CHAPTER 12

Liability Insurance & the Regulation of Firearms

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Along with the recognition that we live in the age of the insurance state has come the recognition that private insurance institutions play governmental roles.[1] If the core "governmental" activities have become the traditional "insurance" activities of risk spreading and loss prevention, then insurance *is* governance and, accordingly, all insurance institutions are governmental. For that reason, any comprehensive account of regulation should at least consider the role of insurance institutions—all the more so when one of the forms of regulation under examination is tort law, because liability insurance has the capacity to translate tort law's incentives into prices and directives.

This chapter has three goals. First, the chapter presents a preliminary description and analysis of liability insurance as a form of regulation. Although we have not finished all of the work required to present a completely satisfactory picture of insurance as regulation, the progress that we have made has informed considerably our research on guns and insurance, and we offer the conceptual framework presented here in that spirit. Second, and most important for this volume, the chapter describes what the U.S. liability insurance industry does (and does not do) to regulate gun activity. In the process, we consider how liability insurance addresses several kinds of gun-related litigation: intentional and accidental shooting cases, traditional products liability lawsuits, and the recent mass tort litigation. Finally, the chapter reflects on the implications of this case study for understanding liability insurance as a form of regulation and for understanding tort law as a deterrence and loss-spreading institution.

Regulation by Liability Insurance

The paradigmatic form of regulation by insurance is facilitative. Insurance spreads the costs of loss, which facilitates activities that might cause loss. Absent insurance, people might be unwilling to proceed in the face of the risk of loss (or, in the case of profit-oriented activity, might demand a higher potential return before proceeding) and might well have to cease activity if and when the risk matured into an actual loss. An early seventeenth-century Act of Parliament described this role of insurance in the shipping trade as follows.

> [B]y meanes of whiche Policies of Assurance it comethe to passe, upon the losse or perishinge of any Shippe there followethe not the undoinge of any Man, but the losse lightethe rather easilie upon many, then heavily upon fewe, and rather upon them that adventure not then those that doe adventure, whereby all Merchantes, sp[ec]ialie the younger sorte, are allured to venture more willinglie and more freelie.[2]

While this description emphasizes the benefits of first-party insurance (insurance that we buy to protect our own property, life, or health), loss spreading is the main attraction of liability insurance as well. By spreading the costs of liability among insurance purchasers, liability insurance helps individuals avoid financial ruin when they cause harm to others.

The fact that the "costs of liability" are based on the "costs of injury to others" means that liability insurance also spreads the costs of injury. In other words, liability insurance is not only a shield for defendants, it is also the institution that makes it possible to think of tort law as a loss-spreading system. Of course, the fact that tort law can be understood as a loss-spreading system does not necessarily make it an effective one. Among other structural problems, the fact that people buy liability insurance for the purpose of protecting themselves from the claims of others (and not for the purpose of protecting those others) creates very significant complications for injury cost spreading, some of which will be illustrated in this case study.

Almost every other aspect of regulation by insurance follows from the facilitative, loss-spreading role of insurance. The power to refuse to take the risk gives an insurance company leverage over the party with the risk. And the decision to take the risk gives the insurance company incentive to manage that risk, both before and after it matures into loss. This leverage and incentive translate into the following broad categories of regulation by insurance: gatekeeping, loss prevention, engagement with public regulators, liability limitation, selective exclusion, management of loss costs, and research and education. The sections that follow briefly describe each using examples from a variety of insurance contexts.

Gatekeeping

Obtaining insurance is often a prerequisite to other activity. You can't register a car without auto insurance, take out a mortgage without homeowners' insurance, obtain a commercial loan without business owners' insurance, bid on a government contract without a surety bond, advertise on network television without media liability insurance, finance a movie without cast insurance, sign a commercial lease without commercial property and liability insurance, obtain practice privileges at most hospitals without medical malpractice insurance, and so on. All these legal or institutional requirements make insurance companies important *gatekeepers* in large sectors of the U.S. economy (and undoubtedly in other parts of the developed world as well).

Liability insurance requirements arise in two main contexts. First, governments sometimes mandate insurance as a way of making sure that people or businesses that engage in certain activities will be financially responsible (at least to some degree) for their liabilities. Automobile insurance is the most common example; other examples include medical malpractice insurance requirements in some states and environmental insurance requirements for hazardous waste handlers.[3] Second, commercial contracts often require that parties have insurance either to make sure that the parties will be able to cover losses to the counter-parties (e.g., landlords requiring tenants to purchase insurance) or to make sure that the parties will be able to cover the losses of people who would otherwise sue the counter-parties (e.g., hospitals requiring physicians to have malpractice insurance).

Going through the gate requires meeting the insurance companies' standards, as well as paying the necessary premiums. This gatekeeping role gives insurance companies the potential to serve as very significant regulators (while at the same time making access to "private" insurance an intensely "public" issue).[4]

Loss Prevention

Once an insurance institution assumes responsibility for the financial consequences of a given harm, it has an incentive to prevent that harm. Insurers prevent harm in four main ways, each of which is potentially applicable to liability insurance: by establishing underwriting procedures that make loss prevention activities a condition of obtaining insurance, by establishing pricing structures that give policyholders an incentive to undertake specific loss prevention activities, by adopting risk-based pricing more generally, and by engaging in loss prevention–oriented monitoring during the course of the insurance relationship.[5] Risk-based pricing is a means of internalizing the loss costs associated with a range of activities. Provided that the policyholder has control over the level or type of activities covered by the insurance, this cost internalization can promote decisions that balance the costs of harm and prevention.[6]

Engagement with Public Regulators

Insurance organizations regularly work with public agencies to further loss prevention and related risk management goals. Although much of this aspect of regulation by insurance could fit under the more general heading of "loss prevention," the involvement of the state makes it different enough from private contract requirements to deserve special attention. Insurance organizations attempt to influence the agencies that are responsible for housing codes, road and highway design, automobile safety regulations, environmental cleanup procedures, and many other activities that affect the frequency or magnitude of insured losses. From the perspective of insurance institutions, the involvement of the public agencies helps with enforcement of loss prevention norms. In addition, the public agency can become a potent source for the collection and transmission of loss-related information, which helps in pricing future policies.[7]

Elimination or Reduction of Liability

From a social perspective, the liability insurance "loss" is the harm that forms the basis for the underlying liability that is insured. From the economic perspective of the people who are liable, however, the loss is not the harm itself but rather the liability arising from that harm. From a potential defendant's perspective, "loss prevention" is really "liability prevention," and the elimination of liability is just as effective as the elimination of the harm and, at least potentially, much cheaper.

As this suggests, insurance organizations can prevent *insured* losses by reducing or limiting the liability that forms the basis for liability insurance claims. Although completely eliminating liability would hardly further the interests of liability insurers (eliminating liability eliminates the need for liability insurance), eliminating some potentially very costly liabilities could serve insurers' interests, at least in the short term, particularly when the insurance that might otherwise cover those liabilities has already been priced and sold. This may explain why insurers have been involved in a number of efforts over the years to "reform" tort law in a manner that reduces liabilities across the board (e.g., damages caps) or that addresses specific kinds of liabilities (e.g., asbestos and environmental liabilities). Whatever else one may think about it, elimination or reduction of liability regulates—or, better yet, deregulates—activities through the withdrawal of the incentives and institutional arrangements that follow from tort liability.

Selective Exclusion

Insurers also can reduce the number of insured claims by refusing to provide coverage for specific kinds of losses. In general, these "selective exclusions" arise out of three kinds of circumstances: moral hazard, known losses, and potential losses that insurers determine are too uncertain. The most common example of moral hazard exclusion is the exclusion of intentional harm. Known loss exclusions include exclusions for asbestos claims and other product-specific exclusions inserted into manufacturers' liability insurance policies once mass tort litigation involving that product has commenced (commonly referred to as "laser exclusions" because of their narrow focus). Exclusions for losses that are deemed too uncertain include exclusions for environmental claims in standard liability insurance policies. In practice, selective exclusion can amount to the elimination of the liabilities that are excluded, particularly when the potentially liable parties are individuals (because of the obstacles to collecting real money from real people)[8] but also if and when the liabilities overwhelm the assets of organizational defendants.[9]

Management of Loss Costs

Along with working to prevent loss (or liability), insurance companies also attempt to reduce the cost of harm that does occur. Loss cost management is a significant focus of almost any kind of insurance arrangement in which the insurer promises to indemnify the policyholder for a given type of loss (as opposed to an insurance arrangement in which the insurer promises to pay a fixed amount in the event of loss). While there is nothing a life insurer can do to manage its loss costs after a covered death has occurred, there is a great deal that a health insurer can do to manage medical costs, that a disability insurer can do to promote rehabilitation, and that a liability insurer can do to manage the defense of claims. Within the medical and legal profession, loss cost management is one of the most visible forms of regulation by insurance, as doctors (who are regulated by managed care practices) and tort defense lawyers (who are regulated by litigation management guidelines) can report. Nearly all of tort law is systematically affected by the loss cost management aspect of liability insurance, because it is tort loss cost management that turns almost all tort lawsuits into a contest with a "repeat player" on the defense side.[10]

Research and Education

Insurance was among the earliest information businesses. Indeed, from a certain perspective an insurance company is simply a tool for the collection, analysis, and use of information. The core analytical task of an insurance enterprise is identifying future losses, choosing which of those losses it is willing to insure, estimating their frequency and magnitude, preparing insurance contracts that reflect those choices, and then deciding how much to charge which classes of people in return for this protection. In addition, insurance companies need to learn how to motivate people to buy their insurance, and they ought to learn as much as possible about how to prevent loss. All of this produces knowledge, much of which can have consequences beyond the insurance enterprise. For example, over the years, insurance institutions have been a significant force in the development and dissemination of harm-reducing technologies and practices. While of course insurers use this research in their underwriting and pricing, consumers also use this information to make decisions about what kinds of products to buy. Examples of such research and education in the liability context include risk management seminars and advice provided to doctors, lawyers, and other professionals; the occupational safety and related research carried out under the auspices of (or in cooperation with) workers' compensation insurers; and at least some aspects of the extensive efforts by insurance-supported groups in the automobile safety arena (although much of this research can be understood as an effort to reduce first-party property insurance losses).

Gun Regulation by Insurance?

In exploring how the U.S. insurance industry approaches gun risks, we focused our efforts on liability insurance. Health and disability insurance primarily is sold through employment-based group policies that do not present an opportunity to engage in individual underwriting, and life insurance companies do not appear to consider gun-related risks in underwriting and pricing their products.[11] Moreover, the focus of this volume is on gun-related tort liability, which is the province of liability insurers. Although we did not set out to learn about property insurance for guns, we could not avoid learning something about that topic because liability insurance commonly is sold together with property insurance. We focused on insurance for gun manufacturers, wholesalers, and retailers, as well as organizations and consumers involved in the recreational use of guns. We did not investigate insurance for public or private law enforcement organizations.

Personal Lines Liability Insurers

Personal lines liability insurers have adopted as their only approach to gun-related injuries the strategy of *selective exclusion*. Individual coverage for nonoccupational liability risks is provided as part of standard residential package insurance policies (such as a homeowners' or renters' policy). These insurance policies universally include an exclusion for intentional harm, which eliminates coverage for the vast majority of gun-related injuries.[12] Allstate and some other insurers have adopted an even more restrictive version of the intentional harm exclusion that excludes coverage for harm resulting from criminal acts, regardless of whether the harm was intentional.[13] Allstate has applied this exclusion to accidental injuries involving firearms, and, on the whole, courts have upheld this approach.[14]

Typically, insurers with the largest market share in this market do not inquire whether applicants have guns, except in situations in which it appears likely that the applicant may have very valuable guns that require the purchase of additional insurance protection to guard against theft.[15] As a result, there is no effort to engage in gun-related prevention through underwriting or pricing, and gun risks do not play a role in personal lines insurance gatekeeping.

This hands-off approach to gun ownership makes sense because the intentional harm exclusion means that only a very small percentage of gun injuries are even potentially covered by liability insurance. In addition, we learned of a controversy involving State Farm that suggests that being perceived as hostile to gun owners may pose some reputational risk to an insurance company.[16] This controversy notwithstanding, we are inclined to discount any conspiracy explanations for personal lines insurers' decision to ignore gun-related liability risks. Were insurance companies to be persuaded that changes in gun designs (e.g., internal locks or personalized, "smart" guns) would pay off in significantly reduced liability insurance claims, they might well offer homeowners' insurance discounts based on gun design. After all, it's not "anti-gun" to offer a discount for a safer gun.[17] But, given the relatively low cost of the liability insurance portion of homeowners' insurance (as compared to the property insurance portion) and the relatively small number of accidental gun injuries,[18] we are inclined to doubt that insurers will ever offer such discounts.[19]

Commercial Liability Insurers

With regard to commercial gun risks, insurers employ a somewhat broader array of regulatory techniques. Selective exclusion is the main tool, but there is evidence of gatekeeping and prevention. In this section we will first describe the insurance environment for gun-related businesses and then characterize insurers' approaches in terms of our conceptual framework.

COMMERCIAL INSURERS AND GUN RISKS

Unlike personal lines insurers, commercial insurers do differentiate between those customers that present gun risks and those that do not. Although the treatment of a gun risk is left to the discretion of the individual insurer, and in some cases the individual underwriter, there are industrywide recommendations that channel that discretion.

When deciding whom to insure, and at what price, many insurers rely on statistical and actuarial data compiled by the Insurance Services Office (ISO). ISO collects loss data from insurers and other entities and organizes it according to the type, or "classification," of business that produced the loss. As a result, ISO's classifications effectively make up a set of de facto industry standards. If ISO classifies, say, lamp manufacturers differently from lamp shade manufacturers, the insurers who rely on ISO's statistics will classify and price them differently as well.

ISO's classification scheme shows that there are relatively few instances in which gun-risk businesses are classed differently from other, similar businesses. Retail sporting goods stores all carry the same general liability classification (18206) whether they sell firearms or not.[20] Pawnshops are also classed the same whether they deal in guns or not. Jewelry stores, liquor stores, and bars are classed the same whether or not they keep guns on premises for security purposes.

Gun-risk businesses that have their own classifications are primarily those that present significant products liability exposures. Firearms manufacturers, for example, are classed separately. Ammunition manufacturers are classed separately as well and indeed are further divided between those that manufacture smokeless powder and those that do not. Other gun risks that do not present significant products liability exposures but nevertheless have their own classifications include gunsmiths, shooting clubs, and shooting galleries.

Although industry standard setters do not set mandatory rules for the treatment of gun risks, they do recommend that insurers take such risks into account. The *A.M. Best Underwriting Guide*, for example, characterizes firearms risks as a "serious exposure" in which the "potential for injury is severe."[21] Best offers a number of recommendations to underwriters who are considering insuring such risks, depending on the type of business seeking coverage.

Sporting Goods Stores. Although ISO does not class gun-selling sporting goods stores differently than gun-free ones, Best's *Underwriting Guide* advises the underwriter that the "hazard index" presented by a gun retailer is higher. Interestingly, the primary area in which Best sees heightened exposure is not in general liability but rather in property insurance coverage—commercial crime and fire in particular. On a scale of one to ten, Best characterizes the general liability hazard index of a sporting goods store at six whether it sells guns or not. But the underwriter is advised that the ordinary commercial crime hazard index of five becomes "higher with the sale of firearms and ammunition." Due to the heightened crime and fire exposures, Best recommends that the insurer consider several factors before agreeing to insure a gun retailer.

Given this focus on fire and crime, it is not surprising that most of Best's recommendations have to do with the prospective insured's gun and ammunition storage practices. Best recommends that the underwriter investigate whether guns are kept in locked display cases constructed of tempered glass. In addition, Best recommends that the underwriter determine whether firearms are stored unloaded and separately from ammunition. It recommends that the insurer investigate the type of ammunition stored on premises—black powder presents explosion hazards that small rifle cartridges do not—and it recommends that the insurer confirm that the insured follows all state and federal regulations in the storage of ammunition.

Best does not offer many specific recommendations concerning the general liability and products liability perils. It reminds the underwriter that the potential for injury is severe and that a retailer is likely to be named as a defendant in any products liability suit brought against a manufacturer.

Information on how carriers are implementing these recommendations is sparse. One carrier (The Hartford) will not insure a sporting goods store that sells handguns.[22] Another carrier (Safeco) will insure a sporting goods store if its gun sales are "incidental." Safeco regards gun sales as incidental if they are less than 15–20 percent of the store's total sales, and the underwriter accounts for the incidental gun risk by manually adjusting the premium upward.[23] The four largest U.S. writers of commercial insurance (AIG, CNA, Travelers, and Liberty Mutual)[24] declined requests for interviews.

Anecdotal evidence suggests that it is becoming increasingly difficult for a gun retailer to get general liability insurance, notwithstanding Best's relatively unthreatening portrayal of the exposure and the actions of individual carriers such as Safeco. John Badowski, managing director of the National Association of Firearms Retailers and director of retail partnership programs for the National Shooting Sports Foundation (NSSF), has noted an increase in the frequency with which firearms retailers are reporting refusal or nonrenewal of insurance.[25] Badowski's assessment is confirmed by Robert Chiarello, an Elizabeth, New Jersey, insurance broker who administers an insurance program endorsed by the National Association of Sporting Goods Wholesalers.[26]

Badowski indicates that the NSSF has attempted to increase gun retailers' attractiveness to insurers by conducting its own loss control activities. The NSSF has created a dealer education program entitled "Don't Lie for the Other Guy" that is intended to increase the dealer's ability to recognize and prevent straw purchases. NSSF, in consultation with a team of engineers, has created a gun display case highly resistant to "smash and grab" thefts. Badowski reports that these loss control efforts have yet to show success in reducing insurer reluctance to accept retail gun risks.[27] This may be because of the general "hardening" of the property casualty insurance market at the time of our interviews over the last three years,[28] as well as concern that retailers may be drawn into the mass tort gun litigation (though that latter concern is addressed in part through selective exclusion, as explained later).

Gunsmiths. ISO maintains a separate classification (95620) for gunsmiths. Gunsmiths are those businesses that are primarily engaged in the "repair and maintenance of firearms" and may also engage in "engraving, bluing, fitting a gun specifically to a customer, suggesting gun improvements to a manufacturer, and selling firearms and other shooting equipment on a retail basis." "In addition to conducting their own business, some insureds also will do warranty work for major manufacturers, much like an authorized service center."[29]

Although a gunsmith's entire business is gun related and a sporting goods retailer's business is only partially so, Best's general liability hazard index is lower for gunsmiths than for sporting goods stores. On a scale of one to ten, Best rates the general liability hazard index of a sporting goods retailer at six and that of a gunsmith at four.[30] This might suggest that Best sees other sporting goods (rollerblades, treadmills, etc.) as more productive of general liability losses than guns.[31] Best rates the products liability hazard index of both gunsmiths and sporting goods stores at six and the crime hazard index of both at five. Best sees a sporting goods retailer as a higher fire hazard than a gunsmith—the former is a six, the latter a five—but the fire exposure presented by a gunsmith is said to be "much higher with ammunition on the premises." Workers' compensation is the only line in which the hazard index is higher for a gunsmith (eight) than for a sporting goods retailer (four). This is due in part to the presence of firearms but also to the presence of cutting and drilling machinery.[32]

As with sporting goods stores, Best's *Underwriting Guide* recommends that the underwriter survey the applicant's gun and ammunition storage practices before agreeing to insure her. Best also recommends that the underwriter review any contracts the gunsmith may have signed with manufacturers for whom she does warranty work, with a view to determining whether the gunsmith has agreed to indemnify the manufacturer for any personal injuries arising from serviced guns. In addition, Best recommends that the underwriter review the professional qualifications of the applicant, since her skill in gunsmithing ought to be directly proportional to the rate at which her repairs will fail and produce products liability losses. The underwriter is also advised to determine whether the gunsmith designs any parts or assemblies for gun manufacturers, since such work would increase the likelihood that the gunsmith would be named in a products suit against the manufacturer.

Best also makes a number of recommendations specific to lines of insurance other than general liability. Since gunsmiths frequently need to test-fire guns to ensure that their repairs are satisfactory, Best recommends that workers' compensation underwriters determine whether the gunsmith's employees have received proper training in the firing of guns. Best also recommends that crime underwriters look closely at the crime rate in the insured's neighborhood and at the types of guns on which she works. Gunsmiths who work on valuable antiques will have more severe bailee losses.

Hunting Clubs, Rifle Clubs, and Shooting Ranges. We were unable to obtain access to Best's recommendations for these kinds of risks. We were able to locate other documents that provide a window into how insurers approach these risks, however. Carpenter Insurance Service of Annapolis, Maryland, administers a hunting club insurance program for the Northland Insurance Company, an arm of Travelers. We obtained a copy of Northland's application for hunting club liability insurance, and the underwriting questionnaire contained in that application tells us much about the risks that Northland perceives in such clubs. Applicants are asked whether they allow the use of horses on their premises; whether they own any vehicles or allow the use of members' vehicles on their premises; whether they hold a liquor license or allow members to participate in hunting or shooting activity while under the influence of alcohol; whether they use tree stands; and whether all members carry proper firearms permits.[33] Another insurance program for hunting clubs is available through the National Rifle Association (NRA). The NRA endorses a program administered by Lockton Risk of Kansas City. Lockton is willing to quote, if not issue, insurance for a hunting club on the strength of an exceptionally short questionnaire. Lockton's application asks the prospective insured to report the number of members it has; whether it uses tree stands; whether it is NRA affiliated, and what its locations are.[34]

Lockton Risk also offers an NRA-endorsed insurance plan for rifle clubs and shooting ranges. Here, the questionnaire is more extensive. Before Lockton will issue a quote, it requires the applicant to reveal the type of range to be insured (indoor, outdoor, rifle, archery, skeet/trap, etc.), the number of range lanes, and the design of the range. In addition, Lockton requires a description of the range's safety practices, including whether it has posted range safety rules, on-site range safety officers, and required ear and eye protection. Lockton also asks the prospective insured about its environmental practices, including the range's ventilation and its disposal methods for spent lead shot.[35]

Gun Manufacturers and Distributors. Little public information exists on the insurance environment for gun manufacturers and distributors. Gun manufacturers and distributors appear to be unable to obtain insurance from the standard commercial insurance market and, thus, can only obtain their insurance from a special, less heavily regulated type of insurance known as "surplus lines" insurance. Although it is difficult to generalize about such a flexible insurance instrument, surplus lines insurance tends to be more expensive and offered by organizations that are administratively leaner and, accordingly, less likely to engage in the more hands-on approaches to risk management (prevention, engagement with public regulators, research, and education). Some of the leading surplus line insurance companies are subsidiaries of well-known insurance groups (AIG, Zurich, Travelers, etc.) and, thus, would seem to have access to very significant administrative resources. Nevertheless, these subsidiaries tend to be run relatively autonomously.

Interviews with industry participants indicate that, even in the context of the ordinarily expensive surplus lines environment, gun manufacturers and distributors are experiencing a "hard market" for insurance. Robert Chiarello, the New Jersey insurance broker, indicates that a number of carriers have withdrawn from the gun manufacturer products liability market. To Chiarello's knowledge, there are "only about five players" remaining in the market. AIG writes products liability for manufacturers and distributors through its Lexington Insurance subsidiary. Admiral, Granite State, and New Hampshire Insurance have manufacturer and distributor programs as well.[36]

In addition to these providers, insurance is available through a captive insurance company founded by some of the larger gun manufacturers. The captive—Sporting Activities Insurance Limited, or SAIL—is a Bermuda corporation formed in 1986 with the assistance of Chiarello.[37] It insures or has insured Smith & Wesson and Navegar, among others.[38] Tom McDermott, a New York attorney who investigates fraudulently undercapitalized insurance companies, classifies SAIL as a "legitimate insurer" and not as an example of the "sleazy insurance" problem addressed later.[39]

Chiarello reports that gun insurers do not directly discriminate between "reputable" gun manufacturers such as Colt and "junk gun" manufacturers such as Bryco but that some of their underwriting guidelines indirectly produce the same practical result. The rating basis for a gun manufacturer—indeed, for manufacturers generally—is gross sales. But "carriers will look not only at the gross dollar amount of sales but also at how those sales are earned. A company that makes a million dollars selling a thousand units will present a different exposure than someone who makes the same million dollars selling one hundred units." So while the underwriter might not enter the process expecting to treat a Bryco differently from a Colt, the two manufacturers end up being treated differently because of the larger number of exposure units Bryco presents per each unit of sales. In addition, Chiarello reports that underwriters understand consumers of expensive guns to be better educated in the use of firearms and therefore less likely to injure themselves. Chiarello cites Anschutz, the German manufacturer of competition air rifles used in the Olympics, as a manufacturer with an enviable loss record. "Anyone who spends three thousand dollars on an air gun probably knows what he's doing."[40]

Chiarello provided us with documents that expand on his verbal description of the underwriting concerns of gun insurers. Chiarello has taken the underwriting concerns of the several market participants and synthesized them into a common insurance application. By asking his customers to answer every underwriting question asked by any of his markets, Chiarello saves his customers from having to fill out a separate application for each insurer that may express interest in the risk. An accidental by-product of this customer service measure is that the Chiarello application gives us a composite view of the underwriting concerns of the market as a whole.

Chiarello's application is actually two separate documents—one for general liability coverage generally and another for products liability specifically. Commercial liability insurance policies typically exclude products liability coverage from the "general liability" coverage and provide it under a separate "products liability" heading. Chiarello's general liability application asks the prospective insured about business history, gross sales and payroll, the nature of her operations, the type of building occupied, loss history, and trade group affiliations.[41] In addition, it asks distributors about the sources of their products—evidently the carriers Chiarello represents are more concerned with distributors of foreign guns than with distributors of domestic ones, presumably because they suspect that plaintiffs will not want to locate foreign manufacturers and will instead sue their distributors.

The products liability application asks many of the same questions. In addition, it asks deeper questions about the insured's business background, including whether the insured purchased any businesses and, if so, whether it assumed that business's liabilities. The application also asks the prospective insured to describe quality control and loss control activities and to break down sales according to the type of gun produced—rifles, shotguns, or handguns. Finally, the application asks about claims history at a greater level of detail.[42]

THE "SLEAZY INSURANCE" PROBLEM

A December 2002 article in the online journal *Slate* claimed that insurers abet the marketing of "junk guns" by helping irresponsible gun manufacturers put up a facade of financial responsibility.[43] According to the article, makers of junk guns teamed up with "sleazy" insurance companies to defraud firearms distributors and retailers into believing that they—the manufacturers—could face their products liability obligations. If not for the contributions of sleazy insurance companies to this scheme, distributors and retailers would not have marketed junk guns and the public would have been safer as a result.

The primary source for the article was Tom McDermott, the New York attorney referred to earlier, and the example presented in the article was an insurance company called Leeds and London. According to McDermott, Leeds and London was conceived by an insurance broker and a principal of the now defunct low-end gun manufacturer Lorcin Engineering. In addition to Lorcin, Leeds and London insured another low-end manufacturer by the name of Davis Industries; McDermott says that Davis "had to have known" that the insurance provided by Leeds and London was illegitimate because the premium was too low.[44] Evidently Leeds and London branched out, offering to cover hard-to-insure operators of carnival rides. A Maryland carnival operator discovered problems with Leeds when a state inspector refused to accept its certificate of insurance, and the company collapsed soon after.[45]

McDermott believes that Leeds-issued certificates of insurance persuaded distributors and retailers to market products that they otherwise would not have marketed. He attributes the existence of the scheme to a near-collapse of state monitoring of insurer solvency in the surplus lines arena[46] and reports that gun distributors and retailers will have to monitor the quality of the insurance carried by the manufacturers they represent, because "no one else is."[47]

Robert Chiarello, the New Jersey insurance broker, disagrees with McDermott's characterization of the reach of what he calls the "rogue insurer problem" but agrees that distributors and retailers must take it upon themselves to ensure the financial responsibility of the manufacturers they represent. Indeed, Chiarello reports that retailers and distributors have already assumed that duty and have, if anything, become overzealous in their oversight of manufacturers' insurance. Chiarello claims that this oversight was prompted less by the collapse of bad actors like Leeds than by the collapse of more upstanding market participants like Reliance and Legion.[48] Since the collapse of Reliance, "all of the distributors will not accept" a manufacturer's certificate of insurance "from someone they do not know." Chiarello relates an anecdote in which a distributor questioned a certificate of insurance from the venerable gun manufacturer Browning, merely because Browning had "gone digital" and had sent its certificate in a format with which the distributor was unfamiliar.[49]

COMMERCIAL INSURERS AND GUN REGULATION BY INSURANCE

Selective Exclusion. Selective exclusion is the commercial liability insurance industry's main approach to the kinds of gun-related injuries that are the focus of gun control advocacy generally and the mass tort litigation in particular. There are two main parts to insurers' exclusion of gun violence risks. First, many insurers exclude products liability coverage from the liability insurance that they sell to businesses such as sporting goods stores, hunting clubs, rifle ranges, and gunsmiths (i.e., businesses other than manufacturers and distributors)[50] and, sometimes, even to manufacturers and distributors.[51] Second, all or most of the relatively few insurers that are willing to provide products liability coverage to manufacturers and distributors appear to have adopted in recent years an exclusion designed to eliminate coverage for mass tort gun litigation.[52]

We were able to obtain a copy of one such mass tort exclusion. The exclusion applies to any "industry liability claim," which is defined to include any class action, whether or not certified as such, and any claim brought by a municipality, interest group or other entity that has not itself been injured in a bodily way.[53] The clear intent of this exclusion is to eliminate any doubt about whether there is coverage for the current round of gun-related mass tort litigation. For example, the omission of property damage as a coverage trigger is not accidental. The small contribution of municipal property damage (e.g., bullet holes in police cruisers) to the overall costs of gun violence has occasionally become an important battleground. Gun manufacturers challenge the municipalities' standing to sue for what the manufacturers claim is an indirect injury, derivative of injuries to third parties. The municipalities cite, inter alia, their own property damage as proof that they have suffered direct injury and thus have standing.[54]

Even without the mass tort or products liability exclusions, some liability insurers have argued that the municipal litigation is not covered. To date, there are only two published opinions, one favoring the insurance companies and one favoring a manufacturer, and both of these opinions rest on unusual circumstances that may limit their precedental value.[55] The coverage litigation continues, and there are substantial arguments on both sides, suggesting that manufacturers and distributors cannot count on coverage even under the old forms.[56]

Gatekeeping. Insurers have the opportunity to act as gatekeepers when insurance is a necessity. Distributors apparently regularly require that manufacturers provide evidence of product liability insurance coverage before they will agree to distribute the manufacturers' guns, and some retailers may as well.[57] Thus, manufacturers who are unable to purchase product liability coverage will not have access to those distributors or retailers. The "sleazy insurance" problem complicates this picture, however, because manufacturers that are unable to get access to reliable insurance coverage may nevertheless be able to obtain a certificate of insurance that would satisfy an unsophisticated risk manager. While we are not in a position to evaluate the extent of this problem, a recent, somewhat impressionistic study of insurance fraud by the sociologist Robert Tillman provides support for the claim that it exists.[58]

Other gatekeeping opportunities are presented when sporting goods stores, gunsmiths, and other gun-related businesses that rent commercial space are obligated under their lease agreements to purchase liability insurance. (Insurance clauses are a standard feature in commercial leases.) Whether the liability insurance that these gun-related businesses obtain in fact provides comprehensive coverage against gun-related risks is doubtful in the current insurance environment (because of the selective exclusion approach, addressed earlier). Nevertheless, the insurance would provide coverage against the ordinary liability risks that are likely to motivate commercial landlords to require that their tenants be insured.

Prevention. As noted previously, *Best's Underwriting Guide* contains many prevention-related suggestions for underwriters of businesses with gun risks, but those suggestions largely concern fire and crime risks. In the relatively few instances in which the suggestions address bodily injury, the primary focus of concern is accidental injury on location, either by customers inspecting or using weapons or by employees working on them.[59]

Some exceptions appear in the entry for gunsmiths, which reflects a concern about liability relating to procedural irregularities in the sale of guns, improper instruction in the use of guns, and improper repair of guns. Under the heading for "general liability," underwriters are cautioned to inquire the following:

> Are special precautions taken to insure that only customers with legal permits are allowed to buy guns? Are all employees who sell guns aware of local and state laws regarding age, criminal record, mental health and waiting periods? Does the insured instruct buyers on the use of guns? What are the qualifications of the instructors and under what conditions are instructions given?

Under the heading for "products liability," underwriters are cautioned as follows:

> A serious exposure will exist relating to accidents arising from the improper repair of customers' guns. This may encompass faulty work or assembly, improper installation of parts, or use of substan-

> dard parts. Improperly repaired guns can misfire and cause severe bodily injury to the user as well as others around the user.

We were unable to determine whether underwriters in fact ask the questions that Best suggests and, if the "wrong" answers are given, whether they deny applications. Assuming that they do, however, these prevention efforts are unlikely to address the intentional gun violence that is the main focus of this book. (The exception might be efforts directed at ensuring that policyholders comply with gun laws.) Instead, insurance industry prevention efforts are directed at minimizing "normal," accidental injuries associated with the legal use of guns—accidents in stores, explosions of powder and ammunition, and injuries from product malfunction.

Management of Loss Costs. Management of loss costs is an important aspect of regulation by insurance generally, particularly because of the impact on the medical and legal professions, but there does not appear to be anything special about management of loss costs in the gun-injury context. For example, emergency room personnel have made great strides in the treatment of gun injuries, but those efforts do not appear to have been led by health insurance interests. Similarly, insurance law textbooks commonly feature cases involving gun-related injuries, but the cases are chosen because they nicely illustrate the difficulties involved in drawing lines between auto and homeowners' insurance and between intentional and unintentional injuries,[60] not because of a special focus in the insurance industry on defending gun-related injury cases.

Liability Limitation. In response to the recent gun-related mass tort litigation, there have been legislative efforts in the states and Congress to limit liability. While insurance industry organizations appear to be supportive of at least some of these efforts, the insurance industry does not appear to be a driving force.[61] This situation contrasts with that of recent legislative efforts directed at limiting liability for asbestos-related injuries, environmental cleanups, and medical malpractice, in which insurance industry organizations are intensively and publicly involved. Although it is always difficult to provide persuasive causal explanations for inaction, the insurance industry's ability to avoid the mass tort litigation risk through selective exclusion is certainly a plausible explanation.

Conclusions and Implications

Although insurance may well be a form of governance, and insurance institutions governmental, the approach to government described here would hardly qualify as activist. Indeed, if we were to limit the use of the term *regulation* to the command and control approach epitomized by the Occupational Safety and Health Administration and by much of the work of the Environmental Protection Agency, then there is very little regulation by insurance of gun-related activities. As noted already, the guidelines from Best are directed primarily at preventing fire and theft and only secondarily at preventing the ordinary accidents that arise in the context of the legal sale and use of guns. The only guidelines that address the gun violence that is the target of the mass tort gun litigation are those that encourage underwriters to make sure that gun sellers follow the procedural requirements established by the applicable state and federal law.

Instead of command and control directives targeted at preventing and minimizing the costs of gun violence, what we find, instead, is selective exclusion. By excluding claims based on intentional harm, liability insurers have largely kept the costs of gun violence out from under the insurance umbrella. Where those costs have threatened to creep in—as in the municipal litigation—insurers have responded by leaving the market or by further selective exclusion.

By excluding gun violence, the insurance industry cannot fairly be accused of *knowingly* facilitating gun violence. Indeed, the historic, moral hazard justification for the most important exclusion—that for intentional harm—was first articulated precisely to protect insurers from similar accusations.[62] Yet, leaving gun violence outside the liability insurance umbrella may in fact promote gun violence by depriving the gun arena of a potentially powerful institutional force for the prevention of harm. Unless liability insurance covers the costs of gun violence, there is no incentive for the liability insurance industry to use the regulatory tools that it has available.

A liability insurance industry responsible for paying millions of dollars in gun-related claims in any given year would have an incentive to learn more about gun violence and, if it determined that there were cost-effective prevention measures, to impose those prevention measures on insureds either through the underwriting process or through engagement with public regulators. In addition, depending on what the research revealed, owning a gun could lead to a premium surcharge, which could remove some guns from circulation. Moreover, as the conditional nature of this discussion suggests, insurance-funded researchers could function as "honest brokers" in the debates over the safety and costs of guns, much as they have in the field of auto and fire safety.

The liability insurance reform that would be most likely to bring gun violence under the liability insurance umbrella would be the elimination of the intentional harm exclusion in personal liability policies. While many people who use guns undoubtedly do not have homeowners' or renters' insurance, some do. Eliminating the intentional harm exclusion would promote the deterrence goals of tort law for the reasons just suggested, without, in our view, affecting the behavior of someone who is deciding whether to draw a gun.[63] Eliminating the intentional harm exclusion would also promote the compensation and retribution goals of tort law.[64] If there is an insurance company available to pay a claim, it is much more likely that a victim of gun violence will bring a tort action against the perpetrators (furthering the retribution goal) and collect the damages to which she or he is entitled under the law (furthering the compensation goal). Jennifer Wriggins has recently made similar observations in the domestic violence context.[65]

As noted earlier, insurers have extended the selective exclusion approach to gun violence by adopting an "industry liability" exclusion when the municipal litigation threatened to bring gun violence under the liability insurance umbrella. This has become standard procedure in the mass tort context. Almost as soon as any manufacturer becomes the subject of mass tort litigation, insurers adopt product-specific exclusions that preclude any new coverage for the mass tort claims. In effect, liability insurers offer manufacturers one set of policy limits per product; after that, liability for the product is treated as a "known loss" that cannot be insured. This reality should temper whatever enthusiasm remains for mass tort litigation as a loss-spreading device.

On the other hand, the routine practice of adopting product-specific exclusions increases the power of tort litigation to force the withdrawal of a product from the market. The gun litigation failed in that regard, not because liability insurers came to the rescue of the manufacturers with promises of continuing protection (they did not) but rather because the manufacturers successfully repulsed the litigation (with some help from insurers under liability policies already sold). In considering whether mass tort litigation can force products off the market, it is important to keep in mind a fundamental difference between gun litigation and other products liability litigation. The gun litigation (like the tobacco litigation before it) had the goal of shutting down entire businesses. That goal prompts a very different response than litigation directed at a single product manufactured by a business that manufactures a variety of products. In the latter context, mass tort litigation and the accompanying withdrawal of insurance might well prompt the manufacturer to cut its losses, abandon the product, and move on, only to return the product to market if and when it prevails in the mass tort litigation.

Finally, the "sleazy insurance" problem highlights an important consequence of relying on insurance as regulation. When an individual or entity is motivated to buy insurance to get through the gate (and not primarily to obtain the risk-spreading and related benefits), we can't rely on the market alone to ensure that the resulting insurance will be high quality, because the person buying the insurance cares less about the quality of the insurance. As this suggests, the more we rely on private insurance to achieve social policy goals, the more we have to regulate insurance itself. Absent a government mandate, the liability insurance industry has little reason to take on gun violence. If we force insurers to provide insurance that they don't want to provide and force consumers to purchase insurance that they don't want to buy, we will need an administrative enforcement mechanism to ensure that insurers really provide and consumers really purchase that insurance.