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# Liability Insurance and the Regulation of Firearms

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# **Liability Insurance and the Regulation of Firearms**

Tom Baker and Thomas O. Farrish

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Prepared for an edited volume on gun litigation, this working paper examines the topic of gun risks as a case study of liability insurance as a form of regulation. The paper identifies the following broad categories of ‘regulation by insurance’: loss spreading, gate keeping, loss prevention, management of loss costs, research and education, engagement with public regulators, liability limitation, and selective exclusion. Personal lines liability insurers have adopted as their main approach to gun related injuries the strategy of selective exclusion, through the application of the intentional harm exclusion. Commercial liability insurers employ a somewhat broader array of techniques. Selective exclusion is the main tool, but there is some evidence of gate keeping and prevention. Interestingly, guns appear to be regarded as more significant property risks (theft, fire and explosion) than liability risks. In the context of the “insurance as governance” literature, the main contribution of the paper is to emphasize that the freedom to exclude risks means that private insurance cannot be counted upon to address difficult social problems such as gun violence.

# ***Liability Insurance and the Regulation of Firearms\****

Tom Baker<sup>\*\*</sup> and Thomas O. Farrish<sup>\*\*\*</sup>

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.<sup>1</sup> 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.

## **Part One: 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 17<sup>th</sup> 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 heavilie 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 ....<sup>2</sup>

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: gate keeping, loss prevention, management of loss costs, research and education, engagement with public regulators, liability limitation, and selective exclusion. The paragraphs that follow briefly describe each, using examples from a variety of insurance contexts.

*Gate keeping.* Obtaining insurance is often a pre-requisite 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 *gate keepers* 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.<sup>3</sup> 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 gate keeping 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).<sup>4</sup>

*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.<sup>5</sup> 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.<sup>6</sup>

*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 clean-up 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.<sup>7</sup>

*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 address 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 moral hazard exclusion is the exclusion of intentional harm. Known loss exclusions include exclusions for asbestos claim 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),<sup>8</sup> but also if and when the liabilities overwhelm the assets of organizational defendants.<sup>9</sup>

*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, a disability insurer can do to promote rehabilitation, and 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.<sup>10</sup>

*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.<sup>11</sup> 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).

### **Part Two: 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.<sup>12</sup> 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.

### **A. 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 non-occupational 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,<sup>13</sup> which eliminates coverage for the vast majority of gun-related injuries.<sup>14</sup> 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 whether the harm was intentional.<sup>15</sup> Allstate has applied this exclusion to accidental injuries involving firearms and, on the whole, courts have upheld this approach.<sup>16</sup>

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.<sup>17</sup> 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 gate-keeping.

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.<sup>18</sup> 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.<sup>19</sup> 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,<sup>20</sup> we are inclined to doubt that insurers will ever offer such discounts.<sup>21</sup>

## **B. 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 gate-keeping 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.

### **1. 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 industry-wide 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 comprise 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.<sup>22</sup> Pawn shops are also classed the same whether they deal in guns or not.<sup>23</sup> Jewelry stores, liquor stores and bars are classed the same whether or not they keep guns on-premises for security purposes.<sup>24</sup>

Gun-risk businesses that have their own classifications are primarily those that present significant products liability exposures. Firearms manufacturers, for example, are classed separately.<sup>25</sup> Ammunition manufacturers are classed separately as well, and indeed are further divided between those that manufacture smokeless powder and those that do not.<sup>26</sup> Other gun risks that do not present significant products liability exposures but nevertheless have their own classifications include gunsmiths, shooting clubs, and shooting galleries.<sup>27</sup>

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".<sup>28</sup> Best offers a number of recommendations to underwriters 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.<sup>29</sup>

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.<sup>30</sup>

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.<sup>31</sup>

Information on how carriers are implementing these recommendations is sparse. One carrier (the Hartford) will not insure a sporting goods store that sells handguns.<sup>32</sup> 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% of the store's total sales, and the underwriter accounts for the “incidental” gun risk by manually adjusting the premium upward.<sup>33</sup> The four largest U.S. writers of commercial insurance (AIG, CNA, Travelers and Liberty Mutual<sup>34</sup>) 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, has noted an increase in the frequency with which firearms retailers are reporting refusal or non-renewal of insurance.<sup>35</sup> Badowski's assessment is confirmed by Robert Chiarello, an Elizabeth, NJ insurance broker who administers an insurance program endorsed by the National Association of Sporting Goods Wholesalers.<sup>36</sup>

Badowski indicates that the National Shooting Sports Foundation (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.<sup>37</sup> This may be because of the general “hardening” of the property casualty insurance market over the last three years,<sup>38</sup> 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 below).

*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.”<sup>39</sup>

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.<sup>40</sup> This might suggest that Best sees other sporting goods (rollerblades, treadmills etc.) as more productive of general liability losses than guns.<sup>41</sup> 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.<sup>42</sup>

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 if

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 if 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.<sup>43</sup>

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 type of guns on which she works. Gunsmiths who work on valuable antiques will have more severe bailee losses.<sup>44</sup>

*Hunting clubs, rifle clubs and shooting ranges.* We were unable to obtain access to the 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, MD administers a hunting club insurance program for the Northland Insurance Company, an arm of the 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 if 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.<sup>45</sup> Another insurance program for hunting clubs is available through the National Rifle Association. 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 how many members it has; whether it uses tree stands; whether it is NRA-affiliated, and what its locations are.<sup>46</sup>

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 tell it 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.<sup>47</sup>

*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 to be 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/distributor programs as well.<sup>48</sup>

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.<sup>49</sup> It insures or has insured Smith & Wesson and Navegar, among others.<sup>50</sup> 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 below.<sup>51</sup>

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.<sup>52</sup> 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.”<sup>53</sup>

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.<sup>54</sup> 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. Additionally, 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.<sup>55</sup> Finally, the application asks about claims history at a greater level of detail.<sup>56</sup>

## **2. 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 façade of financial responsibility.<sup>57</sup> 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.<sup>58</sup> 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.<sup>59</sup>

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,<sup>60</sup> 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.”<sup>61</sup>

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 over-zealous in their oversight of manufacturers’ insurance. Chiarello claims that this oversight was prompted less by the collapse

of bad actors like Leeds than it was by the collapse of more upstanding market participants like Reliance and Legion.<sup>62</sup> 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.<sup>63</sup>

### **3. 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)<sup>64</sup> and, sometimes, even to manufacturers and distributors.<sup>65</sup> 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.<sup>66</sup>

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.<sup>67</sup> 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 (bullet holes in police cruisers, etc.) to the overall costs of gun violence has occasionally become an important battleground. Gun manufacturers challenge the municipalities' standing to sue for what they (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.<sup>68</sup>

Even without the mass tort or products liability exclusions, some liability insurers have argued that the municipal litigation is not covered.<sup>69</sup> 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 precedential value.<sup>70</sup> 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.<sup>71</sup>

*Gate keeping.* Insurers have the opportunity to act as gatekeepers when insurance is a necessity. Distributors apparently regularly require that manufacturer provide evidence of product liability insurance coverage before they will agree to distribute the manufacturers' guns, and some retailers may as well.<sup>72</sup> 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.<sup>73</sup>

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 above). 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 above, 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 addressed bodily injury, the primary focus of concern was accidental injury on location, either by customers inspecting or using weapons or by employees working on them.<sup>74</sup>

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

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 “products liability,” underwriters are cautioned:

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 substandard 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, 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 lead 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,<sup>75</sup> 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.<sup>76</sup> 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.

### **Part Three: 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 OSHA and much of the work of the EPA, 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.<sup>77</sup> 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 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 \$X million 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.<sup>78</sup> Eliminating the intentional harm exclusion would also promote the compensation and retribution goals of tort law.<sup>79</sup> 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 are entitled under the law (furthering the compensation goal). Professor Wiggins has recently made similar observations in the domestic violence context.<sup>80</sup>

As noted above, 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, and only 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 that we rely on private insurance to achieve social policy goals, the more that 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 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.

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\*. Thank you to Laura Nigro for significant assistance in fieldwork..

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\*\*\*. J.D. student, University of Connecticut School of Law and former claims analyst, Safeco Insurance Company.

1. Tom Baker, "Risk, Insurance and the Social Construction of Responsibility," in Tom Baker and Jonathan Simon, eds., *Embracing Risk: The Changing Culture of Insurance and Responsibility* (Chicago: University of Chicago Press, 2002); Richard V. Ericson, Aaron Doyle and Dean Barry, *Insurance as Governance* (Toronto: University of Toronto Press, 2003).

2. An Acte coner[er]ninge matters of Assurances, amongste Merchantes, 1601, 43 Eliz., c. 12 (Eng.).

3. For an example of a law requiring doctors to carry medical malpractice insurance, see FLA. STAT. ch. 458.320. For an example of a law requiring hazardous waste transporters to carry insurance, see FLA. ADMIN. CODE 62-730.170(2)(a).

4. Carol Heimer, "Insuring More, Ensuring Less: The Costs and Benefits of Private Regulation Through Insurance," in *Embracing Risk: The Changing Culture of Insurance and Responsibility*, eds. Tom Baker and Jonathan Simon (Chicago: University of Chicago Press, 2002), 116.

5. See generally George M. Cohen, "Legal Malpractice Insurance and Loss Prevention: A Comparative Analysis of Economic Institutions," *Connecticut Insurance Law Journal* 4 (1997-1998):305.

6. This should not be mistaken for a blanket endorsement of risk-based pricing. See Tom Baker, "Containing the Promise of Insurance: Adverse Selection and Risk Classification," in Richard V. Ericson and Aaron Doyle, eds., *Risk and Morality* (Toronto: University of Toronto Press, 2003).

7. See, e.g., Richard V. Ericson and Kevin D. Haggerty, "The Policing of Risk," in *Embracing Risk: The Changing Culture of Insurance and Responsibility*, eds. Tom Baker and Jonathan Simon (Chicago: University of Chicago Press, 2002), 238 (describing how police departments collect information in a manner that is designed to be useful to insurance companies).

8. Tom Baker, "Blood Money, New Money, and the Moral Economy of Tort Law in Action," *Law and Society Review* 35:275-320 (2001).

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9. Of course, a decision to exclude selective risks from the liability insurance pool does not mean that there are no means to socialize the losses that result. For business activities, shareholders and creditors will absorb some of the loss and, to the extent that victims have first party insurance, the losses will be spread through those insurance pools.

10. Cf. Marc Galanter, "Why the 'Haves' Come Out Ahead: Speculations on the Limits of Legal Change," in *In Litigation: Do the "Haves" Still Come Out Ahead?*, eds. Herbert M. Kritzer and Susan S. Silbey (Stanford, Calif.: Stanford Law and Politics, 2003), 13.

11. For example, insurance professionals established Underwriters Laboratories to test materials for resistance to fire and other hazards, and insurance professionals routinely test and rate the crash worthiness of cars.

12. It can be argued that the fact that life insurance companies do not ask questions about gun ownership indicates that owning a gun does not affect the risk of death. Our assumption, however, is that life insurance companies have not in fact tested the effect of gun ownership one way or the other. Cf. Brian J. Glenn, "The Shifting Rhetoric of Insurance Denial," *Law and Society Review* 37 (2000): 779.

13. - Insurance Services Office, Inc., "Homeowners 3 - Special Form" 17, in *Personal Risk Management and Insurance* (Dallas: International Risk Management Institute, Inc., 2001).

14. On the whole, courts tend to allow personal lines insurers to avoid coverage for intentional shootings even if the policyholder did not intend to cause as serious an injury as resulted. The following cases are representative: *State Farm Fire and Cas. Co. v. Morgan*, No. 01 C 458, 2003 WL 1796004 (7th Cir., Mar. 19, 2003). The insured aimed a gun at her daughter's boyfriend and fired, killing him. The insured was convicted of reckless homicide. The insurer sought and was granted a declaratory judgment that it was not obligated to defend and indemnify its policyholder. *N.C. Farm Bureau Mut. Ins. Co. v. Mizell*, 530 S.E.2d 93 (N.C. Ct. App. 2000). The insured's daughter's boyfriend had threatened her earlier in the day. Later in the day he broke a window in the insured's home and attempted to gain entry. The insured discovered him, and he ran away. As he was running away, the insured fired shots at him, striking him in the head. The insured claimed to be trying only to scare the boyfriend. The insurer defeated the policyholder's coverage claim on summary judgment. See also *Auto-Owners Ins. Co. v. Harrington*, 565 N.W.2d 839 (Mich. 1997); *Chapman by Ricciardi v. Wis. Physicians Serv. Ins. Corp.*, 523 N.W.2d 152 (Wis. Ct. App. 1994).

15. See Tom Baker, *Insurance Law and Policy: Cases, Materials and Problems* (New York: Aspen Publishing, 2003), 498-505. See also *American Family Mut. Ins. Co. v. White*, 65 P.2d 449 (Ariz. App. 2003). Note that the exclusion does not require that the crime be prosecuted.

16. Id. But see *Safeco Ins. Co. v. Robert S.*, 26 Cal 4<sup>th</sup> 758 (2001) (declining to apply an exclusion for "illegal acts"). Cf. Jonathan Simon, "Moral Hazards" (unpublished manuscript,

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2003).

17. Standard homeowners and renters policies contain a special \$2500 limit “for loss by theft of firearms or related equipment.” Insurance Services Office, Inc., “Homeowners 3 - Special Form” 3-4, in *Personal Risk Management and Insurance* (Dallas: International Risk Management Institute, Inc., 2001). Applicants can purchase additional theft coverage through an “increased special limits of liability” endorsement. *Id.* at 13.E.212-13. Firearms losses arising out of perils other than theft are covered up to the insured’s limit of coverage for personal property.

We were able to determine the underwriting policies of three of the five largest residential insurance carriers in the U.S. (State Farm, Allstate and Travelers). In combination, these three companies wrote \$12.5 billion in homeowners’ premiums in 2000, representing 36.7% of the market. *See* Insurance Information Institute, *The Fact Book 2002* (New York: Insurance Information Institute, 2002), 61. In underwriting a residential package policy, none of the three asks whether the applicant has a gun, except to the extent that the agent is attempting to inquire whether the applicant will need additional first party property coverage for the guns. *See* David Tideman, Counsel, State Farm Insurance Cos., telephone interview with author, 19 June 2003 (“I don’t think that we actually mandate that the information be communicated to us. Of course, if some extreme situation, like the keeping of an arsenal, came to the attention of the local agent, we might take some underwriting action on that.”). State Farm’s web site confirms that questions about gun ownership are the exception rather than the rule. While the site does not yet quote homeowners’ insurance online, it does quote renters’ insurance and it will produce a quote on both property and liability insurance without any inquiry into the gun habits of the prospective insured. State Farm Ins. Cos., *Renters Rate Quote*, available at <http://www.statefarm.com/quote/renters.htm> (last visited June 24, 2003). Allstate’s and Traveler’s underwriting policies appear to be similar. *See* Marissa Quiles, Media Relations, Allstate Insurance Co., e-mail to author, 29 May 2003 (Allstate does not ask a prospective insured if she owns or keeps guns, “except to the extent the agent is attempting to determine whether the policyholder will need additional property coverage for the firearms.”); Travelers Property Casualty Corp., *Homeowners E-Quote General Insurance Information*, available at [http://www.travelerspc.com/personal/equote/homecondrent/HCR\\_general.cfm](http://www.travelerspc.com/personal/equote/homecondrent/HCR_general.cfm) (last visited June 19, 2003) and *Homeowners E-Quote Information About Your Valuable Items*, available at [http://www.travelerspc.com/personal/equote/homecondrent/HCR\\_valuables.cfm](http://www.travelerspc.com/personal/equote/homecondrent/HCR_valuables.cfm) (last visited June 19, 2003)(indicating that Travelers does not ask its prospective insureds whether they own guns, except in the context of scheduled personal property insurance).

18. Evidently one gun rights group has concluded that State Farm is unfairly reluctant to insure gun owners, and has publicized the charge. The Conservative Monitor, *State Farm Frowns on Guns*, at <http://www.conservativemonitor.com/news/2001020.shtml> (last visited June 6, 2003). The National Rifle Association carried a brief description of the incident on its web site:

After 34 years with State Farm Insurance, South Carolinian Gary Atkinson has been forced to find someone else to provide him insurance. You see, Atkinson has a shooting range on his property, and his State Farm agent informed him that his coverage would be dropped.

The trouble began when Atkinson, wanting to be sure his coverage was up to

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date, informed his agent that he had a swimming pool and shooting range on property adjacent to his house. Never mind that the shooting range is professionally built. Never mind that many more children are killed in swimming pools each year than die by gunshot. The following day Atkinson's agent informed him that he had seven days to find a new policy; State Farm was dropping his coverage.

Atkinson got a million-dollar liability policy through the nra [sic] covering his shooting range. He went so far as to offer to sign a waiver of responsibility for State Farm on any firearm-related claims. This too was rejected.

Atkinson was later told by his State Farm agent that she had the discretion, not the requirement, to cancel his policy, as he was a gun owner. When Atkinson told his agent he would inform others of the way State Farm had treated him, his agent asked, 'What are you going to be able to do by yourself?'

Perhaps if State Farm heard from the 70 million gun owners in America, they would realize it might be good for business if they started offering the same coverage to that segment of law-abiding citizens that they offer to others."

National Rifle Association, *State Farm Insolence*, available at <http://www.nrahq.org/publications/tag/gijoe.asp> (last visited June 24, 2003)

19. Nor, in our view, is it anti-gun to ask people whether they own guns in order to evaluate whether gun ownership increases or reduces the risk of liability or property insurance claims. Thus, an insurance company should be able to conduct internal research through the policy renewal process in order to evaluate whether a gun in the home increases or decreases the risk of injury or property loss.

20. In 1998 there were 866 accidental gun deaths in the United States. For every gun fatality, it is estimated that there are two non-fatal gun injuries. Brady Campaign to Prevent Gun Violence, *Firearm Facts*, available at <http://www.bradycampaign.org/facts/research/firefacts.asp> (last visited Jan. 14, 2004). We extrapolate that there were 2,598 fatal and non-fatal gun injuries in that year. By contrast, in 1996 there were 3,552,907 motor vehicle injuries and fatalities. National Highway Traffic Safety Administration, *Report to Congress: The Effect of Increased Speed Limits in the Post-NMSL Era* (Washington: National Highway Traffic Safety Administration, 1998), 15.

21. From a public health perspective, the more effective insurance-based strategy may well be to persuade insurers to offer discounts for gun locks and smart guns as a way to reduce crime losses (and, reduce the flow of stolen guns into the hands of criminals). Of course, the kind of person who purchases a gun lock or a smart gun may well be the kind of person who is less likely to have a gun stolen in the first place. Although this "propitious selection" (*see* Peter Siegelman, "Adverse Selection: A Critique", (forthcoming in *Yale Law Journal*)) would not undercut the utility of discounts to insurers, it would reduce the public health benefits of the discount.

22. International Risk Management Institute, Inc., *Classification Cross-Reference* (Dallas: International Risk Management Institute, Inc., 1999), 228.

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23. *Id.*

24. *Id.* at 225-228

25. *Id.* at 234.

26. *Id.* at 233.

27. *Id.* at 229.

28. A.M. Best Co., *Best's Underwriting Guide* (2003). This is not a public document. We obtained a copy from an underwriter on the condition that we not reveal the source.

29. *Id.*

30. *Id.*

31. *Id.*

32. Cynthia Michener, Media Relations, Hartford Financial Services Group, e-mail to author, 28 July 2003.

33. Donna Choquette, Underwriter, Safeco Property and Casualty Insurance Cos., interview with author, 26 June 2003.

34. Insurance Information Institute, *The Fact Book 2002* (New York: Insurance Information Institute, 2002), 71.

35. John Badowski, Managing Director, National Association of Firearms Retailers, telephone interview with author, 11 Aug. 2003. Hereinafter Badowski Interview.

36. Robert Chiarello, Broker, Joseph Chiarello & Co., Inc., telephone interview with author, 7 Aug. 2003. Hereinafter Chiarello Interview.

37. Badowski Interview. We asked Badowski if retailers had attempted to solve their insurance availability problems by asking the manufacturers they represent for vendors' protective liability endorsements – in other words, if the retailers were solving their insurance problems by transferring them to the manufacturer. Badowski says that the business sophistication of gun dealers varies greatly – some are sizable concerns with their own risk management departments, and others are small mom-and-pop operations with little insurance savvy – and consequently awareness of that technique is spotty. Badowski confirmed that some retailers have indeed approached the problem that way, but he had no sense of how common it was. He said that he did not perceive the practice to be widespread.

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38. For reasons that are not fully understood, there are insurance-industry specific business cycles, called “underwriting cycles.” During the “soft” phases of the cycle, insurance prices are low and underwriting standards relatively open. During the “hard” phases of the cycle, prices are higher and underwriting standards more strict. *See generally* J. David Cummings, Scott E. Harrington, and Robert W. Klein, eds., *Cycles and Crises in Property/Casualty Insurance: Causes and Implications for Public Policy* (Kansas City: National Association of Insurance Commissioners, 1991) and Sean M Fitzpatrick, “Fear is the Key: A Behavioral Guide to Underwriting Cycles,” (forthcoming in *Connecticut Insurance Law Journal*). At some point in the 2000-2001 period, the commercial property casualty insurance market entered a “hard” phase that has continued through 2003.

39. A.M. Best Co., *Best’s Underwriting Guide* (2003).

40. *Id.*

41. One reader suggested that the higher hazard rating for sporting goods stores might reflect the fact that they are less competent at selling guns. While that may be the case, the fact that sporting goods stores carry the same hazard index for liability risks whether they sell guns or not (see text at note 22) suggests that gun risks are not a significant component of liability risks for sporting goods stores.

42. A.M. Best Co., *Best’s Underwriting Guide* (2003).

43. *Id.*

44. *Id.*

45. Northland Insurance Company, *Hunting Club Liability Application* (2002). If the underwriter accepts the risk, coverage is inexpensive. “Limited” coverage – general liability coverage that excludes injury to club members – is available for an annual premium of \$8 per member, with a minimum premium of \$200. At this price, limits of liability are \$100,000 per occurrence and \$200,000 in the aggregate. \$100,000 of “broad” coverage – coverage that does not exclude member injury - is available for \$10 per member with a minimum premium of \$250. Additional charges apply if the club uses tree stands, or if it owns more than 25 acres of land. But in no event can the coverage be characterized as expensive. For an annual premium of \$22 per member, Northland will offer “broad” coverage with limits of \$1,000,000 occurrence/\$2,000,000 aggregate to a club that uses tree stands. Additional premium for each acre of land over 25 is only \$0.12.

46. *Hunt Clubs Quick Application for General Liability Insurance*, at <http://www.locktonrisk.com/nrains/huntclubsapp.asp> (last visited May 22, 2003).

47. *Rifle Clubs Quick Application for General Liability Insurance*, at <http://www.locktonrisk.com/nrains/rifleclubsapp.asp> (last visited May 22, 2003).

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48. Chiarello Interview.

49. Sporting Activities Insurance Ltd., *Your Ally in Risk Management*, at <http://www.sail-bm.com/yairm.htm> (last visited Aug. 14, 2003). For documentation that Chiarello assisted in organizing SAIL, see <http://www.nafr.org/ssu/faculty.htm> (NAFR is the National Association of Firearms Retailers).

50. Sporting Activities Insurance Ltd., *Defending an Industry Under Attack*, at <http://www.sail-bm.com/daiua.htm> (last visited Aug 14, 2003).

51. Tom McDermott, telephone interview with author, 11 Aug. 2003. Hereinafter McDermott interview.

52. Chiarello Interview.

53. *Id.*

54. Joseph Chiarello & Co., Inc., *Application for Sporting Firearms Business Insurance* (2002). Hereinafter Chiarello GL Application.

55. *Id.*

56. Joseph Chiarello & Co., Inc., *Application for Products Liability Insurance* (2003). Hereinafter Chiarello Products Application.

57. Carol Vinzant, "Gun Victims' Silver Bullet? The New Secret Weapon in Gun Litigation," *Slate*, 18 Dec. 2002, available at <http://slate.msn.com/id/2075714/> (last visited June 17, 2003)

58. Davis's prior carrier had charged \$285,000 a year with a self-insured retention of \$25,000 per claim; Leeds and London charged Davis only \$75,000 a year for the same coverage. McDermott Interview.

59. *Id.* See also Sharon Walsh, "Insurers Put Pressure on Gun Industry," *Washington Post*, 26 Nov. 1999, A section (available on Westlaw).

60. For similar views on solvency supervision in the surplus lines market see Robert Tillman, *Global Pirates : Fraud in the Offshore Insurance Industry* (Boston :Northeastern University Press, 2002).

61. McDermott Interview.

62. Reliance became insolvent in October of 2001. The Alliance of American Insurers reported that Reliance's liabilities exceeded its assets by \$1.1 billion. Legion was placed into runoff in March of 2002; in December of 2002 its claim liabilities were estimated at \$2.5 billion. Phil

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Zinkewicz, "The Perfect Storm': As in the Movie, Are Conditions Right for State Guaranty Funds to Get Horrendously Hit?," *Rough Notes*, Dec. 2002, available at <http://www.roughnotes.com/rnmagazine/2002/december02/12p66.htm> (last visited Jan. 14, 2004).

63. Chiarello Interview.

64. Chiarello Interview. It appears that those carriers who are willing to accept such risks, are willing to do so on standard ISO contract terms. Northland Insurance, for example, offers qualifying hunting clubs a standard ISO CG 0001 Commercial General Liability Coverage Form. Northland does attach a "Combination Endorsement HC-1" that, among other things, changes the CGL's definition of an "insured contract" to omit hold harmless and indemnity agreements. But it is not clear that this change is directed to the gun risk; it could equally be directed to the leased premises exposure. Other endorsements address mold, asbestos, terrorism and punitive damages, but none address guns specifically. Michele Lawler, Underwriter, Carpenter Insurance Group, letter to Laura Nigro, Research Assistant, University of Connecticut School of Law, 11 June 2003.

65. Apparently, at least some manufacturers have purchased liability insurance policies that did not provide products liability coverage, either. See *Beretta U.S.A. Corp. v. Federal Ins. Co.*, 17 Fed. Appx. 250, 252, 2001 WL 1019745 at \*1 (4th Cir. 2001) (holding that the insurer was not obligated to defend Beretta in 12 municipal lawsuits because the policy did not provide products liability coverage: "Regardless of whether the injuries involved could also be said to arise from Beretta's negligent marketing and distribution of its products, the 'but for' cause of the injuries in the claims arose out of Beretta's product.").

66. Chiarello Interview. In addition, Internet research reveals that the technique is in use by at least one carrier not represented by Chiarello. Phil Zinkewicz, "United Coastal Rides High Through Turbulent Seas," *Rough Notes*, Oct. 2001, available at <http://www.roughnotes.com/rnmag/october01/10p64.htm> (last visited Aug. 15, 2003)

67. Lexington Insurance Co., *Industry Liability Claims Exclusion* (2002).

68. See, e.g. *Ganim v. Smith and Wesson Corp.*, 780 A.2d 98, 129 (Conn. 2001).

69. The SAIL website proclaims that it has defended the industry in the municipal litigation, suggesting that at least some insurers do not contest coverage under the older forms. Sporting Activities Insurance Ltd., *Defending an Industry Under Attack*, at <http://www.sail-bm.com/daiua.htm> (last visited Aug 14, 2003). Even SAIL has adopted a new mass tort exclusion in more recent policies, however. Chiarello Interview.

70. In *Ellett Bros. v. USF&G*. Ellett Bros., a South Carolina gun distributor, asked USF&G to defend and indemnify it from three California municipal suits and a private suit brought by the

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NAACP. USF&G noted that the underlying plaintiffs asked for injunctive relief and restitution of wrongfully-acquired profits, and claimed that such a prayer for relief placed the suits outside the policy's provision that it would respond only to claims for "sums that the insured becomes legally obligated to pay as damages." The District Court granted summary judgment to USF&G and the Court of Appeals affirmed, holding that "the term 'damages,' as used in the [USF&G policy], does mean legal damages only, and therefore does not extend to claims for equitable relief." *Ellett Bros., Inc. v. U.S. Fid. & Guar. Co.*, 275 F.3d 384 (4th Cir. 2001), *cert. denied* 123 S.Ct. 94 (2002). The types of claims brought in the California suits differ from the types of claims brought elsewhere, though, and consequently the result of this suit may not have broad applicability. At the time, the California Legislature barred California municipalities from bringing the most common claim - the claim that "negligent marketing" of guns caused direct monetary damage to municipalities in the form of increased policing and health costs - and consequently their prayers for relief were composed entirely of equitable remedies. *Cal. Civ. Code § 1714.4* (repealed 2002).

In *SIG Arms Inc. v. Employers Ins. of Wasau*, 122 F. Supp.2d 255 (D. N.H. 2000), a gun manufacturer won a declaratory judgment that its insurance carrier owed it a defense against fifteen municipal lawsuits in which damages were claimed. As in *Ellett Bros.*, the insurer defendant in *SIG Arms* claimed that the municipal lawsuits did not activate the Commercial General Liability policy's insuring agreement. But in *SIG Arms* the insurer's reasons were different - it claimed that the policy's requirement of "bodily injury" was not satisfied by the economic damage claims of municipalities that had not themselves been injured in a bodily way. The District Court noted, though, that the insuring agreement's "damages" provision contained an express representation that the policy would respond to damage claims by "by any person or organization for care, loss of services or death resulting from bodily injury." This language does not appear in many liability policies, thus this case, too, may easily be distinguished.

71. See, e.g. Walter J. Andrews and Michael J. Levine, "Is There Insurance Coverage for Lawsuits Against the Firearm Industry?," *Nevada Law Journal* 2 (2002)::533; Steven M. Levy and Mary Kay Lacey, "Are Sales of Dangerous Products Such As Guns 'Accidents' For Purposes of Liability Insurance Coverage?," *American Law Institute - American Bar Association Continuing Education* (2000) (available on Westlaw at SE64 ALI-ABA 1085).

72. Chiarello Interview; McDermott Interview. See also Sharon Walsh, "Insurers Put Pressure on Gun Industry," *Washington Post*, 26 Nov. 1999, A section.

73. Robert Tillman, *Global Pirates : Fraud in the Offshore Insurance Industry* (Boston :Northeastern University Press, 2002).

74. See, e.g., entry for "sporting goods stores" under "general liability":

The sale of guns and ammunition presents the most serious exposure. This is more typical of general line stores than specialty stores; specialty shops, such as gunsmiths or hunting shops, may carry a full line of firearms. The potential for injury is severe, and all firearms should be secured in display cases. Customers should

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not have unsupervised access to guns. Additionally, all firearms must be displayed unloaded and kept separate from ammunition at all times. See Gunsmiths for more information.

A.M. Best Co., *Best's Underwriting Guide* (2003).

75. See, e.g., Tom Baker, *Insurance Law and Policy: Cases, Materials and Problems* (New York: Aspen Publishing, 2003) at 492.

76. See Hartwig (2003), "Liability Trends, Issues and Jury Verdicts: Impact on Insurance Liability and Excess Casualty Markets" (New York: Insurance Information Institute, October 2002). See also Robert Hartwig, Sr. V.P. and Chief Economist, Insurance Information Institute, e-mail to author, September 3, 2003.

77. "The mid-nineteenth century witnessed a cultural struggle over the morality of the insurance enterprise in which insurance was attacked as a form of gambling, a handmaiden to crime, and, above all, a presumptuous interference with Divine Providence. The insurer's moral hazard both reflected these concerns and responded to them." Tom Baker, "On the Genealogy of Moral Hazard," *Texas Law Review* 75 (1996): 255.

78. Nevertheless, we recognize that others may not be so ready to dismiss moral hazard concerns. The answer to those concerns need not be the intentional harm exclusion, however, because there exists a much more effective approach to addressing that concern. Instead of excluding intentional harm claims, liability insurance contracts could cover those claims, but authorize the insurer to subrogate against the responsible insured for the limited purpose of recovering damages paid in satisfaction of claims based on that harm. Cf. *Ambassador Ins. Co. v. Montes*, 76 N.J. 477, 388 A.2d 603 (1978) (holding that a liability insurance company that paid an intentional tort claim may subrogate against its insured). If a concern about tort liability in fact provides any deterrent for someone contemplating committing an act of violence, knowing that an insurance company stood next in line after any individual claimant would, if anything, increase that deterrent.

Although the purpose of this brief discussion is not to set forth a comprehensive case for the elimination of intentional exclusions, it is worth pointing out that this result could only be accomplished through legislative or administrative action. When given the choice between a less expensive insurance policy that excludes intentional harm and a more expensive policy that covers intentional harm, but authorizes the insurance company to go after the insured for that harm, a rational individual will choose the former. See Tom Baker, *Insurance Law and Policy: Cases, Materials and Problems* (New York: Aspen Publishing, 2003), 488 n.3. Given the prevalence with which insurance companies already have to defend claims alleging intentional harm under personal lines liability insurance policies, the industry might find that elimination of the intentional harm exclusion would not be as bitter a pill as it would seem at first (as long as

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rates are allowed to rise as a result).

79. Although compensation is no longer a favored goal of liability among many tort law scholars (e.g., Shavell), it remains a fundamental purpose of tort law as articulated by lawmakers. *See, e.g., Lodge v. Arett Sales Corp.*, 243 Conn. 563, 578-79, 717 A.2d 215, 223 (1998) ("[t]he fundamental policy purposes of the tort compensation system are compensation of innocent parties, shifting the loss to responsible parties or distributing it among appropriate entities, and deterrence of wrongful conduct"). *Cf.* John Fleming, "The Collateral Source Rule and Loss Allocation in Tort Law," *California Law Review* 54 (1966): 1549 (suggesting that tort liability will and should become only a secondary source of compensation "to the extent that the cost of compensation has not been met by another source"). For further discussion of how insurance can promote the retribution purposes of tort law see Tom Baker, "Reconsidering Insurance for Punitive Damages," *Wisconsin Law Review* 1998 (1998): 101-30.

79. Jennifer Wriggins, "Domestic Violence Torts," *Southern California Law Review* 75 (2001): 121.