Can We Compensate for Incompensable Harms?

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I. INTRODUCTION

Compensating for harms is the bedrock of the practice of tort law. The hypothetical ideal of "making the victim whole" guides many a classroom discussion and judicial opinion. Yet we all know that this ideal is often unattainable for a variety of practical and conceptual reasons. Focusing on the conceptual issues, a question might be asked: Are we ever really able to make the victim whole? Realizing this ideal requires that the victim be brought to a state of indifference between (1) having been harmed and subsequently compensated and (2) having never been harmed in the first place. Obviously, in practice we never expect to be able to give a potential tort victim such a choice, but this is

often the benchmark we use in assessing proposed compensation.

Striving for an unattainable ideal is never easy, especially when dealing with personal harms so prevalent in tort law. Yet one type of harm stands out as posing even more difficulties: those harms where moral intuition suggests that no compensation may ever be sufficient to bring the victim closer to a state of indifference. It is precisely this stronghold that Robert Cooter aims to conquer with his theory of compensation for risks rather than harms in his article, *Hand Rule Damages for Incompensable Losses*.[1]

In a nutshell, the problem Cooter addresses is this: With harms that are by their nature incompensable, even the hypothetical ideal of making the victim whole breaks down. The problem of incompensability makes any amount of monetary compensation irrelevant to the basic goal of bringing the victim to a state of indifference between the actual turn of events and the hypothetical absence of a tort. While some have suggested that this makes compensation irrelevant, Cooter correctly stresses that this would exacerbate the problem rather than mitigate it.[2] We are thus in need of a theoretical ideal to strive for in the case of incompensable harms, since making the victim whole is impossible in theory as well as in practice. Cooter's article aims to fill this gap by shifting the focus from compensation for the actual harm to compensating for the potential harm, namely direct compensation for the *risk* created by potential tortfeasors.

It must be stressed that Cooter is well aware that his framework may be inapplicable in full due to practical considerations, yet he defines the first-best ideal to strive for in the case of incompensable harms. This contribution to the theoretical literature is thus significant, even if practical issues preclude full implementation at this point. The article does an important service, not only in outlining the hypothetical ideal that may guide future discussions, but also in presenting and developing the key methodological tools that must be mastered by those who venture into this difficult arena.

Of course, one need not accept an argument in its entirety in order to concede its value. In what follows I aim to stress and develop the aspects of the argument I find most convincing, while critiquing others. While Cooter is focused on the end result of developing a compensation theory that circumvents the problem of incompensable harms, most of my misgivings and suggestions lie with the methodology employed in the process. I do hope that improving upon the means will enhance the

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    1.   Robert Cooter, *Hand Rule Damages for Incompensable Losses*, 40 SAN DIEGO L. REV. 1097, 1098 (2003).
    2.   *Id*. at 1101–02.

end as well, but I also hope to convince the reader that advances in method are worthy in and of themselves and that discussion within this context may lead to application in others as well.

II. ANALYZING INCOMPENSABILITY

Cooter draws an important distinction between harms that are incompensable in practice and those that are incompensable in principle.[3] Practical considerations preclude full compensation in a variety of circumstances, such as lack of markets that would allow objective assessment of the harm caused or replacement of a unique good. The key problem addressed here, though, is incompensability in principle—when the harm done is of a nature simply impossible to compare to any monetary unit. Because our aim to make the victim whole may be seen as the victim's hypothetical indifference as described above, Cooter utilizes the framework of indifference curves prevalent in the microeconomic literature. This graphic representation is a powerful tool for overcoming problems that seem to require interpersonal comparisons of utility, but can actually be solved by relying solely on an individual's own utility. Discussion of compensation is especially suited to this type of analysis, as we refer directly to hypothetical points of indifference: the first-best aim of compensatory damages. While some see incommensurability as limiting the application of economic models in legal and philosophical debate,[4] Cooter shows that the indifference curve methodology may still be judiciously employed. Incommensurability is thus interpreted as the incomplete ordering of indifference curves, allowing for flexibility in the point at which the harm becomes incommensurable with monetary compensation.

The use of indifference curves to graphically convey incommensurability is carried out in two formats that Cooter presents as similar for our purposes. In the first, we see that for some values of health, compensation for loss is possible in principle, while below a certain point we lose commensurability altogether. Graphically, the indifference curves fail to cover all of the relevant space. An economist would take such an argument to state that economics simply cannot inform the discussion of compensating below the relevant threshold. In the second, however,

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3. *Id*. at 1103, 1109.
4. *See, e.g*., Margaret Jane Radin, *Market-Inalienability*, 100 HARV. L. REV. 1849 (1987).

indifference curves do cover all values of the good measured, only they are lexical below the threshold and convex above it. Thus, where preferences are lexical, no amount of money can compensate for any additional loss of health.

While Cooter presents both formats as signifying incommensurability, I find an important distinction here is overlooked: Lexical preferences signify that preferences do exist for all of the relevant space, only that one good (here, health) is valued infinitely more than the other. In the first instance of no indifference curves, an economist should profess humility by recognizing that some human decisions cannot be described with economic models. In the case of lexical preferences, however, it is not that the model is inapplicable to the question at hand; it is only that its results are difficult to analyze. A *lack of preferences* is not the same as the existence of lexical preferences, despite both cases' resistance to standard monetary compensation for harms caused.

For example, Cooter poses the question: "How much money would you take for your eye?" as an example of a question which is wrongly formulated, that the amount of money should never influence the answer.[5] If this is the case of lexical preferences, one must ask what is so different from a previous example Cooter uses: "I do not know how much I would accept for a fifteen percent decrease in my visual acuity, but I could figure it out if faced with the possibility of selling it."[6] Granted, some people may agree that there exists a fundamental difference between losing one's eye and a relative decrease in visual acuity, but is one really commensurable with money, while the other is incommensurable in principle? If so, and assuming that we are able to somehow figure out where exactly the fine line between the two cases lies, is this the case of lexical preferences or of incomplete ordering?

I suggest that there exists a fundamental difference between incomplete ordering and any type of complete ordering, including partially lexical preferences. Lexical ordering, as its name implies, grants one of the goods infinite value with respect to the other. Incomplete ordering is, as its name implies, well—incomplete. Thus, in the examples of incommensurability typically posed in philosophical and legal debate, lexical ordering is implicitly assumed. When asking how the courts can compensate for the loss of a loved one, or for significant bodily harm, scholars routinely assume money is of less value than the harm caused, that is, that preferences are lexical. Incomplete ordering would imply that we have *no opinion* regarding the comparison, thus it is not that no amount of money would compensate for the loss, but that there is a fundamental

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5. Cooter, *supra* note 1, at 1101.
6. *Id.*

difference between the money and the harm, so that money is simply not a factor. To stress the point, most people would be offended by the question, "How much money would you accept for the death of your child?" not because they *do not know* how to compare the two, but because the life of a child is presumably much *more valuable* than any amount of money. To say that the ordering is incomplete in this case would lead us to the result that a person would be unable to formulate whether he prefers the money or the life of a child.

Contrary to Cooter's treatment of both types of ordering as similar forms of incommensurability, I find lexical preferences to be much more suited to signify the problems encountered in the legal literature of compensatory damages. From this we can conclude that the economic model of indifference curves is applicable to the problem at hand, but we shall need to deal with the difficulties of analyzing lexical preferences.

III. ECONOMETRIC ANALYSIS OF RISK AND PROSPECT THEORY

The main problem in using any type of economic model to study incommensurability is that economics has little to offer if we cannot, at least theoretically, compute the value of the harm caused. Since the outset of this discussion, it has been repeatedly stressed that, similarly to certain other types of harms, life has no monetary equivalent. What is an economist to do? Cooter utilizes previous studies in order to shift the focal point not to the harm caused, but to the risk of its occurring. "If we cannot measure the value of a life," it might be stated, "can we at least measure an individual's subjective assessment of the risk involved?" Measuring people's actual expenditures to reduce the risks they face, the argument goes, allows us to infer the subjective value they associate with their lives. Now it must be stressed that Cooter is careful to avoid actually associating monetary expenditures with the value of life as such and explicitly rejects such an identity. Yet he is able to use these studies by shifting the discussion as a whole from compensating for loss of life or limb to compensation for the creation of such risks. We cannot measure the subjective valuation of human life; indeed our whole discussion of incommensurability stresses that such a monetary valuation is impossible in theory as well as in practice. What we can do is measure the monetary valuation of the reduction in risks, including the risk of suffering incommensurable harms, and Cooter makes full use of this. It is here that the crux of the argument lies, and it is here that I shall focus my critique.

The study of people's actual expenditures to reduce the risks they face is commendable as a measure of their subjective risk valuations. Still, there is a conceptual problem that must be faced before such an inference can be made. We are all aware that people suffer from various idiosyncrasies in their investment decisions. As long as these idiosyncrasies are personal in nature, we may still use studies evaluating large numbers of such investments as a good measure of average valuation because personal eccentricities[7] tend to cancel out, leaving us with a statistically unbiased estimator. However, the problem we need to attend to is that investments in risk reduction are subject not only to mistakes but also to significant bias in a manner that taints the average itself. Simply put, there exist elements affecting most individuals in a certain way, so that these investments do not reveal their true risk valuation; studying averages of a large number of such decisions does nothing to correct for these biases.

The types of bias to which I refer have been extensively studied, beginning with Tversky and Kahneman's famous "prospect theory."[8] Examples of such behavior are widespread and well-known and include the difficulty most people have in fully incorporating the existence of low levels of risk into their behavior, despite the fact that if the risk does materialize, a significant harm will occur. For example, an individual maximizing his expected utility should be willing to spend at least an identical amount to eliminate a 1% risk of a $100,000 loss as he would to eliminate a 50% risk of a $2000 loss.[9] Experimental evidence shows that this is not the case, as individuals generally see the higher risk level as *more real* even when the individual has (and is able to understand) convincing data that the discounted present value of both risks is identical.[10] Similarly, studies show that following a large and widely-reported earthquake, more people buy homeowner's insurance, despite the fact that their objective circumstances have not changed, and the risk to their property is no greater than it had been before the earthquake.[11]

The relevant point for Cooter's article is that we cannot use data on people's actual expenditures in order to achieve a true assessment of

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7. An economist might refer to these eccentricities as irrational.

8. *See generally* Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, *in* CHOICES, VALUES, AND FRAMES 17 (Daniel Kahneman & Amos Tversky eds., 2000).

9. Actually, this understates the problem by assuming risk neutrality. Most economic models assume risk aversion, so the person should be willing to spend *much more* to eliminate the low probability risk, given that the expected value of the loss (here, $1000) is the same.

10. CASS R. SUNSTEIN, RISK AND REASON: SAFETY, LAW, AND THE ENVIRONMENT (2002).

11. *See* Paul Slovic et al., *Rational Actors or Rational Fools: Implications of the Affect Heuristic for Behavioral Economics*, 31 J. SOCIO-ECON. 329 (2002).

their subjective valuation of the harm they would suffer if the risk materialized. Monetary investments in risk reduction are subject to numerous effects, biasing different individuals' choices in similar directions. These biases do not cancel out over large samples. To the contrary, they are reinforced and must be considered when making the transformation, on which Cooter relies, from the value of risk reduction to the value of harm avoidance.

It must be stressed that the word "bias" is not to be taken as derogatory in any way. The problematic nature of such biases is simply that most people are affected in similar ways. Hence, eccentricities do not average out over large groups. In order to convincingly use statistical data regarding risk assessment, we need to address the problems of psychological bias directly. Cooter thus relies all too readily on the available statistical data and would do better to incorporate some of the insights behavioral economics have to offer on topics such as these.

IV. THE HAND RULE AND THE PERFECT INSURANCE MARKET

An important step in Cooter's argument is in offering a novel method of employing the well-known Hand rule to solve the incommensurability problem. While traditionally used for assessing either the reasonableness of behavior governed by no clear norm or the reasonableness of an existing norm, Cooter proposes to "turn the rule around" in order to assess the harm done. I shall not repeat Cooter's excellent explanation of the "new" Hand method,[12] but instead focus on where I find the method wanting. Granted, a simple formula is easy to invert. Rather than multiply the probability of harm (the level of risk) by its "price" (if materialized) in order to assess the required reasonable level of investment in care, we can do the opposite: calculate the price of harm from the known level of risk and actual investment. Cooter does well to infer subjective value from use of an individual's own risk reduction investment to calculate his assessment of the harm. However, practicality demands that available data on averages be employed in our imperfect world. Still, a number of points must be made.

First, this is an application of the data referred to above, and the problem with inherent bias persists. We must remember that the problem is more than of statistical value. Cooter employs the above econometric data to get around the incommensurability problems by arguing that

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12. *See* Cooter, *supra* note 1, at 1112–15 (explaining the new Hand rule).

subjective investment in risk reduction shows subjective valuation of the harm itself: here, harm to life and limb. Thus, if we are to be convinced by his overall argument that risk valuation can be employed rather than the impossible valuation of the harms themselves, it is of special importance that at least the data regarding risks be measured without inherent statistical bias.

Second, this inverted use of the Hand formula does not come without a cost. Once we decide that the variable of interest is the level of harm (L in Hand's notation), we can no longer use the formula to calculate the original variable, the burden of care (B in Hand's notation). In essence, this is the old problem of "grasping the stick from both ends" bathed in mathematical jargon. One equation cannot be used to calculate two unknowns.

Thus Cooter's use of the Hand formula to determine the appropriate valuation of incommensurable harms necessitates an independent negligence assessment, which would be a return to the original "reasonable person" standard unassisted by the Hand rule. This point goes unattended in the article and may perhaps be defended by a firm belief in judicial insight and experience regarding negligence determinations and reasonableness, such that the Hand formula is unnecessary in this respect. Still, as one accustomed to economic analyses of tort law, it seems to me that this would be a high price to pay. Cooter's emphasis that "the reasonable person . . . does not make mistakes or suffer regret"[13] makes it clear that he still holds on to the hypothetical ideal governing tort law, thus making it less likely that he would gladly relinquish the formula's contribution to judicial consistency and predictability.

Utilization of perfect insurance markets completes Cooter's treatment and is presented as a theoretical framework that would solve the problem of incompensable harms in a first-best world. The move from compensating for the harms themselves to compensation for risk creation truly is remarkable as a theoretical insight and holds potential for circumventing incommensurability altogether. While many share the view that harms of the nature described are incomparable with money in any way, individuals do allocate funds to reduce the risks of such harms and make constant choices as to how much they are willing to spend. Thus, if we can focus on compensating for risk rather than harm, we have solved both the conceptual and the practical problem with which we began. The conceptual problem is solved because the incommensurable harm is not compensated for directly. The practical problem is solved because risk is, to a certain extent, measurable, using real data concerning the value people place on risk reduction.

Cooter's argument for a first-best regime in which risks are directly compensated for without further compensation when the harm materializes

13. *Id*. at 1113.

is convincing. His utilization of perfect insurance markets implementing such a regime while allowing for trade is in the best tradition of law and economic scholarship, achieving a first-best efficiency incentive while respecting individuals' rights to form their own subjective value and satisfy their own preferences perfectly. Of course, we are all well aware that insurance markets are not perfect, and practical issues preclude direct implementation of this framework. But that is irrelevant when dealing with a theoretical construct for a first-best world.

Unfortunately, I still find a basic conceptual flaw in the argument. The "compensation for risk" framework suggested creates perfect efficiency incentives, but Cooter aims higher than that. He also strives for fairness and a solution to the incommensurability problem. In essence, his solution can be stated as such: We cannot really compensate for these types of harms, because they are incomparable with money in principle. Let us then compensate for the risk created, using real world data and subjective risk valuations, allowing us to create the right incentives while maintaining the moral position that incommensurability implies with respect to the harms themselves.

In this move, Cooter implicitly assumes that the risk itself is compensable, regardless of the harm underlying it. However, are we convinced that such a fundamental difference exists between risk, as a probability of some harmful occurrence, and the occurrence itself? Surely, many find the question "How much money would you accept for the life of your child?" to be both repugnant and conceptually mistaken. Would those same people have no misgivings when the question is reframed as "How much money would you accept to put your child's life at risk?" If the life is incommensurable with money in principle, can we safely assume that the risk for that same life is commensurable? I think not.

True, many people make financial decisions regarding risk to life and limb, and the amount devoted to risk reduction is a finite sum. Yet this is not a determinant of the conceptual incommensurability problem. Similarly, the fact that juries in many jurisdictions do eventually award wrongful death monetary damages does not imply that life itself is comparable with money. We do these things because we live in an imperfect world and many times have no recourse but to make financial decisions regarding issues that are conceptually incompatible with money. The econometric analysis referred to above, while extremely important from a practical point of view, proves nothing in the moral realm. The move from compensation for harm to compensation for risk,

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while important and insightful, does not solve the incommensurability problem with which we began.

A related problem can be seen when we assess what it is that people actually insure for. For example, it has been observed that people are more likely to buy insurance (or are willing to pay more) for an object they have affection towards, regardless of pecuniary value.[14] While this seems self-evident, it suggests that insurance is not aimed solely to mitigate risk in securing an income in the face of some external monetary loss. Insurance is also often regarded as a form of consolation, so that the added income gives the insured some feeling of having received a benefit at a time of emotional distress. Surely some types of distress would be classified as incompensable in our discussion, notwithstanding the fact that the victim receives insurance benefits. The existence of such insurance in no way makes the harm suddenly compensable. It only implies that people correctly anticipate that some form of consolation will be needed and settle for what they can realistically get. Incommensurability is thus not avoided when we deal with risk rather than harm.

Returning to the preferences analysis above, it might be possible to interpret Cooter's position regarding incommensurability of harms as an incomplete ordering. Thus, people can be said to have no method of comparing certain types of harms to money, or even to each other.[15] Shifting the discussion to the risks involved might allow for a more complete ordering, based on the argument that risks are inherently more comparable than harms. Therefore, the indifference curves may cover more of the relevant space, allowing for traditional analytical methods of previously unrelenting dilemmas. On the other hand, if one assumes that incommensurable harms do have associated preferences, only that they are lexical in nature, the shift towards risk analysis demands that preferences change from the vertical, or lexical, type to a more standard convex shape. One must ask why such a change in preferences is to be assumed. If the risks cannot be disassociated from the underlying harms, why should we expect preferences to change with this shift? Of course, Cooter commits to neither of these options, as the point of incomparable risks is not addressed in his article.

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14. Christopher K. Hsee & Howard C. Kunreuther, *The Affection Effect in Insurance Decisions*, 20 J. RISK & UNCERTAINTY 141 (2000).

15. The famous dilemma of a parent forced to choose between saving only one of two children comes to mind. How does one compare the harm in order to make such a choice?

V. APPLICATION TO AUTO DEATHS

Cooter applies his analysis to compensation for wrongful deaths in automobile accidents, arguing that his framework would increase actual compensation.[16] Here especially we should stress the problematic nature of the econometric data relied upon, applying the lessons of prospect theory mentioned above. Investment in risk reduction is very sensitive to the type of risk assessed, and auto death is a notable example of existing bias. Without going into too much detail at this point, I shall just point out that the risk of automobile accident death is both highly publicized—an aspect leading to overinvestment due to the saliency effect—and a common, everyday occurrence, leading to underinvestment.[17] It may be that these biases tend to cancel each other out, but that is a very strong assumption requiring substantiating research.

More importantly, the conclusions stated rely on the standard economic assumptions that raising the price of auto insurance would result in higher care, thus reducing accidents. I find this particularly unconvincing in the chosen context of automobile accident deaths. While, as a general argument, increasing price does indeed increase supply, it seems that driving care is a notable exception. The price people pay for their lack of care while driving is not monetary, but manifests as an increased risk of bodily harm. Increasing the monetary cost of driving does little to alter the overall incentive scheme, given that the nonpecuniary loss is so large anyway. In economic terms, the supply of care in driving is very inelastic with respect to monetary returns, and if we aim to change driving habits, we must seek alternative methods.

Perhaps it is fitting that the problem faced here is precisely of the sort this discussion aimed at solving to begin with. Raising compensation for automobile accident deaths, if convinced that such is warranted, relies on data regarding risk valuation to raise the real price of driving. My critique above argues that this method is insufficient to circumvent the incommensurability problem because the risk itself may be incomparable with money in principle. In the context of automobile accident deaths, we encounter the application of this same problem. Monetary incentives are employed in order to change driving behavior, but this behavior has been chosen by drivers who consciously (one would hope) face risks of bodily harm. Because these types of harm are incommensurable with

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16.   Cooter, *supra* note 1, at 1114–16.
17.   Cass R. Sunstein, *Selective Fatalism*, 27 J. LEGAL STUD. 799 (1998).

money in principle, my critique suggests that the risks involved may be similarly incommensurable. Thus, looking to monetary incentives as a behavior altering mechanism may be overly optimistic. To the extent that money is an insufficient representation of the true value people attach to the risk of bodily harm, monetary incentives will be imperfect in achieving the results sought. Employing Cooter's terminology, if preferences were lexical to begin with, so that money is not interchangeable with bodily harm, raising the monetary price of careless driving adds little, if anything, to the perceived costs of an automobile accident.

Of course, this is not to imply that money will have no effect on driving behavior, as biases in risk perception may be constructively employed as well. It might be argued that raising the price of careless driving aids in adding to the low accident probability a higher probability and more immediate payment for insurance. This payment may induce care due to the saliency effect, thus assisting in our end result. While helpful in practice, this will not solve our more basic incommensurability problem. Cooter's theoretical construct is extremely helpful in reformulating the issues so as to advance our analysis. Still, it seems to me that if we wish to fully describe attitudes towards the risk of bodily harm as well as attitudes towards the harm itself, we must continue to struggle with incommensurability.