Economic analysis of current liability for terrorism-related risk and alternatives

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In this chapter, the current liability regimes are examined from a law and economics perspective. The main focus is on the question of whether the liability regimes are structured in an efficient manner, i.e. whether they provide incentives for a minimisation of social costs.

We start by stressing the function and goals of tort law according to the economic analysis of law (10.1). Then, we draw some of the main lessons from liability for TRR under EU law (discussed in Chapter 2) and the liability for TRR under international law (discussed in Chapter 1). It is interesting to come back briefly to those two chapters (in 10.2. and 10.3., respectively) since some of the particular features of liability for TRR under EU law and international law can precisely be criticised from an economic perspective. This considers more particularly the channelling of liability and the financial caps, as well as the fact that compensation in some situations is not provided by operators but through public funds.

We then analyse options to limit liability in 10.4. from an economic perspective, focusing on options that fit within the current TRR liability regime, such as channelling and linking liability to regulation. From an economic perspective, a relevant question is whether operators are able to pay the compensation for which they are held liable. That is important not only from the perspective of compensation, but also – and especially – because insolvency may lead to under-deterrence. That may justify the question of whether mandatory financial security (which could also be observed in TRR liability under international law)[1] should be introduced (10.5.).

This chapter should be read in conjunction with Chapter 8, where alternative systems for redressing terrorism-related risks, more particularly victim compensation solutions, have been discussed. Section 10.6 concludes.

[1] See Chapter 1.

10.1. Goals and functions of liability law

10.1.1. Goals

There is a remarkable difference between the way in which traditional lawyers view the liability system and the way in which the goal of the liability system is viewed from an economic perspective. Traditional tort lawyers, at least in Europe but to some extent in the US as well, view the liability system as a system of compensating victims of accidents. In that perspective victim protection and more particularly ex-post compensation of victims is the main goal of accident law. The benchmark by which a liability system will be judged is then often whether or not it is able to grant this compensation.

In the economic analysis of accident law a different perspective is taken. Economists stress that the exposure to liability of a potential injurer will provide substantial incentives for accident prevention.[2] The central idea is that actors (mostly industrial operators, but also others) will react to a potential exposure to liability by taking optimal preventive measures. In this perspective the main goal of the liability system is not ex-post compensation, but rather ex-ante prevention. "Prevention is better than cure" is hence the guiding principle for the economic analysis of law. This starting point has two important consequences. First, if operators were not exposed to the financial consequences of their actions via a liability rule, their incentives for prevention would fail unless other legal rules (such as regulation) provided an alternative. Second, when an operator is ex-post (after the accident) appropriately exposed to liability (i.e. having to bear the costs of his action) this will provide an ex-ante incentive to take optimal care. From an economic perspective a liability system has an important social function in remedying market failures.[3]

At the end of the last century there have been fierce debates between economists and lawyers on the goals of tort law, and some attempts have also been made to reconcile the legal (corrective justice-based) approach with the economic (deterrence-based) approach.[4] Now, especially in the environmental arena, also the legal community and policymakers have become more and more convinced of the importance of liability rules

[2] A classic contribution in this respect is from Shavell 1980; see also Shavell 1987.
[3] See generally on the economic analysis of environmental liability and the role of tort law in that respect Bergkamp 2001, 67–119, De Smedt 2007, 28–64 and Wilde 2013, 138–148.
[4] See for example Schwartz 1997; Hinteregger 1994.

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as an instrument of prevention.[5] One of the reasons for this change is the increasing empirical evidence that is available showing that at least industrial operators (as in the environmental field) respond to financial incentives provided through the liability regime.[6]

10.1.2. Functions

In Chapter 8, the US Safety Act was already addressed. It is important to stress that there is an important difference between the use of tort law in the US and in Europe which should be discussed. This concerns the fact that most victims in western Europe, contrary to their American counterparts, do not have many incentives to bring a liability suit, since the social security system in many western European countries provides for a relatively wide coverage of many expenses that a victim incurs when an accident happens. Partially as a result of international conventions[7] and European directives, many countries have elaborated systems of compulsory first-party insurance covering medical expenses. In addition, lost income is often taken care of. Depending upon the legal system, this is usually mandatory if one is employed and on a voluntary basis for self-employed individuals. In some cases, even property losses are insured, depending upon the type of accident. A consequence of this relatively elaborate first-party insurance system is that a large part of the damage to the victim in European legal systems is already taken care of. Therefore, victims in Europe often do not have incentives to sue an injurer in tort. Their only incentive to use the tort system is for the part of the damage that was not taken care of via the first-party or social security insurance scheme. This may relate to property loss, or to the higher part of one's income which could not be compensated, but also to pain and suffering, for which first-party insurance is usually not available. In addition, the

[5] The preventive effect of liability rules was for example explicitly stressed in the so-called EU White Paper on Environmental Liability which preceded the European Environmental Liability Directive (EU Commission, White Paper on Environmental Liability, Brussels, 2000 (COM) 2000 66 final). See for a comment on this White Paper the contributions in Faure 2003.

[6] For an overview of empirical evidence concerning the effects of liability rules generally see Van Velthoven 2010, and for an overview of empirical evidence with respect to the deterrent effect of environmental liability rules see Faure 2012), 301–305.

[7] See in that respect e.g., the European Social Charter of 18 October 1961 and the ILO-Conventions No. 24 concerning sickness insurance for workers in industry and commerce and domestic servants, No. 25 concerning sickness insurance for agricultural workers and No. 102 concerning minimum standards of social security.

social insurance carriers could execute recourse against liable tortfeasors or their insurers.

As a consequence of this system, many victims in Europe do not use the tort system even if they could. This considers especially individuals with lower or average income who are compensated via social insurance schemes and who do not wish to use the tort system for pain and suffering. Indeed, for "*Existenzsicherung*", victims in European legal systems can call on social security and social insurance schemes. Furthermore, social insurance carriers de facto rarely use their right to exercise recourse, inter alia because exercising that right creates relatively high administrative costs.

The situation in the US is of course completely different where, in addition to Medicaid and Medicare and some workmen's compensation schemes, many tort victims cannot benefit to the same extent as in Europe from generalised social security schemes.[8] Hence, as a consequence victims in the US will (have to) use the tort system also to obtain compensation of their primary needs (medical expenses and lost income) whereas that is largely covered by social security and social insurance schemes in Europe. That hence creates fundamental differences between the need to call on tort law for victims in the US and in Europe. Whereas in the US using tort law for many victims is a matter of survival and receiving compensation of basic needs, in Europe, the tort system is rather a "luxury". That fundamental difference of course explains the fact that the exposure of (the security) industry in the US to liability suits is potentially much larger than in Europe.

We will now consider the goals of tort law from this economic perspective and critically analyse the liability for TRR under EU law (10.2.) and international law (10.3.).

10.2. Lessons from EU law

When first addressing the attribution of liability, it is striking that the ELD channels the liability exclusively to the operator, thus potentially limiting liability of other parties who could contribute to environmental harm. The system of allocation of liability in the PLD is more complex, in principle allocating liability to the manufacturer or importer, but also expanding to the supplier of a product if the first two are unknown. In

[8] See Faure and Hartlief 1996, 254–261. Even where victims benefit from certain social security benefits, the tort liability system provides strong incentives to initiate litigation.

case of auditor's liability,[9] joint and several liability is recommended not only for individual audit firms or accountants, but also for accounting networks who could (depending on the legal system) be held vicariously liable. Already this point shows how the attribution of liability can have an important bearing on the scope of liability of the security industry. A regime which would e.g., for airport-related security risks channel liability to air carriers and aircraft operators would thus exclude the liability of the security industry. A joint and several liability regime, to the contrary, would increase liability exposure of the security industry.

Also the scope of damages has an important bearing on liability exposure. This is not only the case for the (financial) limit on liability, but also for the heads of damages compensated. The ELD has no financial cap; the PLD does not have a financial limit either, but included the option for Member States to adopt a liability cap. Such an optional system is also provided for in the Recommendation concerning audit liability which basically provides three options to Member States if they wish to limit auditors' liability. The damages under the ELD are limited to damage to protected species, habitats, water damage and land damage, but traditional damage, such as damage to health and property, has been excluded. Also the damage covered in the ELD is limited to personal injury and damage to private property; other heads of damages are excluded. This may be an important issue since the literature, for example with respect to auditors' liability, held that especially economic losses and wrong assessment of damages were important reasons for a large liability exposure of auditors.[10]

The ELD has optional compliance with permit and state-of-the-art defences, whereas the PLD excludes liability for development risks, but provides Member States with the option to make producers nevertheless liable for development risks too. Whether it is desirable to hold the security industry liable for the development risk is an issue which will have to be discussed further, in the light of general goals of liability of the security industry. The question that will inter alia have to be addressed in that respect is to what extent liability for the development risk provides (additional) incentives to the security industry to invest in research and development.

An important aspect related to liability is whether it is covered by insurance. Especially when strict liability is introduced (such as in the ELD for Annex III activities and in the PLD for product defects) it is held

[9] Philipsen 2014. [10] Ibid.

that it is important to provide a financial guarantee against the insolvency of operators. The ELD has no compulsory insurance requirement, but at least stimulates Member States to take measures to encourage the development of financial security instruments. The PLD completely lacks solvency guarantees. Interestingly, in some of the regulatory regimes discussed in this book, compulsory insurance was required, for example in the Machine Directive[11] and the Construction Products Regulation.[12] An interesting aspect of the Regulation on insurance requirements for air carriers and aircraft operators[13] is that in case of insurance market failure, the Commission may determine the appropriate measures to realise the obligation of providing insurance coverage. Here, the limits of the insurance market in providing security are recognised and the Commission sees an active role for itself in determining appropriate measures to realise the obligation of providing insurance coverage.

An important aspect bearing on the scope of liability is the relationship to regulation. We already mentioned that the existence of a regulatory regime could have an important influence on liability. Of course, compliance with regulation (such as REACH) may not automatically exclude liability, but compliance could lead to a presumption of products being not defective. We mentioned the example of EUDRALEX, which explicitly holds that regulated entities must not be subject to civil or administrative liability for unapproved use of medicinal products if such use is recommended or required by the authorities in response to particular public health risks. Also, compliance with the personal protective equipment may lead to an assumption of conformity with basic safety requirements, thus potentially reducing liability. Also the example of CE-marking directives, such as the Machinery Directive, is interesting: standards and certification could possibly result in a limitation of liability, and machinery especially designed and constructed for police purposes is excluded from the scope of the Machinery Directive.

It merits further analysis what this precisely means. One has to be careful with drawing from this the conclusion that safety regulation of the security industry would be needed. It depends on other factors, including

[11] Directive 2006/42/EC of the European Parliament and of the Council of 17 May 2006 on machinery, and amending Directive 95/16/EC [2006] OJ L 157/24.

[12] Regulation (EU) 305/2011 of the European Parliament and of the Council of 9 March 2011 laying down harmonised conditions for the marketing of construction products and repealing Council Directive 89/106/EEC [2011] OJ L 88/5.

[13] Regulation (EC) 785/2004 of the European Parliament and of the Council of 21 April 2004 on insurance requirements for air carriers and aircraft operators [2004] OJ L 138/1.

the contents and quality of the regulation. For example, there is criticism of REACH holding that it would provide limited incentives for innovation. Moreover, it is one thing to take into account compliance with regulation as a presumption of following the due care standard or assuming "safety" of a particular product; it is quite another to infer from compliance with regulation that the security industry could no longer be held liable. Hence, this relationship between regulation and liability still merits further analysis, also from the perspective of the economic analysis of law.

A final point, especially as far as potential EU action is concerned, is that one notices that the instruments analysed in Chapter 2 often provide various options for Member States. For example, the ELD leaves the important issue of the compliance with permit defence (which has a significant influence on the scope of liability) to Member States and the same is true for the PLD which, for example, allows Member States to reject the development risk defence. The Recommendation on auditors' liability even goes a step further by providing Member States three options of (financially) limiting auditors' liability. This way of regulating liability has the major advantage of providing a lot of flexibility and leaving it largely up to the Member State to determine the scope of liability, thus respecting the subsidiarity principle and having the benefits of flexibility and differentiation. However, for an industry branch where risks are typically transnational (as in the security industry) operators working in this transnational branch may wish to have a European-wide liability regime in order to create an EU-wide level playing field. This is again a trade-off that needs further attention.

Also it is important to stress that one particular issue which has an influence on the potential liability of the security industry is in fact not explicitly regulated in any of the EU legislation discussed in this chapter, being causation. This is a crucial issue since the security industry will normally never be considered itself a direct tortfeasor or injurer. The direct tortfeasor will often be a criminal organisation or terrorists who intentionally inflict harm on victims. The charge against the security industry may be that through its negligence it facilitated the terrorist activity that inflicted harm upon the victims. The extent to which one accepts liability of the security industry in that case is strongly related to the question of whether one considers the behaviour of the security industry (supposedly wrongful) as a cause of the damage suffered by the victims. Notions like the proximity of the cause, breaking the chain of causation and the remoteness of damage are hence crucial in that respect.

These issues are not dealt with explicitly in any of the EU legislation analysed in this chapter, but do have a crucial bearing on the scope of liability of the security industry.

10.3. Lessons from international law

In Chapter 1, we analysed several international treaties regarding liability for damage. Based on that analysis, we concluded that the distinguishing features of these conventions, including exclusive channelling of liability and financial limits, reduce the incentives to invest in efficient prevention of damage. On this ground, we concluded that the model of these conventions is not appropriate for defining the scope of liability for damage resulting from terrorist attacks, because preventing such damage is generally more important than mitigating liability.

10.4. Limiting liability

Channelling of liability basically means that only one party can be held liable, thus excluding the liability of other parties involved. Such channelling can be found in the liability regimes set forth in the international treaties described in Chapter 1. As the comparative overview made clear, many of the international treaties channel the liability to a particular party, such as a ship-owner (in the Civil Liability Convention and the HNS Convention) or the operator (in the nuclear liability conventions). The current channelling of liability is beneficial to the security industry, because it implies that it reduces the threat of liability from the security industry. However, the channelling is not perfect in all conventions. In some cases, it is not exclusive and other parties can still be held liable. This is for example the case in the Montreal Convention on international carriage by air.

Theoretically, one could envisage enlarging the channelling to an exclusive liability of operators (the customers of the security industry), thus preventing any liability of the security industry. However, also the channelling of liability, more particularly with respect to nuclear liability and marine oil pollution, has been criticised in the literature. The main problem is that when liability is exclusively channelled to one liable operator, this automatically excludes liability of all others who may also have contributed to the accident risk. If one believes that liability rules provide incentives for prevention, the disadvantage of channelling is that it removes the incentives for prevention from all parties other than the single operator to whom the liability is channelled.

The March 2011 Fukushima incident in Japan illustrates some of the undesirable consequences of channelling. The first reports on the Fukushima case made clear that the meltdown of the nuclear reactors may have been caused by the simple fact that the generators for the cooling system were located in the basement of the turbine buildings, which of course made them vulnerable to a tsunami.[14] The question could be asked whether this is the result of negligent action by the operator TEPCO or rather the result of bad design or engineering by General Electric. In the latter case, a channelling of the liability to the operator TEPCO would be problematic, since channelling would lead to an exclusion of liability of all other parties who may have contributed to the risk, in this particular case (at least potentially) General Electric. The Fukushima case suggests that channelling can be problematic in removing incentives for prevention from other parties who are able to limit or otherwise influence a risk.[15]

A similar argument can be formulated with respect to the liability of the security industry. In this respect it should not be forgotten that the security industry is contracted by its clients precisely to provide the security they expect and that third parties (the public at large) also rely on the security industry to do what they are paid for, i.e. provide security. Fully excluding their liability, by making customers exclusively liable, may therefore be undesirable.

As we made clear at the end of Chapter 2, many activities related to the security industry (although not necessarily the security industry itself) are subject to detailed safety regulation. Safety regulation can have an important influence on liability. Compliance with regulation does not automatically exclude liability, but compliance could lead to a presumption of a security-related product not being defective. For example, compliance with the Personal Protective Equipment Directive may lead to an assumption of conformity with basic safety requirements, thus potentially reducing liability of operators.

The question arises what lessons can be drawn from this relationship with regulation for the security industry. On the one hand, the suggestion could be made to issue additional detailed regulations with which the security industry should comply. However, the comparative analysis also made clear that failure to comply with regulation is in all jurisdictions a strong indication that the defendant breached the required standard of

[14] See Yoshiada 2011 [15] See Faure and Liu 2012b, 214.

care (common law) or acted unlawfully or negligently (civil law). Hence, it could be argued that the more regulation that is enacted,[16] the more the liability of the security industry could potentially be expanded or limited. Indeed, as was argued in Chapter 3, regulation in that sense constitutes a double-edged sword: to the extent that the security industry complies with the regulatory standards, compliance could constitute a presumption of not having acted unlawfully (although that is not certain and debated), but non-compliance, on the other hand, will likely be regarded as negligence per se. Compliance with safety regulation could generally increase care levels and thus reduce the accident risk, and in that way limit the exposure to liability of the security industry. However, more detailed rules in safety regulation also make it easier for victims to prove that a particular regulatory standard has been breached and, in that sense, the requirement of fault/negligence has been met. If the breach stands in a causal relationship with the damage of the victim, liability may be given.

Going a step further, one could argue that if detailed safety regulation were issued this would constitute more than just a presumption of lawfulness (which could be set aside if the court finds that the security provider nevertheless acted negligently). One could argue that compliance with safety standards, provided that those safety standards reflect optimal care levels, should exclude liability of the security provider. However, there are considerable problems with this option, both from a legal as well from an economic perspective.

From a **legal** perspective the problem would be that such a position would collide with the current principles of liability law and the tradition of the Member States. The mere fact that the operator complied with regulation is in most legal systems considered only a minimum and not a reason to exclude liability. This points at a second problem from a legal perspective: there is no legal system among those examined in this book that has a rule freeing an operator from liability if regulatory standards are complied with (see *supra* 3.2.). Introducing such a rule would hence constitute a deviation from traditions in national tort law.

There are also good **economic** reasons to reject a "regulatory compliance defence". If compliance with a regulatory standard or licence would automatically result in a release from liability, a potential injurer would have no incentive to invest more in care than is required by the regulation, even if additional care could still reduce the expected accident

[16] Several countries already provide for special rules concerning the licensing of security companies and the supervision of their activities.

costs efficiently.[17] A first reason to hold an injurer liable (if the other conditions for liability are met), although he has followed the regulatory standard, is that indeed this standard is often merely a minimum. A complete "regulatory compliance defence" prevents any incentive to take precaution in excess of the regulated standard.[18] Exposure to liability will give the potential injurer incentives to take all efficient precautions, even if this requires more than just following the regulation. This, by the way, holds both under negligence and strict liability. Since the regulatory standard cannot always take into account all efficient precautionary measures an injurer can take, testing the measures taken by the injurer even though the regulatory standard was followed will provide additional incentives. Allowing a regulatory compliance defence would also reduce the beneficial incentive effects of strict liability. Strict liability has the advantage that it provides the injurer with incentives to take all efficient measures to reduce the risk (prevention and activity level), even if regulatory requirements are followed. This outcome has been shown formally by Kolstad/Ulen/Johnson[19] and by Burrows.[20] They argue that a complete compliance defence prevents any precaution in excess of the regulated standard. If there is serious under-enforcement of standards, the role of liability as an incentive to take precautions remains important.

A second reason is that exposure to liability might be a good remedy for the unavoidable capturing and public choice effects that may play a role when regulations are adopted. If a regulation would always release from liability, an operator would have strong incentives to spend resources on securing a good regulation with easy conditions. That would then exclude any lawsuit for damages by a potential victim. Obviously, these capturing and public choice effects could be addressed also via direct tools. In this respect, one can think of the liability, even under criminal law, of regulatory authorities.[21] Liability of the regulatory authorities (and appropriate sanctions within administrative law) can provide incentives to civil servants to act efficiently when issuing regulations.[22] This, however, still requires tort law to take into account the fact that regulatory standards

[17] Shavell 1984, 365.

[18] Burrows 1999, 242. Later Schwartz added to the debate by discussing whether compliance with federal safety statutes should have a justificative effect in State tort cases; see Schwartz 2000.

[19] Kolstad, Ulen and Johnson 1990, 888–901.

[20] Burrows 1999, 227–244.

[21] Faure, Koopmans and Oudijk 1996.

[22] Note, however, that industry may argue against such a liability of the authorities, as this may entail the risk that authorities would be too reluctant in allowing emissions.

are not always set efficiently. If the optimal level of care is higher than the regulatory standard, liability will efficiently provide additional incentives.

Finally, tort law can also be seen as a "stopgap" for situations not dealt with by regulations. This makes clear that the exposure to liability notwithstanding the regulations and/or permit is an important guarantee that the plant operator will take efficient care.

10.5. Mandatory financial security

One potential issue that we have not yet discussed is whether one should consider the introduction of mandatory financial security to be provided by the security industry to cover its potential liability exposure. Several arguments or criteria in favour of compulsory financial security are examined below.

One argument is related to information problems. These might arise in case the potential injurer cannot make an accurate assessment of the risk it is exposed to and/or the benefits of the purchase of insurance. An underestimation of the risk would in that case lead to the wrongful decision of the injurer not to purchase liability insurance. The legislature could remedy this information problem by introducing a general duty to insure. For example, this information problem is probably a valid argument to introduce a general duty to insure for motor vehicle owners, because the average driver of a car is likely to underestimate the benefits of insurance. If there were no information problem and the legislature nevertheless introduced a duty to insure, because this would be "in the best interest" of the insured, this would reflect mere paternalism.

If empirical evidence existed that the security industry would greatly underestimate the costs of damage it may cause and/or the probability that they would be held liable for this damage, this would then lead injurers to reserve too few resources to cover their potential liability. If these conditions are met and one can indeed assume that injurers underestimate the cost of damage, this information deficiency may be considered an argument in favour of compulsory insurance. But again, the policy argument based on information asymmetry relates merely to the fact that the injurer would underestimate the potential benefits of insurance. However, this argument does not seem very convincing in the case of the security industry where there is no proof of specific information deficiencies. The industry appears to be well aware of its exposure and suggests that insurance is either unavailable or priced at levels that make it prohibitive. This is also a possible problem; if few security companies seek insurance, it is harder for insurance providers to develop attractive products, because of problems relating to potential adverse selection and the lack of the benefits of the law of large numbers.

Another argument for introducing compulsory financial security would be the potential insolvency of an injurer. Insolvency may result in under-deterrence. If the expected damage exceeds the injurer's assets, the injurer will only have incentives to purchase insurance up to the amount of its own assets. It is indeed only exposed to the risk of losing its own assets in a liability suit. The judgement-proof problem may therefore lead to underinsurance and thus to under-deterrence. Jost has rightly pointed at the fact that in these circumstances of insolvency, compulsory insurance might provide an optimal outcome.[23] By introducing a duty to purchase insurance coverage for the amount of the expected loss, better results will be obtained than with insolvency whereby the magnitude of the loss exceeds the injurer's assets.[24] In the latter case, the injurer will indeed only consider the risk as one where he could at most lose his own assets and will set his standard of care accordingly. When it is, under a duty to insure, exposed to full liability, the insurer will obviously have incentives to control the behaviour of the insured. Via the traditional instruments for the control of moral hazard, the insurer can make sure that the injurer will take the necessary care to avoid an accident with the real magnitude of the loss. Thus, Jost and Skogh argue that compulsory insurance, provided that the moral hazard problem can be cured adequately, can provide better results than voluntary insurance under the judgement-proof problem. This is one of the reasons why, for instance, traffic liability compulsory insurance was introduced. Uninsured and insolvent drivers who have little money at stake which they may lose compared to the possible magnitude of accidents they may cause, may have little incentives to avoid an accident. Insurers might be better able to control this risk and could force the injurer to take care under the threat of shutting him out of the insurance. Thus, the insurer becomes a regulator of the insured activity.

Indeed, this economic argument shows that insolvency may cause injurers to externalise harm: they may be engaged in activities that may cause harm greatly exceeding their assets. Without financial provisions these costs would fall on society and would hence be externalised instead of internalised. Such an internalisation can be achieved if the insurer is able

[23] Jost 1996. A similar argument has recently been formulated by Polborn 1998, 141, 146. Skogh 2000 has also pointed out that compulsory insurance may save on transaction cost.

[24] See also Kunreuther and Freeman 2001, 316.

to control the behaviour of the insured. The insurer could set appropriate policy conditions and an adequate premium. This suggests that if the moral hazard problem can be cured adequately, insurance leads to higher deterrence than a situation without liability insurance and insolvency.

However, also this argument is not particularly convincing in the case of the security industry. In earlier chapters, we have repeatedly argued that as of yet (and probably in the future as well) the exposure of the security industry to liability risks is not of such a nature that this would be uninsurable, and that large insolvency risks are likely to emerge if companies are not negligent. Moreover, if one were to consider the introduction of mandatory financial security, the more logical step to take would be to impose mandatory financial security on operators, the clients of the security industry. As we have shown in Chapter 1 (dealing with the international treaties related to nuclear safety, civil aviation and environmental liability) many of those treaties do indeed impose compulsory financial security. Since we have argued also that it is more likely that liability will be focused on the operators who may be victims of particular security breaches (e.g., by terrorists), it is logical that a duty to obtain financial security is imposed upon those operators rather than on the security industry.

Since there is no convincing evidence yet of huge insolvency risks as a result of which the security industry may not be able to meet its liabilities towards third parties, imposing mandatory financial security upon the security industry would potentially only create huge administrative costs without compensating benefits.

10.6. Conclusions

In this chapter we provided an economic analysis of current TRR liability. We first sketched that, from an economic perspective, the goal of tort law is not so much compensation, but rather efficient deterrence of accidents. We also explained that within the European context the function of tort law is usually different from in the US, where victims may need tort law for basic compensation of their losses.

We equally analysed the findings from Chapter 1 (international law) and Chapter 2 (EU law) from an economic perspective, pointing at the strengths and weaknesses of those regimes concerning liability for TRR. Whereas we argued that channelling liability protects the security industry by exclusively focusing liability on operators, at the same time we argued that this may lead to the undesirable effect of limiting the liability exposure of the security industry, thus potentially limiting its incentives for prevention. We equally pointed at the problematic aspect of e.g. nuclear liability conventions, which on the one hand strongly limit the liability exposure of operators but on the other hand provide public funds to compensate victims. As a result, neither operators nor the security industry is fully exposed to the true social costs of their activities, which does not correspond with the economic goals of tort law as they were sketched in 10.1.

We also sketched that, especially in the European regime which was central to Chapter 2, the standard of care to be followed by either operators or the security industry is often defined by safety regulation. Such safety regulation may, so we argued, under circumstances have either an expanding or limiting effect on private liability. However, from an economic perspective there is no reason to limit or exclude private liability of operators or the security industry merely because there would have been compliance with safety regulation. After all, the level of optimal care may be higher than the standard required by safety regulation.

Economic analysis has also pointed out that in case of a serious insolvency risk, under-deterrence may occur. If there were proof of such an insolvency risk, that may be a strong argument in favour of imposing mandatory solvency guarantees, such as compulsory insurance. Examples of that can be found in the international treaties that were discussed in Chapter 1. In many of those cases (nuclear accidents and marine oil pollution), the potential damage that an operator can cause could be substantially higher than his assets. In those cases, imposing mandatory financial guarantees (like insurance) upon operators is hence completely justified. However, we argued that the case may be different for the security industry itself. As long as there is no proof that the industry may not be able to meet its liabilities towards third parties, it may not be immediately necessary to introduce mandatory financial security since this obviously creates high costs as well.

An interesting question that we in fact already addressed in Chapter 8 is to what extent alternatives may be better able to deal with damage resulting from terrorism-related risks. We pointed at the possibility of introducing victim compensation solutions such as either victim compensation funds or government-provided compensation. Those have, so we argued in Chapter 8, negative effects on both the incentives of operators and the security industry to take preventive measures, and are from that perspective undesirable. However, an alternative may be the model of a mandatory first-party insurance scheme, as exists in France. To the extent that those victim compensation solutions exclude liability of either operators or the security industry, the disadvantage of those schemes is unavoidably that liability rules can no longer have their deterrent effect, and that there hence may be negative consequences as far as the incentives for prevention are concerned. This may result in an increase of the risk.

In this chapter, we looked at several devices limiting liability that are currently employed such as channelling of liability and linking liability to regulation. However, the analysis of TRR liability in international law equally made clear that many international conventions contain limits on liability which are, as we argued in Chapter 1, problematic from the perspective of providing incentives for prevention. This of course raises the question to what extent either operators or the security industry should at all be subject to direct liability limitations; which was the subject of analysis of Chapter 9.