from 2A A. LARSON, THE LAW OF WORKMEN'S COMPENSATION (1976).

medical care. (Usually, the employer's insurer processes the claim and makes the payments.) In return for the employer's absolute liability for such specified amounts, the law relieves it of any common law liability it may have had based on negligence.

Workers' compensation laws, however, do not affect the injured employee's cause of action against third parties. Consequently, an employee with a compensable claim may also seek damages based on negligence or products liability theories against a third party. The employer who paid (or whose insurer paid) the workers' compensation benefits and medical care costs has a right to share in the employee's recovery against the third party up to the amount it expended in benefits or, in some states, to compel or institute suit in the stead of the employee for that purpose. As with tort and products liability suits, most third party claims proceed to settlement rather than judgment.[4] The employer's and employee's interests in such suits often conflict, however, and the employer (or its insurer) can, and often does, settle its suit for the amount of its claim without producing any recovery for the employee to whom any amount over the compensation claim belongs (less a proportional share of attorney fees and court costs).

II. WHO ARE THIRD PARTIES

Although no data exists that shows the numbers and characteristics of third parties, litigated cases and experience indicate that many have some direct relation to the employer, employment, or employee (such as a subcontractor working alongside the contractor's injured employee or the

4. MACHINERY AND ALLIED PRODUCTS INSTITUTE, PRODUCTS LIABILITY: AMAPI SURVEY (1976), *reported in* I INTERAGENCY TASK FORCE ON PRODUCT LIABILITY, PRODUCT LIABILITY: FINAL REPORT OF THE INDUSTRY STUDY IV-82 [hereinafter referred to as INTERAGENCY INDUSTRY STUDY] noted that for the period 1970-75 claim disposition followed this pattern:

	# of claims	Percent of Claims Disposed
Total Claims	16,785	—
Claims rejected by company	2,858	31
Claims paid administratively	4,396	48
Suits settled out of court	1,218	13
Court judgments against company	212	2
Court judgments for company	464	5
Total Dispositions	9,148	
Suits pending	3,203	
Claims pending	3,272	

manufacturer of the employer's equipment) while others are strangers (such as a truck owner whose equipment strikes the employee on a highway). The states differ as to who may be considered a third person for purposes of common law suit: some jurisdictions regard anyone other than the immediate employer as a third person;[5] others grant immunity to employees in the same employment;[6] and some grant immunity to the employer, fellow employees, and all contractors and their employees engaged in a common employment. In addition, several statutes[7] leave the matter in doubt, thus requiring judicial resolution; the courts' responses, predictably, have varied.

States granting immunity from suit to co-employees do so only when the co-employee acts "in the course of his employment." The question arises as to which course of employment test applies—the workers' compensation or the tort vicarious liability test. California, on the one hand, bars tort suit against a co-employee only if the co-employee actively performed some service for the employer at the time of the injury. Consequently, an employee may receive workers' compensation because injured within the course of employment, but not be immune from suit arising out of the same incident because not engaged in service for purposes of tort immunity. For example, an employee struck in a parking lot after work by a co-employee's automobile was not barred from suing the co-employee even though the co-employee received compensation benefits for an injury suffered in the course of employment.[8] (Such a result boosts automobile insurance rates and lowers workers' compensation rates, the latter a more cost/benefit efficient coverage.) In contrast, the test adopted by New Jersey[9] simply uses the regular workers' compensation course of employment standard for both eligibility for benefits and immunity from suit. (Such a result fixes the burden of such occurrences upon the workers' compensation coverage.)

In certain situations a general contractor may be considered a third party. For example, the general contractor remains liable to third party actions by a subcontractor's employees unless it meets the conditions for

5. Approximately one third of the states have such statutes. 2A A. LARSON, *supra* note 3, § 72.10, at 37 (Supp. 1977).

6. 30 states statutes do so. *Id* § 72.20, at 42-45 (Supp. 1977).

7. *See* statutes cited *id.*; Note, *Workmen's Compensation: Third Party Actions in South Dakota*, 18 S.D.L. REV. 423, 425 n.13 (1973).

8. Saala v. McFarland, 63 Cal. 2d 124, 403 P.2d 400, 45 Cal. Rptr. 144 (1965).

9. Konitch v. Hartung, 81 N.J. Super. 376, 195 A.2d 649 (1963).

establishing the status of a statutory employer. In all but seven states, "statutory employer" legislation requires that the general contractor provide workers' compensation benefits to the employee of a subcontractor under him who performs work that constitutes a part of the general contractor's business, trade, or occupation.[10] Although these statutes ordinarily apply in the case of an uninsured subcontractor, they occasionally impose liability whether or not the subcontractor is insured. In the latter jurisdictions the courts generally do not allow third party tort actions by the subcontractor's employees against the prime contractor, reasoning that the statute makes the general contractor an "employer" and hence immune from liability. When the statutes subject the general contractor to only a secondary obligation (to provide compensation if the subcontractor fails to do so), the courts ordinarily hold that a general contractor not liable for compensation in lieu of the subcontractor is subject to third party liability.

If the actual employer of the injured worker were an independent contractor over whom the general contractor had no control, the general contractor would remain subject to third party suit. Thus, if a plumbing contractor hired by a builder to install bathroom fixtures in a home retained the right to hire and fire his employees and do the work according to his own judgment and methods without supervision, the builder would remain liabile to third party suit by the plumbing contractor's injured employees.

The majority of jurisdictions, on the other hand, permit the employee of a general contractor to proceed against the subcontractor as a third party. This results from the quite formal reasoning that, although the subcontractor is doing the general contractor's work, the subcontractor cannot be regarded as the injured employee's employer, even though the contractor may stand in the shoes of the subcontractor vis-a-vis the subcontractor's employee. Such recoveries by contractors' employees against subcontractors necessarily increase the liability insurance rates of subcontractors. This cost of doing business must be reflected, in full or in part, in the prices subcontractors charge to contractors. Thus the workers' compensation limitation upon the contractors' liability disappears. This certainly seems neither rational nor desirable for the overall system, but results from the interests of the several parties' insurers to shift the particular claim to another insurer.

10. A. Larson, *supra* note 3, § 72.31, at 14-47.

In addition, the one incident leads to more than one claim proceeding, which multiplies costs. Indeed, often both the general and the subcontractor will purchase both compensation and liability insurance covering some of the same costs. In so doing, all pay overhead costs and other non-benefit charges of their insurers. Hence contractors end up paying pure premium (actual payout) for the equivalent of the workers' compensation, *plus* the portion of the third party liability recovery exceeding the compensation, *plus* the costs of pursuing and defending the third party claim. Whether or not such accidents actually occur on a particular project, the general contractors' costs, and therefore the builders' costs, rise to cover the multiple insurance arrangements.

Managers and executives may also be subject to third party suits. Often the employer insures them for work-related liability. Such arrangements produce two odd results: the "guilty" party does not bear the cost of the injury and the employer, supposedly afforded limited liability under the compensation act, pays additional insurance costs.

Permitting recovery against a fellow employee, if it can be collected, enables an injured employee to increase his total award beyond the compensation benefit. But the sums recovered against third parties do not come as net gains. Costs for pressing the claim, often including substantial attorneys' fees, reduce the net recovery to both employee and the employer or its insurer (discussed in VI below).

III. EMPLOYER RIGHTS AGAINST THIRD PARTY

An employer who pays compensation for an injury caused by the negligence of a third person ordinarily has a right to share in its employee's cause of action against the third person. The compensation acts of most states (a) provide for subrogation, (b) grant the employer a lien on the employee's recovery, or (c) assign the employee's action to the employer. Whatever form the employer's right to share in his employee's action takes, it remains limited to reimbursement for the amount he paid.[11]

Most jurisdictions that have considered the question hold that the compensation act provides the only basis for the third party's liability to the employer.[12] Thus, in the three jurisdictions without statutory subrogation provisions—Georgia, Ohio, and West Virginia—the courts ordinari-

11. *Id.* § 71.20, at 14-2 -14-4. A few narrow exceptions exist.
12. *See id.* § 77.10, at 14-408-14-430.

ly deny the employer a right to recover compensation payments from a third party.

IV. THIRD PARTY RIGHTS AGAINST EMPLOYER

Only one state confers upon a third party the right to contribution by the employer.[13] The courts in jurisdictions that otherwise permit contribution in tort suits generally deny contribution recovery against the employer. They reason that no joint liability exists between the third party and the employer because the employer's liability arises from its status while the third party's liability arises from its negligence[14] or products liability. This denial of contribution enables the employer to shift his entire burden to a third party even when the employer has partially caused the injury. Hence a "wrongdoer" in Larson's language,[15] escapes most of the cost of its "wrong."

An injured employee's third party claim (or that of the employer suing in his stead) remains subject to the defense of contributory negligence and is reducible in comparative negligence jurisdictions in proportion to the employee's "fault." The employer's contributory negligence, however, normally is irrelevant since the employer's suit derives solely from his employee's cause of action. Consequently, the employer's contributory negligence will not bar a third party recovery.

V. JUSTIFICATION OF THIRD PARTY LIABILITY ASSESSED

All workers' compensation systems in the United States recognize that a worker who incurs a compensable injury, or his dependents in the event of his death, retains a cause of action against a third person whose negligence caused the injury. Since the compensation system undertook to replace fault recovery with a form of compulsory insurance, so that losses resulting from accidents would be viewed as a cost of production to be paid by the enterprise and then passed on to the consumer in the form of higher prices, a question arises as to whether such third party suits should exist.

A. *Professor McCoid's Three Arguments*

Professor Allan McCoid[16] offers three justifications for retaining rights against third parties despite his acceptance of the enterprise liability

13. *See id.* § 76.22, at 14-307.
14. *Id.* § 76.21, at 14-298.
15. *Id.* § 71.10, at 14-1–14-2.
16. McCoid, *The Third Person in the Compensation Picture: A Study of the Liabilities and Rights of Non-Employers*, 37 TEX. L. REV. 389 (1959).

concept. First, he argues that the risk of accident through the intervention of someone outside the employment relationship does not constitute a "typical" or inherent risk of the enterprise, although for compensation purposes the injury is viewed as arising out of and in the course of employment. While the connection between the injury and the employer's enterprise might justify requiring it to bear some of the burden of loss, McCoid argues that it does not justify relieving the third party of all responsibility. Further, in many accidents the injury is just as typical of the third party's commercial or industrial activity as of the employer's.

Second, both tort and enterprise liability proceed, in part, on the shared assumption that compensation should be provided at the least cost to society, and that the enterprise can better distribute and bear the risk than an injured employee who cannot readily nor so efficiently insure against such hazards. Whereas tort liability ideally provides for recovery of the victim's actual losses—including pain and suffering as well as past, present, and future medical expenses and loss of earning capacity—workers' compensation does not provide such extensive coverage.

Further, McCoid argues that by imposing liability upon the third party enterprise, many accidents can be eliminated through safety programs which only those enterprises can initiate. Even in the case of individual (non-business) third parties, the possibility of some deterrence from unreasonable conduct cannot be ignored, he asserts.

Yet in certain principal-third party relationships the parties are not strangers, their physical juxtaposition is frequent and typical, and activities of employees of one often endanger the other. Even "stranger" contacts frequently are "typical." A newspaper truck driver, for example, or a construction or repair person at work in streets, "typically" can be expected to be battered in some predictable proportion of cases by "stranger" motorists. Furthermore, many employee injuries sustained at the hands of strangers result from a combination of the stranger's and the employer's activities and the ways that our society organizes production, commerce, trade, and leisure. Accepting McCoid's observation that many injuries are as typical of the third party as they are of the employer, it is proposed here that the law can hold such third parties financially accountable for such typical occurances without subjecting them and the injured to the inefficiencies of third party suits.

Theoretically, tort recovery provides a fuller recovery for the employee "lucky" enough to be injured by a third party's negligence. The third party suit, however, is a questionable way of achieving that fuller recovery. The tort system skimps most on the seriously damaged, just as workers' compensation does. In addition, when the employer or its insurer rather than the employee brings the third party proceeding, it may seek to recover only its compensation payment. The unrepresented or poorly represented employee may agree to settle, unaware that reimbursement of the compensation payer has first priority against the tort recovery. Moreover, if the employee *is* represented, he must pay for two proceedings—his claim for workers' compensation and his tort claim against the third party.

The third McCoid argument, deterrence, is a constant issue in all discussions of tort. Its validity is open to serious question except in the realm of products liability where the third party has real control over design, materials, workmanship, supervision, and quality and would have a lively appreciation of the liability costs of lapses. Even in such situations, however, the manufacturer may respond to its possible liability by limiting its warranty rather than limiting the product's hazards. In other circumstances, the third party's lapse may be typical and not readily deterred (as with most drivers, for example). Or the deterrence incentive may be muffled by insurance, especially for those not experience rated (if, indeed, the beneficent safety-inducing effects claimed for experience ratings occur in the real world).

B. *Professor Larson's "Moral" Arguments*

Larson argues that "[t]he concept underlying third party actions is the moral idea that the ultimate loss from wrongdoing should fall upon the wrongdoer."[17] He states that, although workers' compensation departs from the moral basis of fault liability so as to provide an assumed recovery to the injured person, the modification should not extend to "change the rules on how the ultimate burden was borne."[18] He seems to combine two arguments: (1) that the "wrongdoer" should pay as a matter of morality; and (2) that the financial burden should fall upon the wrongdoer as a matter of proper economic allocation.

The "moral" justification for holding the co-employee liable rests upon the principle that a person whose negligence causes injury should bear the consequences of his own wrongdoing. While the "moral" basis would seem to depend upon actual negligence, many recoveries result from presumptions that substitute for proof of negligence; actual causa-

17. 2A A. LARSON, *supra* note 3, § 71.10, at 14-1.
18. *Id.*

tión thus may be lacking. Moreover, this reasoning, with its emphasis upon blameworthiness, is questionable in many accident situations.

In automobile caused injuries, for example, the occurrence of an actual accident is often fortuitous, resulting from common driver lapses which usually produce no mishap. Most "negligent" drivers, therefore, are morally indistinguishable from the bulk of drivers. Whether fastening the responsibility upon such fortuitously unfortunate individuals stimulates the exercise of greater care by many in the group is debatable. In most cases the insurer, rather than the "responsible" individual or employer, responds in damages. And often in the third party situation not the lax individual, but his employer, pays for the insurance. The potential impact upon the individual is arguably too attenuated to lead to greater caution. One would suppose that a person who is amenable to such a rational incentive would exercise care in the first place simply to protect against harm to himself and fellow passengers. For insured individuals whose rates do not rise commensurately because they are not experience rated, the incentive is nonexistent or dulled. It seems to be a fact of life that insurance practice under both fault and non-fault arrangements spread some of the losses caused by the accident producers among the non-producers and thus do not tax those involved in accidents with the full consequences of those occurrences.

Third party suit will fail to fasten liability upon the "wrongdoer" in two other situations. An employer whose negligence contributed to an accident retains his subrogation rights in any third party recovery. The negligent third party, however, is barred from seeking similar recompense from the employer. Consequently, the third party bears the burden for the accident while the negligent employer escapes all liability.[19] In addition, third party suits may be barred for any number of technical legal reasons. For example, tort statutes of limitation generally ban a suit two, or three years after the negligently caused injury. In malpractice suits, which may be brought against physicians rendering services provided under workers' compensation, the statute may be as short as one year. Some serious consequences óf an injury may occur only after that time has passed, yet these statutes will preclude third party compensation. (Consequently, some insurers simply institute suit whenever a slight

19. This supports the argument that either employers should be liable for negligence—which thoroughly disrupts the workers' compensation "compromise" of certain but limited liability—or that the third party's liability should be reduced in proportion to the employer's liability which is the case in jurisdictions where the third party's liability is limited to his share in the causation.

possibility of third party liability exists, thereby incurring useless costs in many such situations—a different but important point.)

Third party liability may vary in otherwise equal situations depending upon how the state workers' compensation law interacts with Social Security Disability Insurance (DI). The federal law provides for reduction of the DI benefit if the combination of DI and workers' compensation produces more than eighty percent of pre-disablement pay. Some states, however, provide for reducing the compensation benefit when DI also is payable. When reduction of the DI benefit rather than workers' compensation occurs, a third party recovery for the disabled person will be smaller than in the reverse situation because a greater part of the third party recovery is deducted from the employee's share. This completely fortuitous and unanticipated result is especially unfortunate since Disability Insurance cases necessarily involve extremely serious injuries, for which tort recoveries tend to replace a relatively small portion of actual losses.

Shifting the financial burden to the wrongdoer also becomes impossible when the wrongdoer is unknown or uninsured. Nevertheless, a device exists for protecting victims against damage attributable to an uninsured or unknown driver. Several jurisdictions require, either explicitly or in practice, uninsured motorist coverage paid for by the potential victim. In some cases, however, this coverage provides for the deduction of workers' compensation medical or cash benefits; jurisdictions vary in allowing such offset. If the uninsured motorist insurer could not make such deductions, its payout would be greater and, therefore, its premium charges to the class of potential victims would be higher. The question arises whether it is more or less sensible and fair to fasten that burden upon the workers' compensation insurers and through them upon employers. Whichever disposition occurs, employers' burdens vary depending upon the fortuitous factor of employee exposure to uninsured or unknown motorists. (As group insurance, workers' compensation is bound to be less costly than uninsured motorist coverage, which is written as individual policies.)

If, as some argue, workers' compensation liability spurs employer attention to safety because its rates may vary according to net benefits paid to its employees, the possibility and predictability of third party recoveries may reduce that incentive. For example, a manufacturer of machinery may be liable to an employee of a purchaser injured by the machine under one or another doctrine governing products liability, despite inadequate maintenance or alteration by the employer whose interests focus upon low costs and high production. In the long run, the employer's insurer charges rates based upon net payout. To the extent that third party liability recoveries reduce that payout, the lowered workers' compensation rates charged the employer reduce the employer's need to pay attention to safety. Similarly, third party recoveries may reduce the employer's compensation insurer's financial incentive to initiate safety reviews.

In summary, if a negligent third party can be found, the employer's insurer may reduce its net payout by recovering from the third party or its insurer. The employee may enhance his compensation if the third party recovery exceeds the employer's compensation payments and the out of pocket cost of obtaining it. Whether such enhancement occurs often depends upon factors that are fortuitous and do not vary according to the needs of the injured employee or the employer's culpability. The first result of third party liability is to reduce the employer's insurer's costs. Whether it also increases the employee's frequently inadequate compensation benefit, notably inadequate in cases of more serious injury, depends upon whether the employee knows of his rights or secures an attorney who knows how to navigate the shoals of third party practice.

VI. Non-Benefit Costs of Third Party Arrangements

Whether or not third party liability enhances the injured employee's total benefit, it undoubtedly increases the non-benefit costs of all concerned. At the minimum, the employee or employer incurs expenditures in presenting and negotiating the third party claim, often duplicating material prepared for the presentation of the original compensation claim. In addition, attorney expenses frequently will be incurred by both sides. The third party and its insurer will expend time and effort on receiving the claim, conducting investigations (duplicating the efforts of the original claimant and the employer's insurer), negotiating, and possibly litigating. In products liability cases, for instance, some experience sets the cost of defense of a claim at additional expenditures of thirty-five cents for each dollar paid in settlements and judgments.[20] As with all tort claims, the parties settle most third party cases. Often insurers pay claims because of their nuisance value. They compromise others, despite doubts about liability, because of the costs and risks of going to trial and verdict.[21] Cases that go to trial, verdict, and judgment occasionally

20. *See* Appendix *infra*.

21. H. Ross, Settled Out of Court: The Social Process of Insurance Claims Adjustment (1970) documents this well known practice for automobile tort claims.

produce dramatically large recoveries which stimulate other third party claims and encourage hard claimant bargaining.

In sum, third party liability raises prices because *all* the possible risk bearers insure separately and build their insurance costs into their prices. The cost does *not* fall only upon the party ultimately liable because each party in the chain incurs commission and other costs of duplicative insurance. Moreover, the resulting multiple procedures increase the non-benefit costs of all parties.

At a rough estimate, third party claims generate $1.5 billion[22] in third party payments, a small fraction of which reduces workers' compensation premiums, at a substantial cost to employees, employers, and third parties. As a consequence, the allocation function (charging the guilty, increasing its costs, and thus lessening its ability to compete) may not operate as advertised. The program proposed here would capture third party funds for more compensation at less cost, with more certainty, better allocation effects, and fairer outcomes to employers, employees, and third parties.

VII. ELIMINATING THIRD PARTY SUITS, IMPROVING COMPENSATION BENEFITS WHILE REDUCING WORKERS' COMPENSATION AND THIRD PARTY COST[23]

The "Longshoremen's and Harbor Workers' Compensation Act Amendments of 1972"[24] suggest a way to reduce compensation and third party costs *and* improve compensation benefits. Prior to 1972, employee representatives complained that the Longshoremen's and Harbor Workers' Compensation Act paid inadequate benefits. Simultaneously, shipowners and stevedores (the companies that provide loading and unloading services to ships with longshore employees) experienced rapid and dramatic increases in liability insurance costs due to application of the "unseaworthiness" doctrine. Under that doctrine, the shipowner (or charterer) had the duty to provide those who worked on ships with a seaworthy vessel. In effect, the vessel owner (or charterer) had almost

22. *See* Appendix *infra*.

23. The book of which this article will be a part introduces a more comprehensive proposal that deals with non-employee injury and illness as well. This article assumes that in the short run, greater interest and possibilities exist for making limited changes in workers' compensation and third party liability arrangements.

24. 33 U.S.C. §§ 905, 906, 908, 909 (Supp. V 1975) relate to liability and compensation.

absolute liability to a maritime worker injured on a vessel and often incurred large damage awards. This situation resulted from the Supreme Court decision that a longshoreman at work on a ship could sue the shipowner (or charterer)—the third party—for tortlike damages for violation of the unseaworthiness doctrine.[25] The Court subsequently ruled that the shipowner (or charterer) could sue the stevedore company which employed the injured longshoreman for breach of implied warranty of workmanlike performance when, as was common, the stevedore or its employees (longshoremen) created the hazard that caused the injury.[26] Thus, despite the stevedores' limited liability under the Longshoremen's and Harbor Workers' Compensation Act, they (or their insurers) paid substantial judgments to the shipowners (or charterers) for their own employees' injuries. As a result, stevedore insurance premiums increased, which led to stevedore price increases to shipowners and charterers. In addition, shipowners and charterers incurred third party liability costs which they could not pass back to stevedores.

Faced with accelerating costs and complaints about low compensation benefits, shipowner, charterer, stevedore, and employee representatives worked out a compromise: abolition of the seaworthiness doctrine for longshore workers, thereby eliminating that brand of third party suit, accompanied by a significant increase in Longshoremen's and Harbor Workers' Compensation Act benefits. The enterprises affected preferred larger but more predictable compensation benefits payable out of the savings effected by eliminating a particularly costly brand of third party liability. Employee representatives preferred the increased benefits that flowed to all longshore workers at the sacrifice of those large individual recoveries that came to a handful of workers. Moreover, all concerned groups shared the savings effected by eliminating overhead and administrative costs associated with such claims.

For much the same reasons and to achieve essentially the same results, I propose the elimination of third party suits *plus* the adoption of arrangements to obtain funds from those relieved of such liability to enhance workers' compensation benefits and to reduce employer workers' compensation premium rates.[27] In part, reducing third party costs

25. Seas Shipping Co. v. Sieracki, 328 U.S. 85 (1946).

26. Ryan Stevedoring Co. v. Pan-Atlantic S.S. Corp., 350 U.S. 124 (1956).

27. I drafted this proposal long before I became aware that "The Special Committee for Workplace Product Liability Reform" proposed elimination of third party liability in workers' compensation cases. My proposal to obtain funds from those whose liability

can be justified on the ground that under present arrangements third parties bear the costs of some unfortunate but quite fortuitous occurrences. By eliminating third party suits, several other inequities inherent in the present system will be alleviated. No longer will negligent employers be able to avoid the costs of some accidents to which they contributed. By removing rights of subrogation from the compensation scheme, the conflicting interests of employer and employee in third party suits will be eliminated. The compensation afforded employees "fortunate" enough to incur injuries implicating third parties and the usual recipients of workers' compensation with equal impairments will be equalized. The adoption of this proposal should also reduce the spiraling costs of all concerned.[28]

It is unclear who bears the costs of insuring against third party liability. Whenever possible, third parties build their liability and non-benefit costs into their price structure. This results in a shift of much of the burden to customers. Subcontractors, for instance, transfer their third party liability costs to general contractors in their job rates. The general contractor, therefore, eventually finances his employee's recoveries against such parties. Similarly, the enterprises that must pay substantial products liability insurance premiums add them to their sales prices, thus shifting the costs of third party recoveries to the enterprises that purchase their products. The costs transferred include substantial non-benefit as well as compensation costs.[29] Thus the employer's limitation of liability under workers' compensation becomes illusory.

Elimination of third party suits would substantially reduce the rising and often duplicative costs inherent in the present system. Unlike the longshore situation, the abolition of third party suits in workers' com-

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would be extinguished constitutes the major difference between the two proposals. The Committee proposal is contained in an undated 1977 processed memo entitled Pending or Proposed Federal Product Liability Legislation (on file in Washington University Law Quarterly office).

28. Recent workers' compensation insurer experience reportedly has been unfavorable. So, in 1975 the major stock company insurers and state funds reported pre-tax losses on their workers' compensation activities. For participating stock companies, the losses amounted to five percent of net premiums written. National Council of Compensation Insurance, Insurance Expense Exhibit, 1975 (1976).

29. *E.g.*, SPECIAL COMMITTEE FOR WORKPLACE LIABILITY REFORM, THE CURRENT PRODUCT LIABILITY CRISIS (Processed 1977); I INTERAGENCY INDUSTRY STUDY I-6, III-2, III-20. THE AMERICAN MUTUAL INSURANCE ALLIANCE, SURVEY OF LARGE-LOSS PRODUCTS LIABILITY CLAIMS (1977) reported several carriers' losses over $100,000 and described defense costs of ten percent of claims paid excluding insurer's internal costs.

pensation cases is insufficient by itself to accomplish the stated purposes. In the longshore situation, the shipowner-charterer group as constant purchasers of stevedoring services bore the cost of the unseaworthiness third party liability; the elimination of that doctrine reduced the immediate costs of the stevedoring employers, enabling them to afford increased compensation payments. In contrast, non-maritime third parties (other than in the contractor-subcontractor arrangements) who would be relieved of third party liability typically are not the customers of the injured employees' employers. Indeed, one large group of third parties consists of strangers, whose savings from elimination of liability could not under present arrangements reach the employer and thus enable it to afford more ample compensation benefits. Another large group, makers of manufacturing equipment, sells to employers only intermittently. Their savings by virtue of eliminating their third party liability would be passed along to a small fraction of employers, if any, in the lowered costs of their products. Past purchasers of such goods amortize the *past* cost and thus participate in price reductions, if at all, only when making a replacement purchase at some future time. In addition, the imperfections of the market give no assurance that third parties will translate their savings into price reductions which would enable the purchasing employers to make larger compensation contributions.

Extinguishing third party liability without the simultaneous creation of a supplementary workers' compensation fund would provide direct advantage only to third parties who seek such relief from rising insurance costs. Eliminating third party liability would increase employer costs because they no longer would be relieved of the payments currently offset by third party recoveries. Nevertheless, by eliminating the third party claims, administration costs, and sharing amounts otherwise devoted to pain and suffering, funds will become available to meet the needs of all groups now enmeshed in the third party web.

Eliminating third party liability would make available perhaps as much as $1.5 billion for these other purposes. To provide incentive to those paying for insurance attributable to third party liability and in recognition of the sometimes arbitrary imposition of liability, a substantial portion should be translated into savings for the third party groups. The remaining amount should be made available (as described in Part VIII below) to enhance workers' compensation benefits and decrease employer compensation costs. Nothing less would persuade employee representatives to forego employee claims against third parties. If the new funds prove quite substantial, they might enable the institution of cost-of-living adjustments for compensation benefits, adjustments that generally do not occur but are sorely needed. By sharing in the funds otherwise devoted to third party liability, employers would have a strong incentive to support such a change. In addition, enhanced employee benefits would reduce pressure and justification for future benefit improvements.

The proposal simply to extinguish third party liability, besides lacking appeal to both employers and employees, also suppresses the allocation function according to which the costs attendant upon more hazardous enterprises tend to reduce their ability to compete with less hazardous enterprises that have lower insurance costs. The proposal put forward here would maintain that allocation function at least by product line. In addition, lower rates might be earned, not as at present by reducing claim payout, which encourages resistance even to valid claims and thus provides no certain guide to comparative hazard, but by adopting specific safety devices or procedures, such as periodic product safety reviews by an independent agency and observance of the reviewer's safety design recommendations.

VIII. Administering the Proposal

The first task is to ascertain the amounts that now go to pay third party claims. Many third party groups have a known or discoverable track record for involvement in injuries to the employees of others. By sampling insurance records this information can be translated into industry and activity accident compensation premiums and administrative costs. Starting with those existing casualty insurance rates by industry, a sampling of carriers for third party claims would make possible reasonable estimates of the portion of premium allocable to third party claims. These constitute the amounts to be shared.

One quarter might be earmarked for third party savings—a premium decrease. The remainder would be mandatorily payable to a workers' compensation supplementation fund. In other words, each employer's contribution to the fund would be based upon his industry rate as ascertained by examination of industry case records. Future adjustments in the industry rates would depend upon sampling closed workers' compensation cases to ascertain the rates of injury associated with each industry. Individuals' insurers would vary their rates, not by "experience rating," but by the adoption of specified safety programs, such as product design reviews by independent experts or by the adoption of specified safety devices. These industry rates and individual variations would produce precisely the allocation effects claimed for experience rated liability insurance. Keyed to workers' compensation benefits rather than tort or products liability recoveries, the rates would be far more stable and predictable. The three quarters of third party premium diverted to the supplementary fund would be shared by employers and employees. Such amounts would be readily translated into premium reductions for all employers and benefit increases to employees, possibly providing fuel for cost-of-living increases.

The results of third party activities often extend beyond the states where they originate. So, for example, products manufactured and automobiles insured in one state may contribute to injury in others. If third party products and activities are to make their proper contribution, they should be pooled nationally and added to existing benefit schedules. Although "national" sounds "public," it need not be; it would, however, require federal legislation. Private insurers, state funds, self-insurers, and unions could participate in a national consortium to operate the National Insurance Compensation Enterprise—which would be NICE.

To ensure national coverage, Congress could invoke its power over interstate commerce to establish the supplementary compensation fund and extinguish third party liability—a classic "compromise" for which there exists ample constitutional authority among the cases validating the early workers' compensation acts.[30] The legislation would enable private insurers and state funds to participate in a corporation to administer the fund, including adjusting rates to reflect changed conditions of industry hazards, the availability of new devices, and procedures designed to improve products and service safety. Access to the advantages and obligations of the corporation could be conditioned upon the state's adoption of the national standards (obliteration of third party liability, making third party groups subject to contributions to NICE, and adopting specified improved compensation rates). The manner of administering the added benefits, either directly to beneficiaries or through existing insurers, could be left to the corporation's decision after all concerned thoroughly canvass the varieties of such arrangements; it might even experiment with different arrangements in several jurisdictions.

CONCLUSION

The pressing need to restore reliability to the products liability field, to temper workers' compensation costs, and to improve compensation ben-

30. *E.g.*, New York Central R.R. v. White, 243 U.S. 188 (1917).

efits all recommend this proposal. Workers' compensation and products liability face real and urgent problems. Both must adapt to rapidly changing circumstances and increased demands. The program proposed here can transform the unnecessary costs, inefficiencies, frequent unfairness, and constant unpredictability of third party doctrines and practices into practical improvements for tort, products liability, and workers' compensation programs.

APPENDIX—Estimated Costs of Third Party Claims

ESTIMATE OF THIRD PARTY (TP) CLAIMS COSTS FOR WORKERS' COMPENSATION CASES CLOSED IN 1974

1. Basic Statistics From Published Reports and Studies
   a. Total number of WC cases closed in 1974 1,500,000
   b. Percent of cases involving TP claims 2.1%
   c. Mean benefit payment for permanent partial cases.......... $4,278
   d. Ratio of average product-workplace-injury payment to average WC payment for cases closed in 1972, (3,325/1,933) 1.67
   e. Medical and hospitalization expense for all WC cases in 1974.. $1,750,000
   f. Administrative and legal expenses for product liability claims as a percent of benefit payments 35%
2. Estimated Unit Costs Per TP Claim
   a. Adjustment factor for relatively greater size of TP awards..... 5.0
   b. Compound adjustment factor for item 1c, (1d×2a)............. 8.35
   c. Benefit costs, (1c×2b) $35,721
   d. Administration and legal fees, (1f×2c) $12,502
   e. Medical and hospitalization costs, (1.5×1e/1a)............... $1,750
   f. Per unit cost of TP claim (2c+2d+2e)........................... $9,973
3. Estimated Gross and Net Additional Costs Arising From TP Claims
   a. Number of TP claims, (1a×1b) 31,500
   b. Gross cost for all TP cases, (2f × 3a) $1,570,000,000

I estimate the potential net costs of third party claims as follows:

The Closed Case Survey of the Interagency Task Force on Workers' Compensation found that 2.1% of its considerable sample of cases closed nationwide in 1974 involved third party claims. It estimated that in 1974 some 1,500,000 (1.a) workers' compensation cases were closed. Hence 2.1% (1.b) would constitute roughly 31,500 cases (3.a).

I assumed that temporary disability claims generally are too small to warrant the expenditure of time and effort required to seek reimbursement from a potentially liable third party. And while death and permanent total disability cases involve substantial claims, they are comparatively few in number. However, an estimated 121,000 permanent partial claims were closed. For simplicity, therefore, I treated all 31,500 closed cases involving third party claims as if they involved permanent partial injuries, a quite conservative assumption. The Task Force assumed a mean permanent partial award of $4,278 (1.c).

In 1974, about $1.75 million were paid out in medical and hospitalization workers' compensation benefits. (1.e) Price, *Workers' Compensation: Coverage, Payments and Costs, 1975*, 40 SOC. SECURITY BULL. 31, 33 (Jan. 1977). Third party cases often will involve larger than average compensation awards. For example, one study of New York awards put the 1972 average compensation for all closed cases at $1,998. Product workplace injury claims (involving aircraft, chemicals, ladders, and motor vehicles), however, produced average closed claims of $4,174, $3,190, and $2,409 respectively (which, unweighted, average $3,325). Thus, workplace injury claims compared with average claims produce a ratio of 1.67.

In addition to costs involved in the workers' compensation procedure itself, third party claims produce additional costs, which include the acquisition costs of the third party's liability insurer, that insurer's cost of investigating the claim (duplicating the workers' compensation insurer's investigation), costs of third party insurer adjustment efforts, and costs of third party counsel and trial, and expert witnesses.

For example, one study reported products liability claims for bodily injury require 35¢ in additional costs for each dollar paid in benefits. (This includes costs for investigating unsuccessful claims.) The greater part (83%) of such costs go for attorneys' fees. Defense costs averaged $3,500 per case. INSURANCE SERVICES OFFICE PRODUCT LIABILITY CLOSED CLAIM SURVEY, A TECHNICAL ANALYSIS OF SURVEY RESULTS: HIGHLIGHTS 3-4 (1977). Whether the processing of non-products liability third party claim cases causes equally high expenditures is not known. It probably does. Hence, I assign 35% as the administrative and legal expenses for products liability claims as a percentage of third party benefit payments.

I further assumed that tort case settlements and verdicts would average out to five times the amount of compensation benefits and medical expenditures (2.a). Several commentators report very approximate rules of thumb for estimating the multiplier applied to "specials" to get a "normal" settlement figure. Professor O'Connell, for instance, reports that a rule of thumb for pain and suffering may range from "two or three, or even seven or ten times the medical bills." J. O'CONNELL, ENDING INSULT TO INJURY: NO-FAULT INSURANCE FOR PRODUCTS AND SERVICES 51 (1975). One handbook puts the range at 2 1/2 to 10 × the specials, but says that five tends to be high. C.T. JOHNS, AN INTRODUCTION TO LIABILITY CLAIMS ADJUSTING 455 (1972). Although admittedly rough, I reasoned that compensation for the more serious injuries tend—according to innumerable studies—not to compensate actual losses of earnings; and even medical expenditures sometimes are not fully compensated. Hence, out of pocket expenditure for workers' compensation victims would be greater than the mean compensation benefit. I therefore applied a further adjustment factor (2.b).

2.c shows the benefit cost per third party claim. 2.d presents the administrative and legal fees obtained by applying the 35% third party costs to the preceding benefits cost. 2.e represents the per case medical and hospitalization cost for a third party claim—assumed to be 1.5×the average such cost for all cases (total med-hospital cost divided by total cases). 2.f is the total per unit third party claim costs (2.c+2.d+2.e).

As noted at the outset, some 31,500 third party claims were closed in 1974 (3.a). Hence, the gross total costs of third party payments totalled $1.57 billion (31,500 cases×$49,973 per case cost). About $.19 billion, however, were assumed to be devoted to reducing workers' compensation payments, i.e. the average payment for permanent partial cases×31,500. Hence, net third party expenditures available for redistribution under the arguments proposed in this article come to about $1.38 billion. This amount does not include non-benefit costs other than investigation and litigation expenses. The attendant insurer costs (such as advertising and promotion, commissions, taxes, etc.) should also be shifted from third party to first party coverage. Thus, approximately all of the third party pure premium would be available to be applied as worker compensation benefits, with the savings to be enjoyed by third parties derived from the portion of gross premiums devoted to investigation, negotiation, and defense of third party claims.

Under the proposal, claimants would realize higher net benefits than under third party arrangements because a smaller portion of benefits would be diverted to claimant lawyer fees; tort claim lawyer fees typically fall in the 20-35% range, while workers' compensation lawyer fees run at about half those amounts—frequently applied not to the full lump sump (as with third party claims) but to smaller portions of the recovery. And I hazard the guess that lawyer representation is more common for third party, tort-based claims than in workers' compensation cases.

The estimate does not take into account the increasing number of products liability claims and rapidly escalating judgments which necessarily result in settlements larger than those assumed in making the estimate presented here.