

The Collateral Source Rule and its Abolition: An Economic Perspective

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I. INTRODUCTION

The existing synergy driving tort reform across the United States is grounded upon the economic utility of special-interest groups. Consequently, it is of little surprise that it has generated defense-oriented, biased public policy outcomes.¹ Substantively, it defies the rational constructs underlying common law jurisprudence as well as the fundamental economic principles upon which our great commercial republic thrives. To reiterate, “proponents of tort reform welcome legislative and judicial mandates that challenge, if not eliminate, critical components of the pricing mechanism of the perfectly competitive marketplace of which such proponents would unequivocally and zealously object if implemented in their relevant commercial markets.”² Captured and fueled by special interests, legislative bodies continually respond to tort reform proponents by replacing tried and tested common law principles governed by the rule of reason with wealth-transferring, arbitrary statutory regulation. The biased and arbitrary nature of tort reform’s assault on the rule of reason and the rational actor model is best exemplified in the recent legislative initiatives seeking to eliminate the collateral source rule.

Arguments in favor of eliminating the collateral source rule ignore well established and long-settled tort principles of compensatory damages,³ indemnity,⁴ restitution⁵ and deterrence.⁶ Moreover, and more importantly, such arguments ignore fundamental micro-economic theory, including the concept of *opportunity costs*, a precept which has long been accepted among economists and utilized in conventional cost-benefit analysis. The misguided, the uninformed, as well as the self-interested who favor the abolition of the collateral source rule argue that it “essentially allow[s] a plaintiff to recover twice,”⁷ characterize it as “a source of windfall,”⁸ blame it for causing “an unacceptable misallocation of scarce resources,”⁹ and generally condemn it for facilitating “perverse outcomes.”¹⁰ While such criticism has successfully driven a majority of the states to recently enact legislation to eliminate (or alternatively, to minimize) the collateral source rule, it is nonetheless misplaced, illogical, deceptive, and most importantly, economically ill-conceived.

This article explores the historical and theoretical underpinnings of the collateral source rule. It observes that the rule was, and is, rational both from a common law perspective and an economic perspective. It further observes that the rule

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was, and is, necessary to effectuate the fundamental purposes of tort law: compensation, indemnity, restitution and deterrence. Finally, it observes that arguments seeking to eliminate the rule are counterintuitive to the economic perspective that has fueled the great commercial republic of the United States. This article concludes by asserting that legislation seeking to eliminate or minimize the application of the collateral source rule exemplifies interest group politics in that it creates arbitrary wealth transfers.

II. THE COLLATERAL SOURCE RULE AND ITS ORIGIN

Simply stated, the collateral source rule provides: “Payments made to or benefits conferred on the injured party from other sources are not credited against the tortfeasor’s liability, although they cover all or part of the harm for which the tortfeasor is liable.”¹¹ In other words, a plaintiff may recover compensatory damages that include amounts for which the plaintiff has already received compensation from sources independent or and collateral to the defendant tortfeasor.¹² While pre-trial compensation paid by a defendant tortfeasor for undisputed sums are credited against the tortfeasor’s ultimate liability, the collateral source rule prescribes “compensation or other benefits which an injured party receives from a source unaffiliated or independent of the responsible party are *not* deducted from the defendant’s liability.”¹³

The collateral source rule is both a substantive rule of damages and a procedural rule of evidence.¹⁴ As a rule of damages, a defendant is precluded from offsetting any award of damages against any receipt of *collateral* benefits or payments by a plaintiff.¹⁵ Such payments or benefits do not have the legal effect of reducing a recovery against the defendant.¹⁶ Whether plaintiffs are themselves responsible for the benefit (e.g., through the purchase of accident/health insurance benefits), or by negotiating favorable employment arrangements (which provide accident/health or disability insurance benefits as part of a total compensation package), or whether plaintiffs are merely the recipient of a gift (from friends, family or social institutions), such benefits are precluded in the analysis of a defendant’s liability. The collateral source rule does not differentiate between the nature of the benefits. It only distinguishes between whether the benefits were directly provided by the defendant (or a person acting on the defendant’s behalf) or from some other independent source.¹⁷ If from the latter, such benefits are to remain external to the analysis and computation of damages.

As a rule of evidence, the collateral source rule serves as an “evidentiary preclusion device.”¹⁸ It precludes the defendant from offering evidence in personal injury or wrongful death cases that some or all of a plaintiff’s damages were paid by some other, collateral and independent source.¹⁹ Accordingly, defendants may not introduce evidence that plaintiffs have access to insurance benefits, or to other benefits

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through their employment or have received gifts from independent third-parties, all of which may be used by plaintiffs to offset their personal losses resulting from the defendant's negligent conduct.²⁰

Although the collateral source rule had long been favored at common law,²¹ it was not until 1854 that the United States Supreme Court formally adopted the rule by holding that the defendant steamboat owners and operators could not avail themselves to a defense that plaintiff received satisfaction from plaintiff's insurers for its damages resulting from the sinking of its ship.²² The Supreme Court specifically reasoned, "[t]he contract with the insurer is in the nature of a wager between third parties, with which the trespasser has no concern."²³ As the Court further noted, "[t]he insurer does not stand in the relation of a joint tort-feasor, so that satisfaction accepted from him shall be a release of others."²⁴ And perhaps the logic of the Court's reasoning may best be understood by way of reciprocal illustration: the full payment of damages by a tortfeasor clearly should have no effect on the *wager* made pursuant to a legally enforceable contract duly supported by valuable consideration to which the tortfeasor is not a party. Although the term *collateral* was not used to characterize the types of benefits to which the rule/doctrine apply until 1871,²⁵ the Supreme Court's reasoning provided definitional substance to the applicability of the doctrine.

In 1871, the Vermont Supreme Court in *Harding v. Town of Townshend*²⁶ concisely summarized as well as fortified the underlying common law rationale for the collateral source rule:

There is no technical ground which necessarily leads to the conclusion that the money received by the plaintiff of the accident insurance company should operate as a defense, or inure to the benefit of the defendant. The insurer and the defendant are not joint tortfeasors or joint debtors so as to make a payment or satisfaction by the former operate to the benefit of the latter. Nor are there any legal privities between the defendant and the insurer so as to give the former a right to avail itself of a payment by the latter. The policy of insurance is *collateral* [emphasis added] to the remedy against the defendant, and was procured solely by the plaintiff and at his expense, and to the procurement of which the defendant was in no way contributory. It is in the nature of a wager between the plaintiff and a third person, the insurer, to which the defendant was in no measure privy, either by relation of the parties or by contract or otherwise. It cannot be said that the plaintiff took out the policy in the interest or behalf of the defendant; nor is there any legal principle which seems to require that it be ultimately appropriated to the defendant's use and benefit.²⁷

Until recently, the collateral source rule, in one form or another, had been universally adopted by each of the fifty states with the exception of Alabama.²⁸ Although initially, the rule was specifically applied to insurance benefits, throughout the twentieth century the application of the rule that collateral benefits could not be

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subtracted from a plaintiff's recovery had been extended to the following general types of benefits:

- (1) Insurance policies, whether maintained by the plaintiff or a third party. Sometimes, as in fire insurance or collision automobile insurance, the insurance company is subrogated to the rights of the third party. This additional reason for keeping the tortfeasor's liability alive is not necessary, however, as the rule applies to insurance not involving subrogation, such as life or health policies.²⁹
- (2) Employment benefits. These may be gratuitous, as in the case in which the employer, although not legally required to do so, continues to pay the employee's wages during his incapacity. They may also be benefits arising out of the employment contract or a union contract. They may be benefits arising by statute, as in worker's compensation acts or the Federal Employer's Liability Act. Statutes may subrogate the employer to the right of the employee, or create a cause of action other than by subrogation.³⁰
- (3) Gratuities. This applies to cash gratuities and to the rendering of services. Thus the fact that the doctor did not charge for his services or the plaintiff was treated in a veteran's hospital does not prevent his for the reasonable value of the services.³¹
- (4) Social legislation benefits. Social Security benefits, welfare payments, pensions under special retirement acts, all are subject to the collateral-source rule.³²

III. CRITICS OF THE RULE AND THE WINDFALL FALLACY

The collateral source rule has been attacked from its inception on the basis that it allows a "windfall" to inure to the benefit of the plaintiff. For example, Professor Stein notes "a common argument against the rule is that damages are intended to compensate the plaintiff for the loss he or she has suffered. The plaintiff, having paid nothing for medical services or having received his or her wages during his or her disability, has in fact lost nothing."³³ The fallacy of such an argument, however, is driven by its oversimplification of the realities of the transactions in question. Moreover, it ignores the fundamental rationales initially proffered at common law in support of the rule in its application to insurance benefits.

Reiterating the logic of the early cases, "[a] contract with [an] insurer is in the nature of a wager between third parties, which the trespasser has no concern;"³⁴ "[an] insurer and [a] defendant are not joint tortfeasors or joint debtors so as to make a payment or satisfaction by the former operate to the benefit of the latter;"³⁵ there is no "legal privity between [a] defendant and [an] insurer so as to give the former a right to avail itself of [the] payment of the latter;"³⁶ "[a] policy of insurance is collateral to the remedy against the defendant, and [is] procured solely by the plaintiff and at his expense, and to the procurement of which the defendant [is] in no way contributory."³⁷

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At the core of this early common law logic is the recognition that such benefits are the subject matter of an enforceable contract, negotiated in the absence of the defendant tortfeasor, and supported by an exchange of consideration between an underwriter and an insured.

To characterize the payment of such benefits as a “windfall” ignores the reality that such benefits were purchased in advance by a rational consumer seeking to maximize his or her utility by optimizing his or her consumption choices. Although perhaps contractually triggered by the negligence of a defendant, the payment of such benefits are exclusively governed by the terms of the insurance contract. The fallacy of the “windfall” argument is that payment of such benefits do not constitute “a sudden and unexpected piece of good fortune or personal gain,”³⁸ but rather constitute an expected remittance purchased (often at great expense) by a risk adverse wagerer. And as maintained below, the fallacy of the “windfall” argument holds with respect to other collateral benefits such as employment benefits, gratuities, and social legislation benefits.

Despite its fallacy, the “windfall” argument has nonetheless prevailed in that it has driven the recent state tort-reform initiatives seeking to abolish the collateral source rule. Remarkably, forty-four (44) of the fifty (5) states have enacted legislation allowing for the consideration of the payment of collateral source benefits.³⁹ In this regard, it is observed that

[a] number of states have enacted statutes limiting or abolishing the collateral source rule, the statutes varying with regard to the extent of their reach—some apply to all personal injury and wrongful death actions and some only to medical malpractice or products liability actions; some apply broadly to all collateral sources, others enumerate those collateral sources to which the statute applies; some provide that any reduction for collateral source benefits received may be offset by the cost of obtaining such benefits, others do not contain such a provision, etc.⁴⁰

A closer review of the various state laws abolishing and/or minimizing the reach of the collateral source rule illustrates the arbitrary and archaic nature of the tort-reform movement. For example, some states have abolished the collateral source rule in its entirety, while others have only abolished it with respect to specific types of torts such as medical malpractice, products liability, or both. Some states have accepted its abolition only to claims involving insurance benefits to which exists a third-party right of subrogation. Several states have abolished it with respect to insurance benefits but not as to social legislation benefits such as social security. And yet, other states have abolished the collateral source rule with respect to certain types of insurance benefits while maintaining its application to other types of benefits such as life insurance and other types of death benefits. Some states have conditioned abolition of the collateral source rule on whether the total compensatory award exceeds a certain threshold

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amount. And finally, one state limited the impact of abolition such that no judgment or verdict can ever be reduced by more than 50% of its original amount in the absence of the rule.⁴¹ The archaic and arbitrary nature of the various state law initiatives illustrates that this reform movement is not fueled by rational constructs but rather by interest group politics. If the collateral source rule unequivocally results in a windfall to the plaintiff by allowing a plaintiff to recover twice, then one would expect the abolition of the rule to be universal its application, regardless of whether the claim was tendered in a medical malpractice or a products liability case, or whether the claim involved a certain type of collateral benefits.

IV. RES INTER ALIOS ACTA: THE COMMON LAW RATIONALE

The common law collateral source rule originated within the context of a plaintiff's receipt of insurance benefits. The argument at common law in support of the collateral source rule as it applied to insurance benefits was that the "[p]laintiff's contract with the underwriters is [and remains] *res inter alios acta* [emphasis added] of which the Defendants cannot avail themselves."⁴² At common law, *res inter alios acta* forbade "the introduction of collateral facts which by their nature are incapable of affording any reasonable presumption or inference as to the principal matter in dispute, and thus evidence as to acts, transactions or occurrences to which the accused is not a party or is not connected is inadmissible."⁴³ The existence of an insurance contract between an underwriter and insured is of no consequence in the determination of the loss caused by a negligent defendant. As stated above, the benefits paid under an insurance policy are exclusively governed by its contract terms. The contract terms, including the amount, payment and duration of the benefits, were negotiated in the absence of the defendant, at a date and time preceding any transaction or occurrence involving the defendant, and involved an exchange of consideration to the exclusion of the defendant. Accordingly, depending on the terms negotiated and the consideration exchanged, the benefits administered pursuant to an insurance contract will likely vary with respect to the amount of benefits available the insured, the condition precedents necessary to trigger their availability, as well as with respect to the subrogation rights, if any, accorded the underwriter. Whether a plaintiff entered into such a contractual relationship to insure himself against loss caused by the negligent acts of others is irrelevant to the measurement of the loss incurred.

Although it was argued at common law that to preclude the payment of insurance benefits in the calculation of defendant's liability would result in the plaintiff recovering "twice for the same injury,"⁴⁴ the early common law courts realistically observed that if a plaintiff cannot recover because of his or her receipt of insurance benefits, "the wrong-doer pays nothing, and takes all the benefit of a policy of insurance without paying the premium."⁴⁵ Ironically, it was within this context and this

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context alone that the common law observed a potential windfall. Only in the absence of the collateral source rule does a “windfall” inure, and it inures to the benefit of the negligent defendant.

It has been suggested that “. . . the collateral source rule reflects a conflict between the desire to provide adequate compensation to plaintiffs and the reluctance to overcompensate.”⁴⁶ Professors Shoben, Tabb, and Jantis write:

because the rule operates to allow a plaintiff to keep the benefits from a collateral source and to assess the wrongdoer for the same damages, it stands as an exception to the traditional goal of compensatory damages to place the plaintiffs as nearly as practicable in the position they held prior to the harm.⁴⁷

Such suggestions, however, completely ignore the context in which the rule originated. The notion that a plaintiff may be over-compensated assumes that the dual compensation received by the plaintiff from the collateral source and the negligent defendant was generated from a single transaction. Such an assumption requires one to ignore the economic and legal reality of the two transactions. To aggregate the compensation paid pursuant to an insurance contract and paid by a negligent defendant pursuant to the common law of torts is to aggregate two entirely separate, independent and unrelated transactions. The fact that a plaintiff purchased an insurance contract under which the underwriter was contractually obligated to pay a benefit to the plaintiff is completely unrelated to the compensation to which the plaintiff may be entitled from a negligent defendant. The benefit paid under the insurance policy constitutes compensation resulting from a contractual wager made between the underwriter and the insured, a wager priced and paid by both parties to the contract given their respective assessment of the risk in question. One might argue that it is analogous to a return on one’s investment in a certain underwriter. Damages paid by a negligent defendant constitute compensation for the loss caused by the negligent defendant. And from inception of the collateral source rule, the common law has zealously remained steadfast in its refusal to acquiesce to the defense bar’s attempt to blur the distinction between the compensation emanating from these two separate transactions. Each transaction is *res inter alios acta*, and hence the phrase *collateral source*.

We note that the ability to blur the distinction between these two separate transactions is eliminated when the transaction involves the receipt of benefits from an individual’s or firm’s ability to self-insure. While such self-insurance benefits are clearly collateral in that they are easily perceived as savings, and therefore a recovery of such benefits is critical to making a plaintiff whole, they technically are no different than benefits derived from a premium-based insurance policy. Both sources of benefits are generated by the plaintiff’s incurrence of economic costs. In both scenarios, the plaintiff incurred the opportunity costs associated with assessing either

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benefit. With respect to the self-insurance benefits, the plaintiff incurred the *opportunity cost*⁴⁸ of ear-marking funds to cover losses associated with a negligent or accidental outcome. With respect to premium-based benefits, the plaintiff incurred similar opportunity costs by rationing funds over time for the purpose of paying premiums required under a contract of insurance. In reality, the opportunity cost of premium-based benefits is much larger than the nominal value of each premium payment. For example, a plaintiff that has incurred the economic cost of monthly insurance premiums for the majority of his natural life lost the opportunity to use his financial resources for other consumption or investment purposes. When one considers the interest a plaintiff could have earned on such foregone resources, the actual economic cost of premium-based benefits is significant indeed.

Although the initial applications of the collateral source rule involved benefits paid and received under an insurance contract, its application has been extended to employment benefits, gratuities and social legislation benefits, i.e., social security benefits, welfare payments, and pension plans. And as with its application to benefits under an insurance contract, its underlying rationale holds with respect to these other collateral benefits. Each source of benefit is collateral to the extent the plaintiff, through his or her independent efforts, invested in and developed his or her human capital such that he was in a position to leverage and negotiate access to such benefits pursuant to a lawful agreement or arrangement, supported by an exchange of consideration, all of which was in the absence of any involvement or contribution of the negligent defendant.

For example, to the extent a plaintiff, given his skill, knowledge and talents, can negotiate a price for his labor which includes the payment of benefits payable in the event he suffers an injury resulting from a negligent defendant, such benefits are analogous to the benefits negotiated under an insurance contract. To the extent a plaintiff, given his character, demeanor and his investment in social relationships can negotiate a social position in which he may be the recipient of gratuitous benefits resulting from the sympathetic reaction of his friends and colleagues, such benefits are likewise analogous to the benefits negotiated under an insurance contract. And to the extent a plaintiff has contributed (by his payments) to social security, welfare, Medicare, Medicaid, or special retirement and pension plans of which all provide for the payment of benefits in the event he suffers an injury at the behest of a negligent defendant, such benefits are intuitively consistent with the common law's substantive definition of a collateral source.

Each of the above categories of benefits originated from the independent efforts and acts of the plaintiff. Each of the above benefits involved the exchange of tangible and/or intangible consideration that can be measured in terms of opportunity costs. Access to the above benefits involved the incurrence of economic costs on behalf of the plaintiff in terms of financial expenditure or opportunities foregone as a result of

investing in his human capital, such that he could leverage his market position as an employee, or as a dues paying welfare recipient, or even as a beneficiary of gratuitous social intentions.

**V. ECONOMIC REASONING AND THE RATIONAL ACTOR MODEL:
INTERNALIZING THE SOCIAL COST OF NEGLIGENT BEHAVIOR**

From an economic (opportunity cost) perspective, it becomes very difficult to blur the distinction between compensation paid pursuant to a contract of insurance and compensation paid by a negligent defendant. Economic theory further demonstrates that such a distinction obstructs the rational-actor model and its market efficiencies. In this regard, economic theory has long acknowledged that the given environment within which society functions is constrained by scarcity, and that such scarcity is the fundamental source of social and political conflict.⁴⁹ Given such scarcity, all societies are confronted with the problem of determining 1) what, and how much, to produce, 2) how to produce it, and 3) for whom to produce it.⁵⁰ The field of microeconomics has demonstrated that the adoption of the perfectly competitive model provides a remarkable social mechanism with which to administer the social problems generated by scarcity. The perfectly competitive model ultimately nurtures, if not assures, efficiencies in the allocation, production and distribution of scarce resources. Central to the perfectly competitive model is the assumption that all market participants are rational, with rational action being defined by utility/profit maximization.⁵¹ Any act of consumption or production that fails to maximize the utility or profit of an individual or firm is considered to be irrational, economic behavior. Consequently, in order to act rationally, all market participants must be fully informed of all costs and benefits associated with their respective economic activities.⁵² Once informed of all costs and benefits associated with a certain activity, an economically rational actor will weigh his or her costs and benefits, and if the benefits exceed or equal to his or her costs, he or she will engage in such activity.⁵³ Economic rationality necessarily requires that all costs and benefits be considered when exercising economic choices. To the extent all such costs and benefits are not considered, that is, they are *external* to the rational decision making process, non-utility/profit maximizing choices will be made resulting in unacceptable market inefficiencies.⁵⁴ The economic consequences of such externalities may be summarized by the following:

. . . people who undertake actions that impose costs on others are likely to undertake these actions more frequently than is socially desirable if they are not held accountable for those external costs. The same holds true for firms. If the production of a certain good is responsible for creating external diseconomies, then more of this good is likely to be produced under perfect competition than is socially efficient.⁵⁵

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The collateral source rule operates to force market participants to internalize the economic costs of their negligent actions. Negligent defendants will obviously find it rational to engage in further negligent conduct to the extent that such defendants are not required to compensate injured plaintiffs for their losses, simply because such plaintiffs can access sufficient resources to cover such losses from collateral sources. Such a scenario creates a negative externality: the effect of such negligent conduct is not directly reflected in the market in which the negligent conduct occurred. Conventional microeconomic wisdom dictates that “[w]hen externalities are present, the price of a good may not reflect its social value. As a result, firms may produce too much or too little, so the market outcome is inefficient.”⁵⁶

The compensation prescribed by a trier-of-fact for one’s negligent act is the *price* one must pay to society for his or her negligent indulgence; it is also the threat of being assessed this *price* that serves to deter the wrongful conduct. The prescribed compensation internalizes the costs of wrongful, negligent conduct. The magnitude of the *price* necessarily places the wrongdoer in a scenario of rational choice. In the absence of such a price, the cost of wrongful, negligent conduct is external to the rational acting individual. Accordingly, legally imposed compensatory damages attempt to correct market failure as it pertains to the internalization of the costs associated with negligent conduct.

While critics of the collateral source rule seek ultimately to abolish its legal applicability, they ignore the relevant economic underpinnings related to the same. In determining the compensation to be paid by a negligent defendant, it is necessary that the magnitude of the damage award be assessed in the context of the tortfeasor’s budget and/or isocost constraint functions. Clearly, the magnitude of the compensatory award must have some relationship to the tortfeasor’s budget and/or isocost constraints. Ignoring any such relationship negates any underlying economic rationale for the common law system of torts and renders the award of compensatory damages much more susceptible to arbitrary implementation.

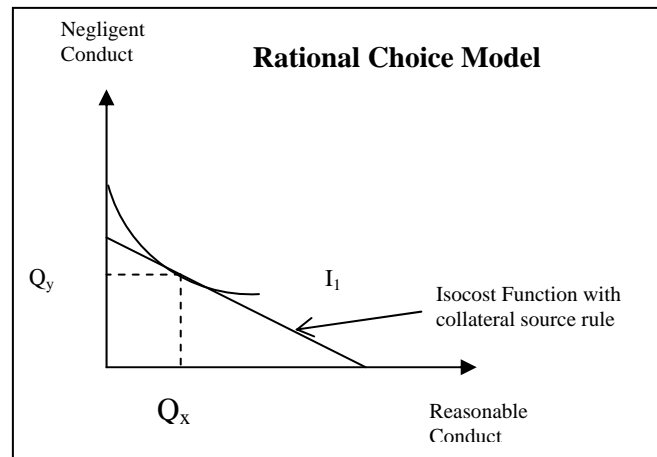
VI. ISOQUANTS AND ISOCOST FUNCTIONS: A CASE FOR THE SURVIVAL OF THE COLLATERAL SOURCE RULE

Drawing from the fundamentals of microeconomics and price theory,⁵⁷ it can be demonstrated that compensatory damages must have some relationship to the financial status (the willingness or ability to pay) of the tortfeasor. Moreover, the award of compensatory damages forces the tortfeasor to internalize the cost of negligent conduct when making the rational choice to act. If we assume a two input model of production consisting of not capital and labor, but rather, negligent production techniques and reasonable production techniques, we can derive an

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isoquant denoted below by I_1 . Isoquant I_1 shows all combinations of inputs that yield the same level of output.

The amount of the two inputs (negligent and reasonable conduct) that the firm uses will depend on the prices of these inputs. The cost of hiring either of these factor inputs is represented by a firm's isocost function. An isocost line shows all possible combinations of the two inputs that can be purchased for a given total cost.



The total cost C of producing any particular output is given by the sum of the firm's input costs associated with reprehensible production activity and reasonable production activity summarized by the following linear equation:

$$C = P_x Q_x + P_y Q_y, \text{ where}$$

C = total costs of production,

P_x = the price of reasonable input activities,

Q_x = the quantity of reasonable input activities utilized in production,

P_y = the price of reprehensible input activities, and

Q_y = the quantity of reprehensible input activities utilized in production.

If we rewrite the total cost equation as an equation for a straight line, we derive:

$$Q_y = C/P_y - (P_x/P_y)Q_x.$$

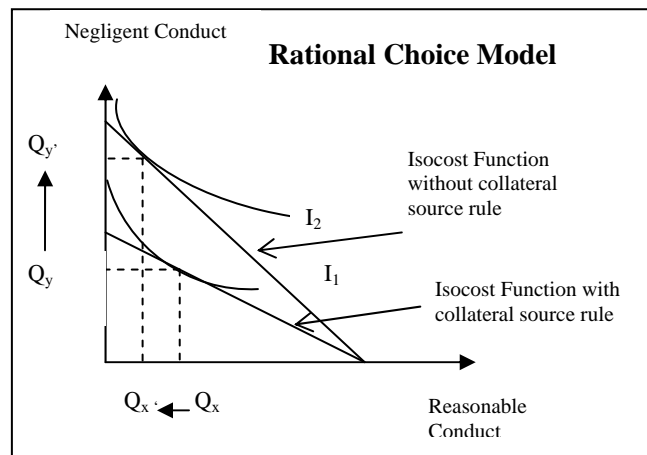
It follows that the isocost line has a slope of $\Delta Q_y/\Delta Q_x$ (the change in quantity of negligent input activities utilized in the firm's production activities divided by the change in quantity of reasonable input activities utilized in the firm's production activities) which is equal to $-(P_x/P_y)$ which is the ratio of the price of reasonable input activities to the price of reprehensible input activities. It tells us that if the firm gave

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up a unit of reasonable input activities (and recovered P_x dollars in cost) to buy P_x/P_y units of negligent input activities at a cost of P_y dollars per unit, the total cost of production would remain the same. For example, if the cost or price of reasonable input activities (P_x) was \$10 and the cost or price of negligent input activities (P_y) was \$5, the firm could replace one unit of reasonable input activities with two units of negligent input activities with no change in total cost.

A rationally acting firm will choose a combination of inputs where the firm's isoquant is tangent with the firm's isocost curve. The point of tangency of isoquant I_1 and the isocost line reveals the cost-minimizing choice of inputs Q_x and Q_y , which can be read directly from the above diagram. At this point, the slopes of the isoquant and the isocost lines are just equal.

Suppose that the price of negligent input activities were to decrease as a result of the abolition of the collateral source rule. In that case, the slope of the isocost line – (P_x/P_y) would decrease in magnitude resulting in the isocost line becoming steeper.



The above diagram illustrates that the firm minimizes its costs of producing output I_1 by using Q_x units of reasonable input activities and Q_y of negligent input activities. When the price of negligent input activities decreases, the firm's isocost function (or line) becomes steeper, pivoting on the X axis with the Y intercept shifting upward from C/P_y to C/P_y' . Facing the lower price for negligent input activities, the firm minimizes its cost of production at I_2 utilizing Q_x' units of reasonable input activities and Q_y' units of negligent input activities. Notably, the rational firm has responded to the lower price of negligent input activities by substituting negligent input activities for reasonable input activities in the production process.

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Equally important is that the lower price for negligent input activities resulting from the abolition of the collateral source rule also expands the firm's input cost budget such that it can now afford to produce at a higher level of production represented by isoquant I_2 at its point of tangency with the firm's isocost function in the absence of a collateral source rule.

In summary, the rational actor model that drives fundamental microeconomic theory upon which the success of our large commercial republic thrives demonstrates that the abolition of the collateral source rule externalizes a firm's cost of production associated with negligent conduct. The collateral source rule, on the other hand, requires a firm to internalize the costs associated with negligent conduct, thereby increasing the price of negligent input activities which results in a rational firm decreasing its use of negligent input activities Q_y and increasing its use of reasonable input activities Q_x . The magnitude of the effect on the firm's production activities and its choice of inputs necessarily depend on the firm's production budget and financial status. The wealthier the firm or greater its ability to pay, the smaller the effect. Accordingly, one of the dominant factors one should consider when considering the abolition of the collateral source rule is the financial position of the rational firm, i.e. its isocost function (or production cost budget). The extent to which a firm is "willing to pay" the price associated with negligent production activities is a function of the firm's isoquant and isocost functions.

VII. CONCLUSION

As illustrated by the continued abolition of the collateral source rule, tort reform across the United States is grounded upon the economic utility of special interest groups rather than rational legal and economic constructs. Unfortunately, such reform ultimately threatens the fundamental economic principles upon which our great commercial republic thrives. Ironically, the proponents of tort reform welcome legislation and/or judicial mandates that essentially challenge, if not eliminate, critical components of the pricing mechanism of a perfectly competitive marketplace to which such proponents would unequivocally and zealously object if implemented in their relevant commercial markets. Accordingly, it is no surprise that the recent state-level legislative initiatives abolishing and/or minimizing the reach of the collateral source rule may be perceived as welcomed victories by most tort reformers. However, such perceptions are economically ill-conceived.

Acknowledgement of individual producer and consumer isoquant and isoutility functions is fundamental in the study of microeconomics. More importantly, its recognition is vital to the efficient production, allocation and consumption of scarce resources. Producer and consumer isoquant and isoutility functions reflect the unique values market participants place on goods and services in all markets. Simply put,

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utility is the satisfaction gained by producers and consumers in their respective economic transactions. The drive to maximize such utility fuels economic activity, minimizes economic waste, and maximizes market efficiencies, resulting in the creation of economic wealth.

Economic theory, as well as historical experience, demonstrates that governments cannot accurately regulate, mandate, or dictate individual economic utility. Economics has long observed that economic utility is profoundly unique to each producer and/or consumer, such that it is only capable of being measured from an individual perspective. Economic choice emanates from the efforts of atomistic individuals pursuing the maximization of their economic utility as they identify, reveal, and act upon their respective tastes and preferences in the market place. Market participants value goods and services differently. For example, one market participant values the consumption of certain products more than other market participants, and it is the manifestation of these unique values from which the supply and demand forces of the product market in question efficiently determine market prices. Consequently, the measurement of the individual and social costs associated with negligent behavior can best be made on an individual, case-by-case analysis, and global legislative initiatives that obstruct such analysis should be avoided.

As demonstrated, the recent initiatives seeking to abolish the collateral source rule can only be explained by special interest politics in that they ignore the fundamental economic underpinnings of efficiency. Such ignorance will likely distort the tortfeasor's rational-cost minimizing choice with respect to the utilization of reasonable and/or negligent input activities. If the price of negligent input activities decreases relative to the price of reasonable input activities, then one can anticipate an increase in such negligent activities. The abolition of the collateral source rule, therefore, will have the direct effect of distorting the pricing mechanism relevant to such input activities, and thus result in not only in the inefficient over-production (waste) of the goods and services utilizing such input activities, but also in the overuse of such negligent input activities.

The continued dismissive attitude towards the economics of the common law tort system is discouraging. By ignoring the common law and the economic rationale underlying the collateral source rule, tort-reform initiatives accomplish little reform at the expense of arbitrary, wealth-transferring regulation. Compensatory damages are no longer grounded on the rational constructs of both the common law and economics but rather are driven by special interests.

By extension, the above analysis is applicable to other tort-reform measures, such as statutory mandates capping damages, as well as the United States Supreme Court's recent rulings in *BMW of North America v. Gore*⁵⁸ and *State Farm Mutual Automobile Insurance Co. v. Campbell*⁵⁹ adopting its arbitrary "reasonable relationship test" with respect to the analysis of the excessiveness of punitive damages.⁶⁰ To the

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extent such reforms operate to distort the price tortfeasors must pay to engage in negligent conduct, such reforms will result in inefficient market and judicial outcomes. Statutory and/or judicial compensatory and punitive damage caps essentially fix the maximum price a tortfeasor must pay to engage in negligent activity. Accordingly, such reforms are likewise grounded on arbitrary policy choices rather than conventional economic constructs which have long been endorsed by and have fueled our commercial republic.

* * *

APPENDIX I**STATE LAW INITIATIVES ABOLISHING AND/OR MINIMIZING
THE REACH OF THE COLLATERAL SOURCE RULE**

	State	Statutory Citation	Summary of the Law
1	Alabama	Code of Alabama §6-5-522 (2005)	Allows defendant to mitigate damages by introducing evidence that plaintiff has been or will be paid or reimbursed for medical and hospital expenses. Applicable only to product liability actions.
2	Alabama	Code of Alabama §6-5-520 (2005)	Sets forth the state legislative intent that plaintiffs be compensated fully for injuries, but that they not receive compensation more than once for the same medical and hospital expenses. Applicable only to products liability actions.

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3	Alaska	Alaska Statutes §09.17.070 (2005)	Permits the court to reduce an injured party's jury award by the amount of unsubrogated collateral source payments already received or to be received. Evidence admissible after the jury award, and after the court has awarded costs and attorney fees. Defendant cannot introduce evidence of benefits protected by federal law, of benefits derived from deceased's life insurance policy and of gratuitous benefits provided to the claimant.
4	Arizona	Arizona Revised Statutes §12-565 (2004)	Allows defendants to introduce evidence of collateral source benefits and plaintiffs to rebut allegations of double recovery by relaying the circumstances surrounding such benefits. Applicable only to medical malpractice cases.
5	California	California Civil Code §3333.1 (2005)	Allows defendants to introduce evidence of collateral source benefits and plaintiffs to rebut allegations of double recovery by relaying the circumstances surrounding such benefits. Applicable only to medical malpractice cases.
6	Colorado	Colorado Revised Statutes 13-21-111.6 (2005)	Directs the court to reduce awards by the same amount the plaintiff has been compensated by collateral sources. Contract exception exists whereby benefits received from an insurance or other liability contract do not reduce the jury award.
7	Connecticut	Connecticut General Statutes §52-225a (2004)	Directs the court to reduce awards by the same amount the plaintiff has been compensated by collateral sources. Not applicable to collateral sources which possess a right of subrogation.
8	Delaware	18 Delaware Code §6862 (2005)	Allows for introduction of evidence of "public" collateral source benefits in medical malpractice cases only. Evidence of benefits received from life insurances or "private" collateral sources inadmissible.

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9	Florida	Florida Statutes §768.76 (2005)	Directs the court to reduce awards by the same amount the plaintiff has been compensated by other sources for the same loss. Not applicable to collateral sources for which a right of subrogation exists, federal medical services benefits, or workers compensation.
10	Georgia	Official Code of Georgia Annotated §51-12-1 (2005)	Permits the jury to consider collateral source benefits in determining an award of damages. Does not require the jury to reduce an award of damages accordingly.
11	Hawaii	Hawaii Revised Statutes §663-10 (2004)	Directs the court prior to judgment to determine the validity of lien holder claims for payments made from collateral sources. Notes state that the purpose of this section was "to prevent double recovery by allowing collateral source payers to recover payments made to an injured party for expenses arising out of the injury that was the subject of the civil action in tort."
12	Idaho	Idaho Code §6-1606 (2005)	Allows the introduction of evidence, after award is rendered, of collateral source benefits and directs the court to reduce the award accordingly. Not applicable to benefits paid under federal programs, death benefits paid under life insurance contracts, or benefits paid and recoverable under subrogation rights by state law or contract.

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13	Illinois	§735 Illinois Compiled Statutes 5/2-1205 (2005)	Directs court to reduce from judgment 50% of benefits provided for lost wages or private or governmental disability income programs and 100% of benefits provided for medical charges, hospital charges or nursing charges which have been paid or which have become payable. The reduction shall not reduce the judgment by more than 50% of the total amount of the judgment or verdict. Damage award to be increased by the amount of premiums paid by plaintiff in the 2 years prior to injury or the amount expected to be paid by the plaintiff in the future for such benefits. No reduction for medical expenses directly attributable to defendant's negligence.
14	Indiana	Burns Indiana Code Annotated §34-44-1-2	Allows the introduction of evidence of collateral source benefits. Not applicable to life insurance benefits or other death benefits, insurance policy benefits, or payments made by state or federal government.
15	Iowa	Iowa Code §668.14 (2004)	Allows the jury to consider previous or future collateral source benefits when determining an award of damages. If such evidence is considered the jury is then to disclose the effect such evidence had on the award of damages.
16	Kansas	Kansas Statutes Annotated §60-3802 (2005)	Evidence of collateral source benefits is admissible in any action for personal injury or death in which the plaintiff demands damages in excess of \$150,000.
17	Kansas	Kansas Statutes Annotated §60-3805 (2005)	The court is directed to reduce the judgment up to the full amount of net collateral source benefits received depending on the circumstances.
18	Kentucky	Kentucky Revised Statutes §411.188 (2004)	Allows the introduction of evidence of collateral source benefits. Not applicable to life insurance policy benefits.

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19	Maine	24 Maine Revised Statutes §2906 (2005)	Allows the introduction of collateral source payments after verdict, but prior to judgment, excluding life insurance benefits. Allows for offsetting the reduction by the amount of payments previously made by plaintiff. Applicable only to personal injury and related professional negligence cases.
20	Massachusetts	Annotated Laws of Massachusetts GL ch. 231, §60G (2005)	In any action for malpractice or negligence evidence of collateral source benefits permitted. Award to be reduced by amount of collateral benefits received minus premium paid for insurance in the year preceding the accrual of the action. No reduction permitted if source of collateral benefits has right of subrogation or if collateral benefits were in the form of public assistance.
21	Michigan	Michigan Compiled Laws Service §600.6303 (2005)	In any personal injury action evidence of collateral benefits and payment of premiums permitted. Award to be reduced by collateral benefits received minus cost of premiums. Any offset shall not exceed the amount of judgment for economic loss or the portion of the verdict which represents damages paid or payable by a collateral source.
22	Minnesota	Minnesota Statutes §548.36 (2004)	Evidence of collateral source benefits admissible. Reduction of award permitted so long as source of collateral benefits doesn't have a right of subrogation. Not applicable to life insurance policy, social security, pension, or private disability insurance policy benefits.
23	Missouri	Missouri Revised Statutes §490.715 (2004)	Allows for the introduction of evidence of collateral source payments. By submitting evidence of collateral source payments, defendant waives right to credit against the related judgment.

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24	Montana	Montana Code Annotated §27-1-308 (2004)	When total amount of an award exceeds \$50,000, recovery must be reduced by any amount paid from collateral sources. Requires certain deductions from insurance policies before they can be used to reduce awards
25	Nebraska	Statutes of Nebraska R.R.S. Neb. §44-2819 (2005)	Any nonrefundable medical reimbursement insurance, less all premiums paid by claimant, may be taken as a credit against any judgment rendered.
26	Nevada	Nevada Revised Statutes NRS §42.020 (2004)	In a separate hearing before entry of judgment, if the court determines that claimant has received any benefits from a collateral source, the court shall reduce awarded damages.
27	New Hampshire	New Hampshire Revised Statutes RSA §507-C:7 (2004)	In any action for medical injury, jury will be instructed to reduce plaintiff damages by defendant's evidence of insurance or other benefit programs minus any payments plaintiff has made to secure those benefits. Non-economic losses shall not exceed \$250,000.
28	New Jersey	New Jersey Statutes §2A: 15-97 (2005)	Requires plaintiff to disclose collateral sources and for any such amount to be deducted from the award. Not applicable to workers' compensation or life insurance policy benefits. SB 63: Applies existing collateral source reimbursement provisions to the newly created "special auto insurance policy."
29	New Mexico	New Mexico Statutes §31-22-14 (2005)	In a restitution action by the victim of a criminal act, any reparation awarded will deduct payments received from a collateral source.
30	New York	New York Consolidated Laws Service §4545 (2005)	Allows the introduction of evidence of collateral source payments. Not applicable to life insurance, title XVIII social security benefits or voluntary charitable contributions.

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31	North Carolina	North Carolina General Statutes §15B-11 (2005)	In a compensation action by the victim of a crime, an award shall be reduced to the extent that the loss claimed will be recouped from a collateral source.
32	North Dakota	North Dakota Century Code §32-03.2-06 (2005)	Allows defendant to apply to the court for a reduction of economic damages to the extent they are covered by a collateral source. Not applicable to life insurance or other death or retirement benefits or any insurance or benefit purchased by plaintiff.
33	Ohio	Ohio Revised Code §2323.41(2005)	Allows for the introduction of evidence of collateral source payments. Not applicable to collateral sources that have mandatory self-effectuating federal right of subrogation, a contractual right of subrogation, or a statutory right of subrogation.
34	Oklahoma	2005 SB 629	In medical liability actions, the court shall admit evidence of payments of medical bills made to the injured party unless the payments are subject to subrogation or other right of recovery.
35	Oregon	Oregon Revised Statutes §31.580 (2005)	Allows for the introduction of evidence of collateral source payments after trial, but prior to final judgment. Not applicable to benefits that the plaintiff is obligated to repay, life insurance or other death benefits, insurance benefits where the plaintiff paid premiums, retirement, disability or pension benefits, to social security benefits.

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36	Pennsylvania	<p>Pennsylvania Consolidated Statutes 42 Pa.C.S. § 8553 (2005) Pennsylvania Statutes 40 P.S. § 1303.508 (2005)</p>	<p>Any benefits, regarding damages suffered, a claimant is entitled to receive under an insurance policy shall be deducted from the total amount of damages recoverable. A claimant in a professional liability action is precluded from recovering damages covered by a private or public benefit, excluding life insurance, deferred compensation plans, Social Security benefits, Department of Public Welfare benefits, and Federal programs under statute that provide a right to reimbursement.</p>
37	Rhode Island	<p>Rhode Island General Laws § 9-19-34.1(2005)</p>	<p>In medical malpractice actions, the jury shall be instructed to reduce the award of damages to the plaintiff by the sum equal to the total benefits received minus the total amount paid to secure those benefits. Payers of benefits shall be foreclosed from recovery and plaintiff shall have no legal obligation to reimburse payer.</p>
38	South Dakota	<p>South Dakota Codified Laws §21-3-12 (2005)</p>	<p>For special damages in a medical malpractice action, evidence of insurance that is not privately purchased by claimant or claimant's family or paid for by the federal government is admissible to reduce damages awarded. Any insurance subject subrogation is admissible.</p>
39	Tennessee	<p>Tennessee Code §29-26-119 (2005)</p>	<p>In a medical malpractice action, any employment or governmental benefits will reduce the amount of damages recoverable. Benefits from plaintiff's own assets will not lessen recovery.</p>
40	Texas	<p>Texas Statutes and Codes Art. 56.45 (2005)</p>	<p>The Attorney General may reduce the collection of any loss due to criminal conduct to the extent that a pecuniary loss is recouped from a collateral source.</p>

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41	Utah	Utah Code 78-14-4.5 (2005)	§	In medical malpractice actions, the court shall reduce the amount of damages by the total of all collateral sources paid to plaintiff, excluding any collateral sources for which a subrogation right exists.
42	Virginia	Virginia Code §8.01-35 (2005)		In personal injury or death actions, damages loss of income cannot be diminished because of reimbursement from any other source, nor will reimbursement be admitted into evidence.
43	Washington	Revised Code of Washington §7.70.080 (2005)		Evidence of previous compensation from any source may be admitted into evidence, unless the source was procured by plaintiff's expenditure of assets.
44	West Virginia	West Virginia Code §55- 7B-9(a) (2005)		Provides medical malpractice reform by providing for a reduction in damages for certain collateral source payments to plaintiffs.
45	Wisconsin	Wisconsin Statutes §893.55 (2005)		Evidence of any compensation for bodily injury received from sources other than the defendant to compensate the claimant for the injury is admissible in an action to recover damages for medical malpractice.
46	Wyoming	Wyoming Statutes §1-40-110 (2005)		Any award of compensation for the victim of a crime shall consider benefits from collateral sources, but will not deny compensation based upon those sources.

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Notes

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1. See Michael C. Blumm, *Public Choice Theory and the Public Lands, Why Multiple Use Failed*, 18 HARV. ENVTL. L. REV. 405, 407-408 (1994) ("Public choice" theory predicts that small, well-organized special interest groups will exert a disproportionate influence on policymaking.); Richard B. Stewart, *The Reformation of American Administrative Law*, 88 HARV. L. REV. 1667, 1713 (1975) ("It has become widely accepted, not only by public interest lawyers, but by academic critics, legislators, judges and even by some agency members, that the comparative over-representation of regulated or client interests in the process of [governmental] decisions results from a persistent policy bias in favor of these interests."). For a concise, summary discussion of public choice theory, see J. MARK RAMSEYER, "PUBLIC CHOICE", CHICAGO LECTURES IN LAW AND ECONOMICS 101-112 (Eric Posner ed., 2000); DANIEL A. FARBER & PHILIP P. FRICKEY, LAW AND PUBLIC CHOICE: A CRITICAL INTRODUCTION (1991); Daniel A. Farber, *Democracy and Disgust: Reflections on Public Choice*, 65 CHI-KENT L. REV. 161 (1989); Jerry L. Mashaw, *The Economics of Politics and the Understanding of Public Law*, 65 CHI-KENT L. REV. 123 (1989).
 2. Kevin S. Marshall & Patrick Fitzgerald, *Punitive Damages and the Supreme Court's Reasonable Relationship Test: Ignoring the Economics of Deterrence*, 19 ST. JOHN'S J. LEGAL COMMENT 237, 256 (2005) (observing that the Supreme Court's reasonable relationship test with respect to punitive damages eliminates the economic foundations of deterrence).
 3. See DAVID W. ROBERTSON ET AL., WILLIAM POWERS, JR., DAVID A. ANDERSON, AND OLIN GUY WELLBORN, III, CASES AND MATERIALS ON TORTS, 325 (3d ed., 2004) ("The basic theory of compensatory damages in tort cases is restoration of the plaintiff to his or her pre-injury condition, to the extent that an award of money can do that.").
 4. See RESTATEMENT (SECOND) OF TORTS § 903 (1979) ("*Compensatory* damages 'are the damages awarded to a person as compensation, indemnity or restitution for harm sustained by him.'" (emphasis added)).
 5. See *id.*
 6. See, e.g., *Reliance Ins. Co. v. Bridges*, 311 S.E. 2d. 193, 208 (Ga. App. 1983) ("Lord Campbell's act and various statutes in this country based upon it are nothing more than a method of punishing negligence by civil action. The multiplication of fatal accidents and the practical impossibility for securing the punishment of mere carelessness by means of criminal proceedings were the causes which brought about the passage of Lord Campbell's act as well as those which have followed it.").

7. *Collateral Source Rule Reform*, National Association of Mutual Insurance Companies, at <http://www.namic.org/reports/tortReform/CollateralSourceRule.asp>. (last visited Nov. 14, 2005). See also *Collateral Source Rule Reform*, American Tort Reform Association, at <http://www.atra.org/show/7344> (“The rule allows a plaintiff to recover the full amount of damages *twice* and also undermines the basis of a fault-based liability system.”) (last visited Nov. 14, 2005); *Collateral Source Provisions*, Ohio Business for Legal Reform, at <http://www.ohiochamber.com/OBLR/collateral.asp> (“The rule allows a plaintiff to recover the full amount of damages twice”) (last visited Nov. 14, 2005); ELAINE W. SHOBEN ET AL., REMEDIES, CASES AND PROBLEMS 646 (3d ed. 2002) (“Critics have attacked the collateral source rule on the basis that in certain instances an injured party actually receives double compensation for a single harm.”); JAMES M. FISCHER, UNDERSTANDING REMEDIES 76 (2000) (“ . . . plaintiff’s injuries have caused her to receive a benefit she would not have realized but for the legal injury to the extent that benefit is not offset against plaintiff’s losses. In effect, the plaintiff recovers twice: once from the collateral source and once from the tortfeasor.”).
8. *Collateral Source Rule Reform*, National Association of Mutual Insurance Companies, at <http://www.namic.org/reports/tortReform/CollateralSourceRule.asp> (last visited Nov. 14, 2005). See also *Collateral Source Rule Reform*, American Tort Reform Association, at <http://www.atra.org/show/7344> (“Insurance does not compensate for an individual’s injuries, but rather is a source of a windfall profit.”) (last visited Nov. 14, 2005).
9. *Collateral Source Rule Reform*, American Tort Reform Association, at <http://www.atra.org/show/7344> (“Whatever the historical reasons for tolerating double recoveries, today they are an unacceptable misallocation of scarce resources.”) (last visited Nov. 14, 2005); *Collateral Source Provisions*, Ohio Business for Legal Reform at <http://www.ohiochamber.com/OBLR/collateral.asp> (“Double recoveries are unacceptable misallocation of scarce resources.”) (last visited Nov. 14, 2005).
10. *Collateral Source Rule Reform*, National Association of Mutual Insurance Companies, at <http://www.namic.org/reports/tortReform/CollateralSourceRule.asp>. (last visited Aug. 17, 2005).
11. RESTATEMENT (SECOND) OF TORTS § 920A(2) (1979).
12. JAMES M. FISCHER, UNDERSTANDING REMEDIES 76 (1999).
13. SHOBEN, *supra* note 7, at 646. .
14. James L. Branton, *The Collateral Source Rule*, 18 ST. MARY’S L. J. 883 (1987).
15. *Id.*
16. See RESTATEMENT, *supra* note 11, at cmt. b.
17. See *id.*
18. SHOBEN, *supra* note 7, at 646.
19. Branton, *supra* note 14, at 883.
20. See SHOBEN, *supra* note 7, at 646.
21. See *Mason v. Sainsbury*, 3 Doug., 61 (1782) (In an action to recover from the destruction of the plaintiff’s house by a mob, the fact that the plaintiff had received the amount of his loss from the insurer would not avail the defendant in defense.); *Clark v. Inhabitants of the Hundred of Blythiny*, 2 B. & C., 254 (9 E. Com. L., 77) (It was held that the owner of certain stacks of hay and corn which were maliciously set on fire, who had received the amount of loss from an insurance company, could nevertheless recover the amount in an action.); *Yates v. Whyte*, 4 Bing. N.C. 272, 33 Eng. C.L., 349 (1838) (In an action for damage to plaintiff’s ship by collision with defendant’s

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- ship, it was held defendant was not entitled to deduct from the amount of damages a sum paid to plaintiff by insurers in respect to such damage.)
22. *The Propeller Monticello v. Mollison*, 58 U.S. 152, 155 (1854).
 23. *Id.*
 24. *Id.*
 25. *See Harding v. Town of Townshend*, 43 Vt. 536, 538 (1871) (“The policy of insurance is collateral to the remedy against the defendant, and was procured solely by the plaintiff and at his expense, and to the procurement of which the defendant was in no contributory.”).
 26. *Id.* at 536.
 27. *Id.* at 538.
 28. *See David Fellman, Unreason in the Law of Damages: The Collateral Source Rule*, 77 HARV. L. REV. 741, 742 (1964). *See also Jones v. Keith*, 223 Ala. 36, 40 (Ala. 1931) (“This court has held that, where certain items of expense have been paid and no expenditure by, or liability attaching to, plaintiff, such expense could not be charged and collected by way of additional damages.”); *Mackintosh Co. v. Wells*, 218 Ala. 260, 265 (Ala. 1928) (ruling that the amount of salary paid to a personal injury plaintiff while absent from work was required to be remitted from verdict, where plaintiff claimed damages for loss of time); *Travis v. Louisville & N.R. Co.*, 183 Ala. 415, (Ala. Sup. Ct. 1913) (ruling that where plaintiff’s employer continued to pay him his usual wages during his sickness and convalescence, he could not recover from defendant for loss of time from work in an action for damages for negligently causing sickness).
 29. RESTATEMENT, *supra* note 11, at cmt. c. *See also Roth v. Chatlos*, 97 Conn. 282 (Conn. 1922) (accident insurance); *Conely v. Foster*, 335 S.W.2d. 904 (Ky. 1960) (hospitalization insurance); *Graydos v. Domabyl*, 301 Pa. 523 (Pa. 1930) (life insurance).
 30. RESTATEMENT, *supra* note 11, at cmt. c. *See also Campbell v. Sutliff*, 214 N.W. 374 (Wis. 1927).
 31. RESTATEMENT, *supra* note 11, at cmt. c.; *see also Hudson v. Lazarus*, 217 F.2d 344 (D.C. Cir. 1954), *cert. denied*, 350 U.S. 856 (1954).
 32. RESTATEMENT, *supra* note 11, at cmt. c.
 33. JACOB A. STEIN, STEIN ON PERSONAL INJURY DAMAGES § 13.3 (3D. ED. 1997). *See also Douglas H. Schwartz, Comment, The Tortured Path of Ohio’s Collateral Source Rule*, 65 U. CIN. L. REV. 643 (1997) (reiterating this criticism of the collateral source rule and further noting that when a tort plaintiff is insured by a collateral source, the rule provides an incentive to litigate in hopes of obtaining a windfall recovery, resulting in increased legal costs and additional demands on limited judicial resources). *See also Daena A. Goldsmith, Comment, A Survey of the Collateral Source Rule: The Effects of Tort Reform and Impact on Multistate Litigation*, 53 J. AIR L. & COM. 799 (1988).
 34. *The Propeller Monticello v. Mollison*, 58 U.S. 152, 155 (1854).
 35. *Harding v. Town of Townshend*, 43 Vt. 536, 536 (1871).
 36. *Id.*
 37. *Id.*
 38. THE AMERICAN HERITAGE DICTIONARY 1383 (2d College ed. 1976).
 39. *See Appendix I, infra*, identifying and summarizing forty-six state legislative initiatives abolishing and/or minimizing the reach of the collateral source rule enacted in the following states: Alabama, Alaska, Arizona, California, Colorado, Connecticut, Delaware, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Maine, Massachusetts, Michigan, Minnesota, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, New York, North

- Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, West Virginia, Wisconsin and Wyoming.
40. STEIN, *supra* note 33, at § 13.4. **Alabama.** ALA. CODE § 6-5-520 (2005) (products liability cases; evidence of collateral payment of medical and hospital expenses admissible). **Arizona.** ARIZ. REV. STAT. § 12-565 (2004) (health care actions). **Colorado.** COLO. REV. STAT. § 13-21-111.6 (2005) (personal injury or wrongful death actions; no reduction for collateral benefits paid for by or on behalf of injured person); COLO. REV. STAT. § 13-64-402 (2005) (medical malpractice actions). **Connecticut.** CONN. GEN. STAT. § 52-225a (2004) (personal injury and wrongful death actions; no reduction for collateral source for which right of subrogation exists and for amount of collateral sources equal to reduction of claimant's economic damages attributable to his or her percentage of negligence). **Florida.** FLA. STAT. ANN. § 768.76 (West 2005) (personal injury and wrongful death actions; no reduction for collateral source for which right of subrogation exists and for amounts paid to secure right to collateral source benefit). **Indiana.** IND. CODE § 34-4-36-2 (2004) (repealed 1998) (personal injury and wrongful death actions; no reduction for life insurance or other death benefits, insurance benefits paid for by plaintiff or members of plaintiff's family, or payments made by government entity as compensation for loss or injury). **Kansas.** KAN. STAT. ANN. §§60-3801-07 (2004) (personal injury or wrongful death claims in which claimant demands judgment for damages in excess of \$150,000). *But see* Thompson v. KFB Ins. Co., 252 Kan. 1010, 850 P.2d 773 (1993) (statute allowing evidence of collateral source benefits where claimants demand judgment in excess of \$150,000 denies equal protection of law). **Kentucky.** KEN. REV. STAT. ANN. § 411.188 (Banks-Baldwin2004) (all actions for damages, contract or tort; collateral source information admissible, except for life insurance). **Massachusetts.** MASS. GEN. LAWS ch. 231 § 60G (2005) (medical malpractice). **Michigan.** MICH. COMP. LAWS ANN. § 600.6303 (West 2005) (personal injury; reduction to be offset by cost of obtaining collateral source benefit by plaintiff or members of plaintiff's family or plaintiff's employer on behalf of plaintiff). **New Jersey.** N.J. STAT. ANN. § 2A:15-97 (West 2005) (no deduction for workers' compensation benefits or life insurance proceeds; set off must be reduced by premiums paid by plaintiff or on behalf of plaintiff). **Ohio.** OHIO REV. CODE ANN. § 2317.45 (West or Anderson 2005) (no reduction for collateral benefits paid for by plaintiff or members of family or for benefits subject to right of subrogation or other obligation of repayment). *See also* Senn v. Alabama Gas Corp., 619 So. 2d 1320 (Ala. 1993) (quoting statute abrogating collateral source rule insofar as it allowed recovery of medical expenses paid by collateral source); Fleming v. Garnett, 231 Conn. 77, 646 A.2d 1308 (1994) (quoting statute abolishing collateral source rule); Zurich Am. Ins. Co. v. Haile, 882 S.W.2d 681 (Ky. 1994) (quoting statute abolishing collateral source rule); Adcox v. Children's Orthopedic Hosp. & Medical Ctr., 123 Wash. 2d 15, 864 P.2d 921 (1993) (statute partially abolishing the collateral source rule in medical malpractice cases). *See also infra* App. 1.
 41. *See infra* App. 1.
 42. Yates v. Whyte, 132 Eng. Rep. 793, 794 (N.C. 1838).
 43. BLACK'S LAW DICTIONARY 1177-78 (5th ed.1979)(defining res inter alios acta). *See also* State v. McCarty, 179 N.W.2d. 548, 550 (Iowa 1970).
 44. Yates, *supra* note 42, at 278.
 45. *Id.* at 283.
 46. *See* STEIN, *supra* note 33, at § 13.2. *See, e.g.,* Douglas H. Schwartz, Comment, *The Tortured Path of Ohio's Collateral Source Rule*, 65 U. CIN. L. REV. 643 (1997); Tiffany G. Becker, Note, *The Collateral Source Rule in Missouri: Questioning the "Double Recovery" Doctrine*, 61 MO. L.

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REV. 633 (1996); Craig L. Farrish, *Note, Restoration of the Collateral Source Rule in Kentucky: A Review of O'Bryan v. Hedgespeth.*, 23 N. KY. L. REV. 357 (1996); Camrin Evans, *Comment, Settlements with Nonparties: A Closer Look at Colorado's Collateral Source and Contribution Statutes*, 66 U. COLO. L. REV. 195 (1995); Joel K. Jacobsen, *The Collateral Source Rule and the Role of the Jury*, 70 OR. L. REV. 523 (1991). *See also* *Voge v. Anderson*, 181 Wis. 2d 726, 733; 512 N.W.2d 749, 752 (1994) (“We recognize that the results in this case allow the injured party a double recovery. However, a contrary conclusion would result in giving the tortfeasor a windfall: the tortfeasor would not have to pay the full amount of damages he would owe even after taking into account the amount of contributory negligence. Since [plaintiff]’s recovery from [defendant] stemmed from his own actions of obtaining underinsurance and paying the premium for it, the better result is to allow [plaintiff] to recover that windfall, not [defendants]. Any windfall in benefits should inure to the injured party, not to the tortfeasor.”). *See also* *Hudson v. Lazarus*, 217 F.2d 344, 346 (D.C. Cir. 1954) (The rationale of the collateral source doctrine was summarized by Judge Edgerton as follows: “In general the law seeks to award compensation, and no more, for personal injuries negligently inflicted. Yet an injured person may usually recover in full from a wrongdoer regardless of anything he may get from a ‘collateral source’ unconnected with the wrongdoer. Usually the collateral contribution necessarily benefits either the injured person or the wrongdoer. Whether it is a gift or the product of a contract of employment or of insurance, the purposes of the parties to it are obviously better served and the interests of society are likely to be better served if the injured person is benefited than if the wrongdoer is benefitted. Legal ‘compensation’ for personal injuries does not actually compensate. Not many people would sell an arm for the average or even the maximum amount that juries award for loss of an arm. Moreover the injured person seldom gets the compensation he ‘recovers,’ for a substantial attorney’s fee usually comes out of it.”).

47. SHOEN, *supra* note 7, at 646.

48. *See* EDWIN MANSFIELD & GARY YOHE, *MICROECONOMICS* 242 (11th ed. 2004) (“The costs incurred by a firm are often thought to include only the money outlays that the firm must make to buy the resources that it wants to employ: A firm’s money outlays are, however, only part of the cost picture. In many cases, economists are interested in the social costs of production—the costs to society when its resources are employed to make a given commodity. Economic resources are, by definition, limited, and they can generally be employed only once. Once some energy is expended in making a car, for example, it cannot be used to produce a computer. So, allocating resources determines output, and reallocating resources from one product to another means less of the one and more of another. . . . To an economist, the cost of producing a certain product is the value of other products that could have been produced if the resources had been allocated differently. . . . So, the cost of employing a particular input is the value of that input if it were employed in its most valuable alternative use. It is these costs that can be combined with a firm’s production function to determine the cost of producing the product; to use these costs is to adopt what has been termed the alternative cost or opportunity cost doctrine.”) *See also* ANTHONY E. BOARDMAN ET AL., *COST-BENEFIT ANALYSIS: CONCEPTS AND PRACTICE* 28 (2d ed. 2001) (“*The opportunity cost of using an input . . . is its value in its best alternative use.*”) (emphasis in original).

49. *See* DAVID C. COLANDER, *MICROECONOMICS* 5 (4th ed. 2001).

50. *Id.*

51. *See id.* at 6-8, 239 (“firms are profit-maximizing entrepreneurial firms”); ROBERT S. PINDYCK & DANIEL L. RUBENFELD, *MICROECONOMICS* 254 (5th ed. 2001) (“The assumption of *profit* maximization is frequently used in microeconomics because it predicts business behavior reasonably accurately and avoid unnecessary analytical complications.”); EDWIN MANSFIELD, *MICROECONOMICS: THEORY AND APPLICATIONS* 55 (6th ed. 1988) (“Given the consumer’s tastes, we assume that he or she is rational, in the sense that he or she tries to *maximize utility*.”); STEPHEN A. MATHIS & JANET KOSCIANSKI, *MICROECONOMIC THEORY: AN INTEGRATED APPROACH 2* (2002) (“ . . . making rational choices is a matter of choosing amount(s) of some decision, or independent, variable(s) such that the extra benefit received from the last unit chosen is just equal to its extra costs. In economics, the process of measuring and comparing the extra benefits and extra costs associated with a rational decision is known as marginal analysis.”); STEVEN E. LANDSBURG, *PRICE THEORY & APPLICATIONS* 634 (6th ed. 2005) (“The economists assumes that people act according to the principle of equimarginality. This is often expressed by saying that the economist assumes that people are *rational*. Indeed, it has been said that a student becomes a true economist on the day when he fully understands and accepts the principle that people equate costs and benefits at the margin.”)
52. *See* MANSFIELD, *supra* note 48, at 290 (“ . . . perfect competition requires that consumers, firms, and resource owners have *perfect knowledge of the relevant economic and technological data*. Firms must know the prices of all inputs and the characteristics of all relevant technologies. And in its purest sense, perfect competition requires that all of these economic decisions-making units have an accurate knowledge of the past, the present, *and the future*.”).
53. *See also* BOARDMAN, *supra* note 48, at 30 (“Choose the combination of [goods and/or inputs] that maximizes net benefits.”).
54. MANSFIELD, *supra* note 48, at 675 (“ . . . producers act in ways that cause harm to others without paying the full cost of the damage. In these and other, similar cases, the pursuit of private gain will not necessarily promote the social welfare.”).
55. *Id.* at 676.
56. PINDYCK, *supra* note 51, at 621.
57. *See id.* at 216-22 (discussing the cost-minimizing input choice model of which we have adapted for illustrative purposes in this article). *See also* PAUL A. SAMULESON & WILLIAM D. NORDHAUS, *ECONOMICS* 132-134, 142-145 (17th ed. 2001); LANDSBURG, *supra* note 51, at 159-62; MATHIS, *supra* note 51, at 238-49; MANSFIELD, *supra* note 48, at 234-43; WALTER NICHOLSON, *MICROECONOMIC THEORY: BASIC PRINCIPLES AND EXTENSIONS* 212-17 (9th ed. 2005); MICHAEL E. WETZSTEIN, *MICROECONOMIC THEORY: CONCEPTS & CONNECTIONS* 222-27 (2005); MARK HIRSCHHEY, *MANAGERIAL ECONOMICS* 241-55 (2003); PAUL G. KEAT & PHILIP K. Y. YOUNG, *MANAGERIAL ECONOMICS: ECONOMIC TOOLS FOR TODAY’S DECISION MAKERS* 313-25 (4th ed. 2003); JAMES R. MCGUIGAN ET AL., *MANAGERIAL ECONOMICS: APPLICATIONS, STRATEGY, AND TACTICS* 317-26, (10th ed. 2005); S. CHARLES MAURICE & CHRISTOPHER R. THOMAS, *MANAGERIAL ECONOMICS* 356-75 (6th ed. 1999); LILA J. TRUETT AND DALE B. TRUETT, *MANAGERIAL ECONOMICS: ANALYSIS, PROBLEMS, CASES* 179-92 (8th ed. 2004); DOMINICK SALVATORE, *MANAGERIAL ECONOMICS IN A GLOBAL ECONOMY* 244-51 (5th ed. 2004).
58. *BMW of N. Am., Inc., v. Gore*, 517 U.S. 559 (1996).
59. *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408 (2003).
60. *See* MARSHALL, *supra* note 2, at 256 (observing that the Supreme Court’s reasonable relationship test with respect to punitive damages eliminates the economic foundations of deterrence).