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Non-insurability of punitive damages in Argentina: an Economic Analysis of Law explanation

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Abstract[*]

In Argentina, punitive damages have been regulated by the Consumer Protection Law since 2008. The majority of legal scholars believe that insurance for punitive damages is barred by the Argentinean Insurance Law. However, the traditional position of the Economic Analysis of Law is that the state should not prohibit this type of insurance. Therefore, this paper examines whether it is appropriate to implement legislative reform in Argentina to allow punitive damage insurance in direct liability situations. After analyzing the potential applicability of the traditional position of the Economic Analysis of Law in the Argentinean reality, in accordance with the requirements for the admission of punitive damages (in particular, that the defendant acted with malice, recklessness or gross negligence), it follows that it is not socially desirable to enact this legislative reform. This conclusion is based on the findings that the insurance of punitive damages in Argentina would: [1] destroy the function of punitive damages (deterrence and punishment); and [2] weaken the social function of insurance liability.

Keywords: Punitive Damages; Insurance; Adverse Selection; Moral Hazard.

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Summary

1. Introduction

In the last three years, Argentina has become the first (and only) country with a Continental Civil Law system (a written law system rather than one based on Common Law) that admits Punitive Damages (hereafter "PD"). They are regulated by the Argentine Consumer Protection Law.

According to the Common Law system, PD can be defined as a monetary award that is not to compensate an injury suffered by a victim but to sanction a defendant guilty of flagrantly violating the plaintiff's rights, and to deter the former and others of acting in the same way in the future (*vid.* JERRY, II, 1987, p. 349; OWEN, 1994, p. 363; COOTER/ULEN, 2004, p. 311). Quebec (Civil Code, 1992) has the Continental Civil Law system that first admitted PD. With the exception of Argentina, PD have not been permitted, until today, in other countries with Continental Civil Law systems. Moreover, although some scholars consider that this legal figure does not fit within these systems, which have legal cultures of Roman descent (SALVADOR CODERCH, 2001, p. 3), they also argue that analyzing PD in terms of their advantages and disadvantages is important (SALVADOR CODERCH/CASTIÑEIRA PALOU, 1997, p. 174). In Spain, several studies have been conducted on this subject (SALVADOR CODERCH, 2000; SALVADOR CODERCH, 2003; SALVADOR CODERCH/AZAGRA MALO, 2004, RUIZ GARCÍA, 2007). Furthermore, we emphasize that in the European Continental Civil law system there are some legal figures related to PD; for this reason, some supreme courts of the European countries with this system have required, in specific cases, tortfeasors to pay more money than the harm caused by them (SALVADOR CODERCH, 2001, p. 4).

The majority of the Argentine doctrine considers that insurance for PD is barred by the National Insurance Law (STIGLITZ/ STIGLITZ/PIZARRO, 2009; SÁNCHEZ COSTA, 2009; IRIGOYEN TESTA, 2009a; TALE, nd). However, the traditional position of Economic Analysis of Law (hereafter "EAL") claims that the state should not prohibit this type of insurance (COOTER, 1982, COOTER, 1989; POLINSKY/SHAVELL, 1998). It is therefore valuable to study whether it is desirable to change the Argentine legislation in accordance with that stand. In this paper we investigate whether it is appropriate to carry out legislative reform in Argentina to allow insurance of PD for cases of direct liability.

Vicarious liability cases are excluded from this analysis since it would exceed the objective of this paper. However, we mention that some U.S. states prohibit PD insurance only for direct liability and allow it for vicarious liability. Grace M. Giesel considers this stance to be inconsistent (GIESEL, 1991, p. 410 and 411).

In consonance with the legal situation in Argentina, in principle, PD are able to be admitted when the defendant acted with intent (or at least, when grossly negligent behavior was proved).

For these reasons, we incorporate this assumption (the defendant's conduct involves malice, fraud, recklessness or—at least— gross negligence) in our analysis, because we understand that theories that do not include it, are not aligned with the Argentine legal reality.

2. Punitive damages in Argentina

2.1. General issues

In Argentina, the Law 26361, of March 7, 2008 (B.O. nº 31378, of 7.4.2008), which amended the *Ley de Defensa del Consumidor* (Argentine Consumer Protection Law), Law 24240, of September 22, 1993 (B.O. nº 27744, de 15.10.1993) incorporates Article 52 bis that provides: "Punitive Damages. If a supplier does not meet his legal or contractual obligations with a consumer, at the request of an injured party, the judge may impose on the supplier a civil fine in favor of the consumer, which is graduated according to the gravity of the offense and other circumstances, beyond compensatory

damages. When more than one supplier is responsible for the failure, they are jointly and severally liable with the consumer, without prejudice to any reimbursement action in their favor. The civil fine that is imposed may not exceed the maximum monetary punishment of the fine provided in Article 47, inc. b of this law." (Article 47, inc. b establishes the maximum of 5 million Argentine pesos.)

Despite the vagueness of this article, there is some consensus in the majority of the doctrine and jurisprudence on two fundamental points: the function of PD, and the requirements for the admission of PD.

The function of PD, as explained in a previous paper (IRIGOYEN TESTA, 2009b, p. 22), can be divided into: a principal function (deterrence); and an accessory function (sanction). The former, the main function, is the deterrence of damages conforming to the socially desirable level of care. The latter, the accessory function, is the sanction of the defendant; this accessory function (sanction for the factual circumstance of being a monetary award that goes beyond compensatory damages) follows the fortunes of the principal function (deterrence). That is, the defendant should only be imposed with PD (sanction function) when society needs to deter him (principal function of deterrence), in an extra way, with an additional monetary award beyond compensatory damages, in line with his reprehensible behavior (due to malice or—at least—gross negligence).

These ideas have been accepted by Argentine jurisprudence. Thus, the National Civil Court of Appeals, Chamber F (*Cámara Nacional de Apelaciones en lo Civil, sala F*), said: "The principal function [of punitive damages] is the deterrence of harms according to the socially desirable level of care (...) The accessory function of punitive damages would be the sanction of the offender, because any civil file, by definition, has a sanction function for the factual circumstance of being a money award that goes beyond compensatory damages—civil files are to sanction defendants as compensatory damage are to compensate victims— (conf. : Irigoyen Testa, Matías, ¿Cuándo el juez puede y cuándo debe condenar por daños punitivos?, published in Revista de Responsabilidad civil y seguros, La Ley, no. X, October 2009)." [CNCiv., F, 18.11. 2009 (La Ley, 2010-A, 203, MP: Fernando Posse Saguier).]

With respect to the requirements for the admission of PD, there are two *sine quo non* conditions: [1] the supplier has to act with extreme indifference to the consumer rights (malice or—at least—gross negligence); and [2] the sanction (accessory function of PD) is "necessary" to address the main function of PD: deterrence. (From the EAL point of view we claim that, in cases of reprehensible conduct, it is "necessary" to sanction the wrongdoer, when there is a probability less than one hundred percent that the wrongdoer is condemned by the total monetary value of the damage caused and/or expected.)

At the recent *Third Euro-American Conference on Consumer Protection Law* that took place in September 2010 at the Universidad de Buenos Aires (organized jointly with the Universidad de Cantabria), Commission No. 5, the following *lege lata* motion passed unanimously: "Punitive damages should only be admitted when the supplier acted at least with gross negligence " and "the monetary punitive damage award should not be less than or exceed the amount necessary to fulfill its function of deterrence." Additionally, the Argentine jurisprudence said: "arguing that a lawyer is entitled to require and a judge should admit punitive damages based on the mere circumstance that the supplier has not fulfilled his legal or contractual obligations is contrary to the essence of punitive damages and more than 200 years of their history. Judges need something else in order to be able to admit punitive damages: the evidence of the defendant's malice or gross negligence" López Herrera, Edgardo, "Daños punitivos en el Derecho argentino, Article 52 bis, Ley de Defensa del Consumidor", JA, 2008-II, 1201." [CApel, Concepción del Uruguay, sala Civil y Com, 4.6.2010 (La Ley *Litoral* 2010 (December), 1264; MP: Ricardo R. Rojas); CCivCom y Minería General Roca, 26.3.2010 (La Ley *RCyS* 2010-XII, 225; MP: José J. Joison).] In addition, the Argentine jurisprudence quoted that punitive damages are "closely associated with the idea of prevention of certain injuries, and also the sanction of wrongdoers and the full dismantling of illicit effects; because of the severity of the wrong or the illicit consequences, more is required than the mere compensation of

harm caused (Stiglitz, Rubén S. and Pizarro, Ramón D., "Reformas a la ley de defensa del consumidor", LL 2009-B, 949)" [(CCiv y Com Rosario, 2ª, 29.7.2010 (*La Ley* 2010-F, 397; MP: Oscar R. Puccinelli); CCiv y Com Mar del Plata, 2ª, 27.5.2009 (La Ley 2009-C, 647; MP: Ricardo D. Monterisi)].

2.2. Insurability of punitive damages

While the novel Argentina legislative reform on consumer protection law provides no clue as to whether or not PD may be insurable, doctrine majority believes that these contracts are barred by the Argentine *Ley de Seguros* (Insurance Law).

In accordance with Article 112 of the Law 17418, of August 30, 1967, *Ley de Seguros* (B.O. nº 21266, de 6.9.1967), the "compensation payable by the insurer does not include penalties imposed by the judicial or administrative authority." This article is considered imperative and cannot be overlooked by the parties. Following Jorge O. Zunino, it is an unchangeable legal rule, in consonance with its text or nature. The aforementioned author considers that "[t]he sanctions imposed by a judicial or administrative body, even when they are monetary penalties or fines, are mandatory and cannot be covered by a contract of insurance..." (ZUNINO, 2001, pp. 174 and 216; IRIGOYEN TESTA, 2009a, pp. 5-6; TALE, nd, p. 8).

Other authors (STIGLITZ/ STIGLITZ/PIZARRO, 2009; SÁNCHEZ COSTA, 2009) also deny the insurability of PD based on other articles of the *Ley de Seguros* (Articles 2, 60, 70, and 114). On the other hand, there is a minority position that would admit this insurance according to the *Ley de Seguros* (JUANES *et al*., 2009, JÁUREGUI, 2009). However, the majority position that states that "punitive damages are not insurable under the [Argentine] laws in force" arises manifestly from the conclusions of the *XXII National Conference on Civil Law*, Córdoba, September 2009 (see: conclusions of commission 3 of the XXII National Conference on Civil Law) and *XII Bonaerense Conference on Civil, Commercial, Procedure, and Labour Law*, Junín, October 2009 (see: conclusions of commission one of the XII Bonaerense Conference on Civil, Commercial, Procedure, and Labour Law). Also, to clear any uncertainty, some insurance policies specifically exclude payment for PD. As an example, Camilo Tale transcribes, in a study on this subject, the following contractual insurance clause: "It is understood and agreed that under this [insurance] coverage any compensation for a fine, a penalty, a punishment or an exemplary punishment as the so-called 'daños punitivos' (punitive damages), vindictive damages, exemplary damages is excluded." (TALE, nd, p. 8.)

3. A brief idea about the insurability of punitive damages in the U.S.

There is no consensus in the U.S. on this issue. In states where, as a rule, PD are admitted, twenty-two of them allow this type of insurance, eighteen bar it, and four have not yet resolved this issue.

States that, as a rule, allow the insurance of PD are: Alabama, Arizona, Arkansas, Delaware, Georgia, Idaho, Iowa, Kentucky, Louisiana, Maryland, Mississippi, New Hampshire, New Mexico, North Carolina, Oregon, South Carolina, Tennessee, Texas, Vermont, West Virginia, Wisconsin, and Wyoming. States that, as a rule, prohibit the insurance of PD for direct liability are: California, Colorado, Kansas, Nevada, New York, Rhode Island, South Dakota, Connecticut, Florida, Illinois, Indiana, Minnesota, Missouri, New Jersey, Oklahoma, and Pennsylvania (however, the first state admits this insurance only if it is not a case of fraud, oppression or malice, and the last nine admit it only in vicarious liability cases but never in direct liability cases). Finally, this issue has not been resolved in Hawaii, Utah, Massachusetts, and Washington (GIESEL, pp. 357, 358, 384 and 385; VISCUSI/BORN, 2005, p. 28, DEMENT-DONARSKI, 1994, pp. 644-649).

The case *Tr Northwestern Nat'l. Cas. Co. v. McNulty* [*307 F.2d 432 (5 Cir. 1962)*] is the leading one against the insurability analyzed, and the case *Lazenby v. Universal Underwriters Insurance Co.* [*214 Tenn. 639, 383 S.W.2d 1 (1964)*] is the principal one in favor of the insurability studied. The arguments developed in those decisions were focused on cases of traffic accidents and the

interpretation of those insurance policies that were purchased by drivers, before the accidents. Therefore, in general, those arguments are not applicable to the problem studied in this work in consonance with the Argentine consumer law.

4. The traditional position of the Economic Analysis of Law

Featured authors of the EAL are in favor of the insurability of PD. Among other scholars, Robert D. Cooter, Mitchell Polinsky, and Steven Shavell espouse this position.

4.1. Cooter's position

Cooter argues that the insurability of PD should not be prohibited by states (COOTER, 1982, p. 96). His main argument is based on this statement: allowing liability insurance to cover PD makes both injurers and victims better off, at least, in reparable damage cases.

This author (COOTER, 1982, p. 96) asserts that the primary objection of allowing PD insurability is the fear that this practice will lead to an increase in the harmful behavior that the courts, precisely, seek to prevent. However, Cooter considers that, in most cases, this insurance would still be desirable to both injurers and victims. On the one hand, given that injurers can decide for themselves whether they are better off with or without insurance, prohibiting its sale would go against their interests. On the other hand, when victims receive compensatory damages plus punitive damages, usually, they are overcompensated. Hence, if the main objection is correct (this insurance leads to an increase in injuries), victims who receive both payments, which exceed injuries suffered, may be better off than they had been previous to suffering an accident. In consequence, if both parties are better off as a result of this type of insurance, Cooter concludes that it should not be banned. However, after further investigation (COOTER, 1991, p. 26), the author admits that this argument fails in cases of harm where perfect compensation is impossible, such as cases of bodily injury, disfigurement, or death. He declares that "[i]f liability insurance results in more incompensable injuries, the victims may be worse off."

Cooter, in another paper (COOTER, 1989, pp. 1182-1185), claims that while short term incentives to avoid harm may decline (due to adverse selection and moral hazard), courts and companies may obtain information from policyholders in a given market, and, consequently, "beneficial selection" will result in the long run (as opposed to "adverse selection"), making the number and severity of injuries decrease.

Conforming to Cooter, in the long term, courts and insurance companies could be considered as monitors to prevent potential injurers from harming others. In a competitive market, insurance companies seeking to reduce costs will require applicants to prove a history of careful conduct before writing a policy that extends to PD. In spite of this control, if the insured's liability claims for PD is out of line with more careful companies, in the future, the insurance company may refuse to renew the policy or may raise rates. The combination of risk aversion by potential insureds and careful monitoring by the insurance companies will result, in the long run, in a "beneficial selection" in the PD insurance market. For this to happen, the author assumes that the insurance companies have enough information to distinguish between good insureds (with low risk) and bad ones (with high risk); so, they would write policies only for the first type of insureds (companies with good safety records). However, Cooter admits that the study on which of the two effects prevail (beneficial selection or adverse selection) is a matter of empirical analysis to be carried out in the future (see COOTER, 1989, p. 1182-1185).

4.2. Polinsky and Shavell's position

Years later, Mitchell Polinsky and Steven Shavell returned to this theme, stating that the insurance of PD should be allowed (POLINSKY/SHAVELL, 1998, pp. 931-934). They argue that the reason for this assertion is best understood by recognizing that PD are a way to make injurers pay for harm caused, when there is a chance of escaping liability. Therefore, in line with their PD

theory, the question whether PD should be insurable is basically the same as whether compensatory damages should be insurable; hence, they must be answered in the same way (p. 932).

Like Cooter, these authors explain that even if the purchase of PD insurance might lead to an increase in the frequency of accidents, on the one hand, in monetary damage cases, both parties (insureds and victims) are better-off. On the other hand, because of that increase, the victims' welfare may decrease in nonmonetary damage cases (irreparable harm cases). However, Polinsky and Shavell argue that such insurance is often socially desirable even in these cases for the same reasons that compensatory damage insurance is desirable and because the value of the insurance to insureds may outweigh the loss of welfare to victims. In addition, among their main arguments, these authors assert that if potential insureds cannot transfer their liability risk to the insurance companies, the costs for awards will impact the prices of goods and services, affecting consumers adversely (p. 933). These arguments, which we question in this work for the Argentine case, have been supported by several authors to this day (among others, DUGGAN, 2006, p. 10; LÓPEZ HERRERA, 2008, p. 131).

5. Assumption included in our analysis for the Argentine case

Besides the classical assumption (requisite), accepted by the EAL traditional theory, for the admission of PD (the defendant's probability of being sufficiently awarded for the total harm caused and/or expected is less than one hundred percent), in agreement with the Argentine Law, we add an assumption (another requisite for the PD admission) in our analysis which is that the defendant's behavior is considered seriously reprehensible conduct: it involves *dolo* (malice or fraud) [any type of *dolo*: *dolo directo* (direct or actual malice); *dolo indirecto* (indirect malice); and *dolo eventual* (recklessness)] or *culpa grave* (gross negligence).

Firstly, we believe that this new assumption (for the Argentine case) could also be justified by the EAL theory. The explanation of this statement exceeds the objective of this paper (see COOTER, 1999, p. 24-29). Secondly, in consonance with the Argentine doctrine and following Matilde Zavala de González (ZAVALA DE GONZÁLEZ, 1999, p. 365), *dolo directo* [as part of a *delito* (crime, offence, wrongdoing , or misdeed)] is when an "intent to injure is the immediate purpose of the [wrongdoer's] conduct"; a conduct entails *dolo indirecto* when "the harm is an inexorable result linked to [the wrongdoer's] behavior undertaken with a different immediate purpose"; a behavior involves *dolo eventual* when "the wrongdoer acts with indifference to the production of harmful consequences, in other words, disregarding the possibility that the injury could occur." Finally, the Argentine doctrine and jurisprudence have stated that in cases of *culpa grave* the wrongdoer behaves with "an extreme negligence, extreme *impericia* (inexperience) or extreme imprudence (conf. Mosset Iturraspe, "Responsabilidad por daños", p. 75, Nº 31), because although he does not have a deliberate purpose to cause harm (as in *dolo* cases), in general, there is an intentional element closest to that deliberate purpose, and, consequently, *culpa grave* can be defined as the conduct that causes a harmful outcome that is predictable and comes from a positive or negative act that diverges so far from the normal standards of behavior that it leads to rejection and censorship by an average individual; this degree of fault shows a deliberate and conscious decision by the wrongdoer to act singularly risky exposing himself and others to the consequences of his conduct." [C.NCiv., 1ª, 23.9.1996 (La Ley 1998-C, 682; MP: Emilio M. Pascual); CNCiv., D, 30.11.2005 (Jurisprudencia Argentina 2006−II−703; MP: Diego C. Sánchez); CNCiv, G, 24.9.2007 (La Ley 16/01/2008, 4; MP: Carlos Carranza Casares).]

As we explain below, in accordance with this new assumption incorporated in our analysis, we consider that the traditional EAL positions described above are not adjusted or applicable to the Argentine legal context.

6. Inapplicability of Cooter's arguments

We agree with Cooter's argument that PD insurance may improve the "particular" well-being of both the injurer and future victim in a reparable harm case (but never in irreparable harm cases). However, that does not mean that PD insurance is efficient in reparable damage cases (or in

irreparable damage cases) according to the criterion of Pareto or Kaldor-Hicks.

On the one hand, conforming to the Pareto criterion of efficiency, a situation is optimal when no one can be better-off, without, at least, another person being in a worse situation. On the other hand, in agreement with the so-called Kaldor-Hicks criterion, we face an optimal situation when there is no room for improvement, since, after any potential change, the winners would benefit less than the losses that others endure (the community welfare would decline). The latter criterion measures only whether or not the winners could, in hypothetical terms, compensate the losers with their gains, but does not require compensation actually be paid (*vid*. KALDOR, 1939; HICKS, 1940; POSNER, 1992, p. 14).

Focusing on the "general" well-being of all the society, we can easily notice that it decreases. The potential improvement of the winners (the insured and the victim that suffered reparable damage) is less than the cost experienced by the losers (potential policyholders and future victims of repairable and irreparable harms). As we develop below, in the Argentine PD insurance market there are relevant problems of asymmetric information between the contracting parties. Because of these market failures (adverse selection and moral hazard), government intervention is justified. Otherwise, the premiums of the liability insurance market will rise, potential wrongdoers will buy less liability insurance than optimal (assuming more risk than socially desirable) and, contrary to the secondary accident cost reduction subgoal proposed by Guido Calabresi, there will be a greater number of future victims not optimally recovered because of not receiving timely compensation (CALABRESI, 1970, pp. 27-28) and other ones that will support an excess risk of not being sufficiently and timely compensated (GÓMEZ POMAR/ARQUILLO COLET, 2000, p. 5).

Guido Calabresi (1970, pp. 24-33) believes that, on the one hand, the most important objective of tort law is fairness. On the other hand, its secondary goal is the reduction of the total accident costs. Calabresi divides this reduction of costs into three categories: the primary accident cost reduction subgoal (by lowering the number and severity of accidents); the secondary accident cost reduction subgoal (by decreasing costs caused by the impossibility of an optimal recovery of victims because of the lack of timely compensation: this is also related to avoiding an inefficient distribution of losses over the population, and translating the obligation to pay for these accident costs to people that "are best able to pay"); and finally, the tertiary accident cost reduction subgoal (by decreasing the costs of administering the treatment of accidents).

We agree with Cooter that in the short term, incentives to prevent harm decrease. On the relevance of this point, remember that, in line with Calabresi's tort theory, this effect goes against the primary accident cost reduction subgoal (related to decreasing the number and severity of accidents) that should be sought by tort law (CALABRESI, 1970, pp. 26-27).

Furthermore, the more injured victims there are (PRIEST, 1989, p. 1026) and the more severe the harm, the less the social wealth, because the impact of certain injuries exceed the mere distribution of private wealth between insureds and victims (LANDES and POSNER, 1987, SHAVELL, 1987; POSNER, 1992).

For example, beyond the distribution of private wealth between a victim and victimizer, there is a loss of social wealth when the latter sets fire to a hospital or a school essential to a community. Of course, this situation is aggravated in an irreparable damage case conforming to the victim's level of indifference (such as cases of bodily injury, disfigurement, or death).

However, at least for the Argentine insurance market, we do not agree with Cooter that it is plausible to predict that, in the long term, a "beneficial selection" would exist and its effects would offset those of the "adverse selection". In the market studied, where a wrongdoer's seriously reprehensible behavior (*dolo* or *culpa grave*) is a *sine qua non* requirement for the PD admission, it is not reasonable to accept as true Cooter's premise (from which he infers his

conclusion): the insurance companies would be able to distinguish between "good" insureds (with low risk) and "bad" ones (with high risk). At least in the Argentine PD insurance market, there would be only "bad" insureds (those whose actions would be considered seriously reprehensible behavior) and, therefore, the asymmetric information problem worsens.

Thus, consistent with the so-called adverse selection (AKERLOF, 1970), in an insurance market where insurers cannot distinguish between potential policyholders who have more risk or less risk than others (since they are all "bad" insureds), the price of premiums would rise dramatically, which would exclude the "less bad" insureds from the market (potential wrongdoers that would predict that they would behave in a less reprehensible manner than the other policyholders).

That is, we do not believe that in the long term policyholders with less risk of PD awards would shut those with more risk of PD awards out of the market. In a market like the Argentine one, in which a wrongdoer's seriously reprehensible behavior for the PD admission is required (*dolo* or *culpa grave*), the adverse selection effects will enhance (and defeat the effect from a potential beneficial selection) in the medium and long term. Those policyholders who will act with *dolo directo* (or *dolo indirecto*) will expel those who will proceed "only" with *dolo eventual* (or at least those who can be proved to have behaved with *culpa grave*) from the market. In the end, policyholders who act with *dolo directo* causing harm that justifies a significant PD award will expel those who also act with *dolo directo* but cause injuries that justify only a moderate PD award from the market.

7. Inapplicability of Polinsky and Shavell's arguments

At least for the Argentine case, in contrast to Polinsky and Shavell's position for other cases, we cannot validly claim that the question whether or not PD should be insurable is essentially the same as whether or not compensatory damages should be insurable, and, that consequently, they must be responded to in the same way.

The above is based on the fact that *compensatory damages* insurance and *PD* insurance do not share the same functions. For this reason, it is not true that the insurance of PD is desirable for the same reasons that the insurance of compensatory damage is desirable.

First, *compensatory damages* insurance is socially beneficial to reduce the risk of negative events against potential risk averse insureds. However, *PD* insurance does not meet this purpose. Mindful of the adverse selection effect explained *supra*, and under the assumption of a wrongdoer's seriously reprehensible behavior required for the PD admission, the insurance of this legal figure under consideration does not reduce any risk. Because there is no risk (uncertain situation), no risk is reduced. When we are dealing with potential wrongdoers that (at least in appearance) have the intention of committing a wrong (*dolo* or *culpa grave*), randomness tends to disappear. In these cases, the policyholder's decision of whether or not to purchase PD insurance, in principle, is not based on the reduction of any risk but on the speculation of earning more money from the expected wrong than what he has to pay for the PD insurance premium.

It could be argued that there is—indeed—a real risk of PD awards because a person can be wrongly condemned by failures in the justice system; however, we believe this risk is residual and it is not the deciding factor for an insured to decide to purchase PD insurance (LONG, 1977, p. 16). The same for cases of *culpa grave* (not *dolo*). If PD insurance is admitted only for insureds that behave with *culpa grave* (not with *dolo*), in accordance with adverse selection effects, we still have a similar problem to that previously explained. In the medium and long term, the

PD insurance market is going to be composed only of "bad" insureds who plan to act with seriously reprehensible behavior and, at the same time, speculate that insurance companies could not prove that they disregarded the possibility that harm would occur (*dolo eventual*), or worse, they acted with *dolo indirecto* or *dolo directo.*
From the AEL literature, Richard A. Posner (1992, p. 225) states that very careless behavior sometimes is equated with deliberate behavior (malice). In this regard, it is noteworthy that in Argentina, the civil liability consequences of *culpa grave* are assimilated with those of *dolo eventual* (CAZEAUX, 1997, p. 165; ALTERINI, AMEAL and LÓPEZ CABANA, 1998, pp. 197-198; PIZARRO/VALLESPINOS, 1999, p. 612; LÓPEZ HERRERA, 2006, p. 250). The rules applied to these behaviors are the same and vary together in cases of contractual liability and in cases of non-contractual liability (tortious liability). This assimilation responds to the difficulty to prove in court what wrongdoers really think (his really state of mind) when he performs an illegal act (in cases of *dolo eventual* or *culpa grave*) and the aspiration of legal certainty. While it is usually very difficult to establish (through direct or indirect evidence) that a person acts with (a state of mind of) indifference to the production of harmful consequences (*dolo eventual*), it is easier to demonstrate that the harmful outcome is predictable and comes from a positive or negative act that fails so far from the normal standards of behavior that it leads to the rejection and censorship by an average individual (*culpa grave*). This is why some Argentine laws prescribe explicitly the same effects for *dolo* (any type of *dolo*) and *culpa grave*. For example, see *Ley de Seguros* (Law 17418): Chapter II (Property Damage Insurance), Article 70: "The insurer shall be released from paying if the policyholder or beneficiary caused the accident with *dolo* or *culpa grave*. (...)"; and Article 114: "The insured is not entitled to be compensated if he causes the loss with *dolo* or *culpa grave* (...)"; Chapter III (Life and Accident Insurance), Article 152: "The insurer is released from paying if the policyholder or beneficiary caused the accident with *dolo* or *culpa grave* or while committing a crime." Moreover, as Zunino expressed, the *exposición de motivos de la ley* (explanatory memorandum of the law) explains that "the maintenance of *culpa grave* as a cause of liberation (...) is desirable in our [Argentine] environment because of circumstances such as a poor police organization and difficulties for the insurer to prove the *dolo* or to intervene quickly in the investigation of the circumstances that produced the insured event (*exp. de motivos*, number XXIX, 3)." (ZUNINO, 2001, p. 174.) Based on the foregoing, in the present investigation, we adopt the same criteria (the effects of the *dolo* and *culpa grave* must be homogeneous in the Argentine PD insurance market).
Finally, besides the PD case (in consonance with the exegesis of the Article 52 bis, *Ley de Defensa del Consumidor*), we can list other examples where the effects of *dolo* and *culpa grave* are explicitly assimilated in Argentina: separation and divorce (FERRER, 1996, pp. 311-327; LÓPEZ HERRERA, 2006, p. 827); accountability of the guardianship and curatorship (Articles 461 and 475 of the *Código Civil* – Civil Code –); *Ley de Sociedades Comerciales* – Commercial Company Law – (Article 274 of Law 19550, B.O. nº 22409, of 25.4.1972), *Ley de Concursos y Quiebras* – Bankruptcy Law – (Article 99, Law 24522, B.O. nº 28203, of 9.8.1995); etc.

Second, compensatory damages insurance is socially desirable because it ensures a solvent patrimony to compensate victims. Thus, it cooperates with what Calabresi calls "the secondary accident cost reduction subgoal" (by decreasing costs caused by the impossibility of optimal recovery of victims because of the lack of timely compensation). For this reason, it reduces the risk of potential victims (who are risk averse) to not be fully and timely compensated by the wrongdoers. However, unlike this *compensatory damages* insurance, *PD* insurance does not cooperate with any of those aspects. PD are monetary penalties or fines in favor of victims, *beyond compensatory damages*, and are not to compensate those (but to deter and sanction wrongdoers) that, at least in theory, have already been compensated (with the compensatory damages awards).

On the other hand, we do not share the assessment of Polinsky and Shavell that even in case of irreparable harm (nonmonetary damages), the value of the insurance to insureds may outweigh the loss of welfare to victims. Clearly, when irreparable harm is caused, there is no benefit that can overcome the loss suffered by their victims (in these cases, we cannot talk about efficient harm according to Pareto efficiency or Kaldor-Hicks efficiency).

Third, Polinsky and Shavell believe that if potential insureds cannot transfer their liability risks to the insurance companies, the costs for awards will impact the prices of goods and services, affecting consumers adversely. While this conclusion may be valid for cases of compensatory damages, it is not for cases of PD. First, as previously explained, this insurance is not intended to transfer risk (from the insured to the insurer) because there is no risk. Second, if PD are, precisely, to make wrongdoers pay *all* harm caused (when there is a possibility to "escape" from

compensatory damages liability), the fact that they are allowed to transfer those payments to the insurance company (paying—indeed—a lesser amount for premiums than for harms caused), implies that wrongdoers will still "escape" from paying for *all* harm caused. Thus, explicit prices of their goods and services may be less than their full actual price (the total social costs of producing, offering and introducing them in a given market). In other words, as Arthur C. Pigou explained a long time ago (PIGOU, 1920), those explicit prices will not reflect the relative scarcity of goods. Consequently, there will be negative externalities, insufficient precaution, excessive production and a distorted market equilibrium (IRIGOYEN TESTA, 2006, p. 47-50). All of which, now, negatively affect the wealth of consumers and the society as a whole.

For these reasons, we understand that under the assumptions that we reasonably accepted for the Argentine case, the question whether the insurability of PD should be allowed must be replied to differently (because of diverse arguments) than that of compensatory damages.

8. Our position for the Argentine case

As discussed *supra*, the PD function can be split into: a principal function of deterrence, and an accessory function of sanction. We understand that in the Argentine legal context, the insurance of PD would destroy the PD function of deterrence and sanction.

Clearly, if it is tolerated that the consequences of a civil monetary penalty against an individual who acted with *dolo* or *culpa grave* are transferred to an insurer (STIGLITZ, 2001, p. 21) and, through it, to the rest of policyholders, then the accessory function of PD (sanction) cannot be fulfilled (*vid* case MacNulty; LONG, 1977, p. 15; ANDERSON, Jr., 1973; CONLEY and BISHOP, 1975).

Conversely, it has been claimed that this argument is extremely simple and not necessarily valid (since the insured for PD will face a higher premium than that of the rest of the policyholders) (GIESEL, 1991, p. 400). However, at least in Argentina, in which seriously reprehensible behavior (*dolo* or *culpa grave*) is required for the PD admission, because of the adverse selection and moral hazard phenomena, the higher premiums will not sanction those potential wrongdoers. If the premium increases, the potential injurer will buy PD insurance again, in the future, only if he calculates speculatively that the expected illicit benefits from his reprehensible behavior outweigh the costs of the new PD insurance premiums. Otherwise, the potential injureds with lower risk (than those who finally decide to buy PD insurance) would be displaced from the insurance market.

Second, if the insurability of PD is allowed, the principal PD function of deterrence will not be fulfilled. In other words, tort law will not meet its primary accident cost reduction subgoal, desirable conforming to Calabresi (reduction of the frequency and magnitude of harms). Under the assumption of the requirement of a seriously reprehensible act (*dolo* or *culpa grave*) for the PD admission in Argentina, the classical problems of asymmetric information found in any insurance market are magnified: the adverse selection phenomenon (which we explained and takes place *ex ante* the signing of insurance contract), and the so-called moral hazard (which manifests *ex post* the signing of this contract).

As we stated, the adverse selection phenomenon would cause, in the medium and long term, only potential wrongdoers who have higher expected PD awards (and plan to act with *dolo directo*) to stay in the analyzed insurance market. On the other hand, *ex post* the signing of the insurance contract, the moral hazard problem increases, since the insurer cannot control or prevent (without an extreme financial investment) that the insured acts even worse than the

foreseen behavior taken into account to calculate the rate of the insurance premium. After signing the contract, the insured will only prevent the loss if it is cheaper than not avoiding it, knowing that he will not finally pay for the expected PD awards. Because an insured's seriously reprehensible conduct will not negate the consequences of the wrong that he causes which are covered by the insurance, if a mere cost-benefit analysis advises him to continue producing inefficient injuries (not preventing them), then they will take place. Finally, because the insured—indeed—does not reduce any risk with PD insurance, he will only buy this insurance again, in the future, if its new premium (after a potential increase) is still less expensive than his future expected PD awards. Otherwise, this insured will be displaced from the market and only the worst providers of goods and services will stay in it (again, due to the adverse selection phenomenon).

9. Conclusions

According to the Argentine legal context, besides the assumptions accepted by the analyzed traditional theory, we must add the following: a wrongdoer's seriously reprehensible behavior (*dolo* or *culpa grave*).

This new assumption incorporated into our analysis compels us to revise the traditional EAL arguments. These arguments cannot be used for the Argentine PD insurance market without transcendental objections.

First, the insurance of *PD* fails to achieve the worthwhile social objectives (social function) that the insurance of *compensatory damages*—indeed—achieves: reduction in the risk of potential risk averse wrongdoers; and, in accordance with some authors, reduction of the social costs because of an optimal recovery of victims who receive timely payments conforming to harm suffered; and reduction of the risk of potential victims who are risk adverse to not be fully and timely compensated.

Second, the insurance of PD in Argentina would destroy the function of this legal figure (deterrence and sanction) and, due to the adverse selection and moral hazard phenomena in the medium and long term, would weaken the liability insurance social function. That is, the provision of insurance would decrease below the optimum level; it would encourage potential wrongdoers (who do not buy liability insurance) to take more risk than socially desirable; it would increase the number of victims that are not optimally recovered because of not receiving timely compensation, and other ones who support an excess risk of not being sufficiently and timely compensated.

For these reasons, we consider it is not socially desirable to enact legislative reform in Argentina to allow PD insurance for the cases studied.

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