



Breaking the Litigation Habit

Economic Incentives for Legal Reform

A Statement by the Committee for Economic Development



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Breaking the Litigation Habit

Economic Incentives for Legal Reform

RESPONSIBILITY FOR CED STATEMENTS ON NATIONAL POLICY

The Committee for Economic Development is an independent research and policy organization of some 250 business leaders and educators. CED is nonprofit, nonpartisan, and non-political. Its purpose is to propose policies that bring about steady economic growth at high employment and reasonably stable prices, increased productivity and living standards, greater and more equal opportunity for every citizen, and an improved quality of life for all.

All CED policy recommendations must have the approval of trustees on the Research and Policy Committee. This committee is directed under the bylaws, which emphasize that "all research is to be thoroughly objective in character, and the approach in each instance is to be from the standpoint of the general welfare and not from that of any special political or economic group." The committee is aided by a Research Advisory Board of leading social scientists and by a small permanent professional staff.

The Research and Policy Committee does not attempt to pass judgment on any pending

specific legislative proposals; its purpose is to urge careful consideration of the objectives set forth in this statement and of the best means of accomplishing those objectives.

Each statement is preceded by extensive discussions, meetings, and exchange of memoranda. The research is undertaken by a subcommittee, assisted by advisors chosen for their competence in the field under study.

The full Research and Policy Committee participates in the drafting of recommendations. Likewise, the trustees on the drafting subcommittee vote to approve or disapprove a policy statement, and they share with the Research and Policy Committee the privilege of submitting individual comments for publication.

Except for the members of the Research and Policy Committee and the responsible subcommittee, the recommendations presented herein are not necessarily endorsed by other trustees or by the advisors, contributors, staff members, or others associated with CED.

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Purpose of This Statement

Litigation, the enforcement mechanism of our civil justice system, is too slow, intrusive, expensive, and complex. At the same time that defendants pay increasing amounts in damages, victims are not compensated fairly or quickly for real injuries when they must rely on litigation to obtain compensation. Our society pays the enormous costs of running this inefficient and inequitable system. Thoughtful people are looking for a better way.

This statement highlights some of the perverse economic incentives at work in our litigation system. CED's Trustees believe that appropriate incentives could help reallocate monies away from litigation and non-economic damages into providing more economic compensation more quickly to more injured parties, without litigation. This statement describes two CED recommendations: Early Offers and Auto Choice insurance.

Litigation is only the enforcement tip of the larger legal system. While preparing this policy statement, we identified other serious problems regarding our civil justice system. The scope of our laws, the increased role of the courts in law making and social policy, and the role of the legal profession and legal education require examination and discussion. These fundamental issues are beyond the purview of this report, and we do not attempt to address them here. Most Americans, however, are not aware of these issues or their economic and social consequences. We are therefore convinced of the need to raise awareness through broad and informed public debate about our legal system and its effects on our society. We hope that this policy statement will spur such a debate.

ACKNOWLEDGMENTS

This report builds on a foundation CED Trustees laid in 1989 with the publication of *Who Should Be Liable? A Guide to Policy for Dealing with Risk*. It was developed by the committed and knowledgeable group of business, academic, and policy leaders listed on page viii. We are grateful for the time, insight, and care they put into making this report balanced and effective.

Special thanks go to the subcommittee co-chairmen, Roderick Hills, Chairman of Hills Enterprises, and Martin Zimmerman, Vice President, Governmental Affairs of Ford Motor Company, for their leadership and persistence. We are grateful to project director John Hoff and to Van Doorn Ooms, CED's Senior Vice President and Director of Research, for their thoughtful contributions, and to Helena Zyblikewycz for exhaustive research assistance.

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Josh S. Weston, *Chairman*
CED Research and Policy Committee
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Introduction*



THE IMPORTANCE OF LAW

America is built on the rule of law. Rebellious from the power and asserted moral authority of hereditary monarchs, our country was founded on the principle that government is created by the governed and is controlled by them. This ideal is given practical application by law. A hallmark of our society consequently is that we are to be governed by laws, democratically enacted, rather than by the fiat of individuals exercising government authority.

Reliance on the law helped develop, and itself was given further impetus by, the country's commitment to the free-enterprise system. A complex market economy, operating across a continental nation, required strangers to deal with each other. Law provided the institutional framework for doing so. Law also served as a glue to bind into one nation the immigrants from various cultures who have made America.

America is thus held together, philosophically and psychologically, economically and politically, by shared commitment to the supremacy of law. We depend on a fair, credible, and efficient legal system to enforce economic and social policies embodied in law, to protect citizens from unwarranted actions by government, to enforce the rules of commerce, and to provide remedies for wrongs done by one to another. A smoothly functioning and respected legal system is essential to the prosperity and, more importantly, to the freedom of all Americans.

Derek Bok, then President of Harvard University and a former law school professor and dean, was one of the first national leaders to

decry the state of the American legal system in his 1983 report to the University's Board of Overseers. At the same time he reminded us that:

there is much in our law that represents a triumph of the human spirit: the steadfast defense of individual freedom and civil liberties, the constant elevation of reason over prejudice and passion, the protections afforded to minority and disadvantaged groups.¹

DRAWBACKS OF THE LITIGATION SYSTEM

As President Bok described, however, the legal system is not serving Americans as it should. The problem is particularly evident in the enforcement mechanism of the law — litigation. When there are disputes, the relevant facts must be found, and the applicable law must be identified, interpreted, and applied to those facts. Litigation is the process for performing these essential tasks. It comes, however, at a price — economic and social — that is paid by the litigants and by our society as a whole.

As Part I of this policy statement will describe, civil litigation is too intrusive, too slow and, too expensive. Most injured people avoid it.² There is a lack of confidence in the result when the process is invoked. In particular, the amount of compensation people who are injured by the act of another recover through the litigation process typically is in inverse relationship to their actual loss. The current compensation system does not adequately provide

*See memorandum by JOSH S. WESTON (page 33).

justice. As a result, respect for the law and the legal process, which is essential to American democracy, is eroded.

The litigation process is a vital tool of a constitutional democracy. It is essential to the rule of law. But it must be made more efficient, fairer, and less intrusive. Numerous efforts already are being made to improve various discrete parts of the litigation system. Because these reforms entail detailed changes in laws and rules, they require the expertise of lawyers and judges. Here we recommend a less technical, and more basic, approach to reform.

RECOMMENDATIONS ON WAYS TO AVOID LITIGATION

We believe that it is not enough merely to improve the conduct of litigation — even assuming that this goal can be accomplished. Americans should be offered alternatives that make it possible and worthwhile for them to avoid litigation. We recommend in Part II, therefore, two specific innovative reforms that introduce economic incentives to provide fair compensation in appropriate circumstances, quickly and without litigation. They allow both plaintiffs and defendants to capture and share the savings that result from avoiding litigation:

- 1. We recommend ways to provide incentives for potential defendants to make offers to pay victims' economic damages soon after an adverse event and to encourage potential claimants to accept.** These *Early Offers* would offer people a choice. Injured parties could obtain fair compensation quickly, when they need it, and without having to resort to the delay, expense, and trauma of litigation.
- 2. In addition, in one discrete area, we recommend the adoption of *Auto Choice*, which would give motorists a choice between two different types of insurance.** Auto Choice would allow a driver to continue under the present system, with fault for an accident being determined through the litigation system and with the possibility of recovering

non-economic, as well as economic, damages. Or the motorist could choose an alternative system that pays compensation for economic (but not non-economic) loss resulting from personal injury, without litigation. Drivers choosing the former approach would pay premiums comparable to what they pay now; those choosing the latter alternative would pay significantly lower insurance premiums and in most cases receive compensation more quickly and without having to litigate.

These mechanisms share a common approach. They recycle the amounts now spent on lawyers' fees and other litigation expenses and on payment of non-economic damages into compensation for actual financial loss for more victims, more quickly, and without litigation. They increase consumers' choices and offer them new advantages.

These mechanisms will not fix the litigation process and are not intended to do so. They will not, nor should they, eliminate litigation. They will, however, benefit all of American society (other than some lawyers and the ancillary businesses nurtured and sustained by litigation) by creating alternatives to litigation and thus reducing the transaction costs the present compensation system requires. They represent balanced reform. They benefit plaintiffs, defendants, and society as a whole. They provide new choices and new rights. Our recommendations, therefore, bypass the political deadlock that has stymied tort reform and promise a new approach.

BEYOND THIS STATEMENT

Our recommendations are important in themselves. They also represent a new direction for reform and, we hope, will catalyze further efforts to develop additional alternatives to litigation. The reforms we recommend are not the only possible ones; more work by more people is needed.

In developing our recommendations, moreover, we became convinced that long-lasting

and fundamental reform is possible only if there is a broad and informed public debate on the benefits and drawbacks of litigation and of possible alternatives to it. This debate should be sponsored and led by leaders of the broader community, as well as by lawyers and the courts. Thus it is particularly important that there be participation by consumer and business groups, the media, and academia (including not only law school professors, but economists, business school professors, sociologists, psychologists, and political scientists).

This debate must include a re-examination of the assumptions that have fostered reliance on litigation. Because litigation is the enforcement tip of the larger legal system, it also must consider the role and scope of law and the process by which law is made. These issues are beyond the scope of this policy statement, which focuses on two specific recommendations. However, we believe this debate should be the next step in reform, and we describe briefly fundamental issues that should be considered.

The country has acted, or more accurately has allowed the legal community to act, on the unexamined assumption that litigation is the standard and expected way to right private wrongs, determine compensation for injury, and resolve many matters of economic and social policy. By a process of slow but steady accretion, the conventional intellectual and political wisdom has come to favor litigation. Institutional and financial incentives to litigate have been built into the system. As Walter Olson, a fervent critic of the litigation culture and its effect on American society, has observed, "America did not begin litigating more and harder because its population suddenly took it into its head to become more contentious. We got more lawsuits because those who shaped our legal system wanted more lawsuits."³ Academia, the courts, the legal profession, and legislatures have all encouraged litigation.

Legislatures have created a wide variety of new obligations that affect most Americans and give rise to rights that can be individually enforced through private litigation. In addition,

statutes too often are written in broad terms and vague language. These legislative gaps leave the real decision making to administrative and judicial fiat, violating the fundamental principle that we are governed by laws and not by individuals, and they have increased the need (and the opportunity) to litigate.⁴ Beyond the failings of legislation, the courts have often expanded statutory rights and, independently of legislation, have expanded common law rights on the basis of their views of what is good public policy.⁵

The public discussion that we urge, therefore, should consider whether creating individual rights coupled with large penalties for violations is the only, or the best, way to carry out social policies. The American people may want to explore other approaches that rely less on litigation and more on education.

They should also consider, if new rights are created, the appropriate roles of legislatures and courts in creating new rights. This should include examination of the extent to which the courts should impose liability for actions that are lawful. In extending legislation and creating new legal rights, the courts enter into areas that traditionally have been left to the citizens or their elected representatives. Court decisions often affect the general population, not merely the litigants before it, and result in social and economic micro-regulation by the courts.⁶ Courts, however, are less well suited than legislatures to consider how much it will cost to comply with any law they make, when it should apply, and what exceptions should be made.

The independence the courts are given to decide cases free of political considerations ironically gives them the ability to make political decisions without the constraints under which legislatures operate. In fact, the general community often is not even aware of new law created by court decisions. Since courts in theory do not make new law but apply and interpret existing laws, their decisions apply retroactively, imposing new standards of conduct on actions taken years before.⁷

The Economist has pointed out the dangers of making social policy through litigation:

American public officials have usurped democratic debate on both tobacco and handguns by launching a wave of lawsuits designed to win through legal threats what they have been unable to win in Congress and state legislatures — stricter regulation and heavier taxation. This unjustified recourse to the courts, unique in the world, now poses a bigger threat to Americans than either tobacco or guns....using the courts to bully industries in this way is an abuse of the legal process and an evasion of democratic accountability.... A legal system which, despite its occasional excesses, enjoys the support of most Americans will be brought into disrepute. Any rational debate about balancing choice with risk will be abandoned as irrelevant. Legislation will be replaced by litigation, deliberation by legal threats....If America is ever to get its priorities right on tobacco, guns or any other issue, it will do so only in the debating chamber of democratically elected legislatures, not through threats of mass litigation.⁸

Some people may disagree with this view. But they should consider explicitly the consequences of allowing courts to make these decisions.

The public debate that we urge should also consider the role of legal education and academic research in developing alternatives to litigation and in encouraging and training lawyers to resolve rather than exacerbate conflict. And it should debate the meaning of professionalism in light of current economic and legal conditions, including the manner in which attorneys' compensation is fashioned.

Litigation is personally profitable to the lawyer — whether representing the plaintiff or defendant, whether paid an hourly rate or a percentage of any recovery on a contingency basis — because of the intensity, complexity, and length of litigation, and because of the amount of money that may be involved. These

incentives to litigate are compounded by the economic pressures and leveraged internal compensation arrangements under which large law firms operate. As professionals, however, lawyers are expected not to maximize profits but rather to act in the best interest of their clients. Reflecting this principle of professionalism, lawyers' Canons of Ethics require that fees be reasonable, not whatever can be extracted from their client. However, the professionalism of lawyers has been greatly eroded in recent years. As Chief Justice Rehnquist has observed, "The practice of law in the United States has evolved from a profession to a business, with all that those terms connote: emphasis on making money, increased competition for clients, increased mobility of lawyers."⁹

The changed role of lawyers as self-interested entrepreneurs has come to be accepted as if it were normal and right. This situation is reflected most baldly in connection with the fees for the lawyers who brought cases against the tobacco companies on behalf of state governments. Omnibus Federal tobacco legislation in 1998 would have imposed caps on those fees. One Senator opposed a cap of \$4,000 per hour on the ground that since the government does not limit profits, it should not limit the fees charged by lawyers, who are nothing less than "legal businesspersons."¹⁰ This legislation was not enacted. Through arbitration, lawyers representing six states have already been awarded \$9 billion. With attorneys in 35 states still awaiting arbitration, total fees may be in excess of \$20 billion for a relatively small number of lawyers.¹¹ No one can seriously consider fees at this level to be reasonable. Nor is it apparent why it was necessary or appropriate for state attorneys general to enter into contingency fee arrangements in the first place.

These and similar issues relating to the role of litigation in American society need to be explicitly considered by the American people. In emphasizing the importance of resolving disputes without litigation and implementing mechanisms for doing so, we mean to set the stage for this larger debate.

Part I

The Nature of Litigation



THE LITIGATION MECHANISM

Every lawsuit, even if necessary, has an adverse effect on the litigants. Rules governing the conduct of litigation are difficult to enforce and are often violated. Even permitted conduct is damaging to the litigants and to bystanders.

Litigation is inherently bitter and highly intrusive. Litigants are permitted to delve into private matters and proprietary information of their opponents, and even of non-parties, through the “discovery” process. Often necessary to develop relevant facts, discovery too frequently extends to matters only tangentially related to the dispute.

Litigation is complex. Detailed factual research is necessary in most cases, a process that may involve abstruse scientific, technical, medical, or economic matters. The applicable law is often vague and complex. As the number of statutes, regulations, and court decisions has grown, the amount of potentially applicable law that must be researched and applied to the particular case has increased.

An injured party who must resort to litigation is denied compensation while the process plays out. Litigants often must wait years for decisions. The time it takes to resolve a case depends on the complexity of the particular matter, the amount of litigation machinery the litigants set in motion, and the extent of discipline exercised by the judge. It also turns on external factors such as the court’s overall workload of both civil and criminal cases (criminal cases typically are given precedence). The time it takes to go to trial, therefore, varies

greatly among jurisdictions, but is often too long. In Los Angeles, for instance, it takes five years on average for a civil case to go to trial.¹² That, of course, is not the entire story. After a case has gone to trial, there may be appeals, at one, two, or perhaps three levels. And in some instances, an appellate court may remand the case to the trial court for a new trial or further proceedings. Each step adds delay, cost, and uncertainty for the parties.

Although only approximately 3–4 percent of lawsuits that are filed actually go to trial,¹³ little comfort should be drawn from this. Most cases are dropped or settled only after they have gone through much of the discovery process, legal and factual research, and motions practice. Discovery alone is estimated to comprise 80 percent of the cost of a fully litigated case.¹⁴ Even if a claim does not go to trial, the average time to settle a product liability claim is two years from the event.¹⁵

Litigation provides ample opportunity for abuse by both plaintiffs and defendants. A party can use the available procedural mechanisms to wear down the opposition by delay and expense. Discovery tools permit a litigant to harass the opposition by making burdensome and intrusive requests for information and documents, accompanied by the threat of disclosing confidential or embarrassing information extracted through the discovery process. There is an almost limitless number of facts that can be examined and witnesses who can be interviewed or deposed. There is also an infinite supply of legal arguments that can be made. And a litigant can often create a new argument, hoping that some court may be sympa-

thetic, adopt the new theory, and turn it into law. Every interaction between the parties can be turned into a motion: "Discovery and motions practice provide a near-inexhaustible repertoire of ways for litigants to tease, worry, irk, goad, pester, trouble, rage, torment, pique, molest, bother, vex, nettle, and annoy each other."¹⁶ The process heavily favors well-financed and unscrupulous parties.

The mere threat of litigation can be used for leverage. A person can file a complaint and set the litigation machinery in motion even without specific information of wrongdoing. It often is not difficult to find some minimal ground on which to base a complaint or defense. A trumped-up lawsuit or frivolous defense of one is thus a powerful tool for unscrupulous competitors or others who seek leverage in business dealings. Because the threat, or even mere implication, of litigation is so unsettling, it may be enough merely to suggest the filing of a suit or the pursuit of an abusive defense to force the other party to do the threatening party's bidding. Litigation provides a powerful tool for economic extortion on matters having nothing to do with the purported subject matter of the litigation.

Complexity and time translate into expense. Lawyers and substantive experts must be paid to prepare the facts and research the law. Each party must prepare both sides of the case. The adversarial process provides an opportunity for a party to throw roadblocks in the way of the other at each step of the process. Each motion and each opposition costs a significant amount of money. The longer a lawsuit is pending, the more expensive it is likely to be. The expense and delay of litigation result in the paradox articulated by President Bok — "far too much law for those who can afford it and far too little for those who cannot."¹⁷

Most citizens whose rights have been violated cannot afford to pay a lawyer to seek redress. They can, however, shift the risk of the litigation cost to their lawyers by entering into contingency fee arrangements, which provide

injured parties with access to counsel and the courts. Claimants who cannot afford to hire a lawyer can proceed with their case and the lawyer is paid a percentage of any recovery. If there is no recovery, the attorney is not paid. If the plaintiff ultimately prevails, the lawyer customarily is paid 30-40 percent, or as much as 50 percent, of any judgment that may finally be collected. These fees are presumed to be justified by the risk assumed by the lawyer that there will be no recovery and thus no fee.

In some cases, because of a lack of information or competition, clients may not be able to negotiate a contingency fee that properly reflects their attorneys' risk. Lawyers are paid an inappropriate premium where the contingency fee compensates them for risks they are not incurring—to the detriment of their clients. This can occur when liability is not in doubt, where a case is settled early in litigation, or where the parameters of recovery have largely been set by previous litigation.

Contingency fees may pose additional drawbacks for claimants. They inevitably create incentives for lawyers to find and pursue most vigorously those cases offering the largest recoveries relative to time expended, and to avoid or abandon cases where the defendant is the most obdurate and has the financial resources to most vigorously resist and delay. Defendants may exploit these incentives by using the tools of litigation to force the attorney to spend more time on a case. They may exploit the possible conflict of interest between the plaintiff and his lawyer by prolonging discovery in the hope of forcing the lawyer to recommend a lower settlement to avoid having to spend more time on the case.

Even a victorious plaintiff may not recover his economic loss in full, because he must pay his lawyer a substantial portion of the judgment. Recovery of damages for non-economic loss in effect pays for the litigation process required to collect economic damages. But, according to one study, more than one-third of the plaintiffs who obtained a judgment won no

damages for non-economic injury,¹⁸ which implies that their lawyers' fees had to come out of damages awarded to compensate them for economic loss.

The contingency fee system thus depends on the payment of non-economic damages, which are intended to compensate a victim with money for the non-financial consequences of an injury. Traditionally, such compensation was provided principally for the pain and suffering incurred, and the awards were small.¹⁹ In more recent times, new theories of liability for non-economic damages have been developed. Plaintiffs now can recover compensation on additional theories such as mental distress, hedonic damages (loss of the pleasure of life), loss of consortium (the company of one's spouse or, as newly expanded, one's child), damages caused by knowing one is going to die, etc. These theories are additive, not mutually exclusive, creating a galaxy of possible grounds for recovery for any one injury.

Awards for this category of damages are subjective. "The standard procedure is to leave the issue to the jury, in the apparent hope that jurors can fill the intellectual void left by the courts and legal scholars."²⁰ Compensation varies widely, and is affected by the type of injury.²¹ Depending on the type of injury, non-economic damages may constitute one-third to one-half or more of the amount awarded.²² Awards for non-economic damages typically are small, but a few are very large, representing the principal part of the award.²³

One type of non-economic damages, in particular, has become important in recent years. With little effective control, punitive damages have rapidly increased in number and size. These are awarded as punishment and to deter others from engaging in similar conduct. Punishment and deterrence are concepts of criminal law, but are introduced into civil cases by giving juries an explicit invitation to "punish." Even if the defendant violated a criminal law that provides a specific penalty, the jury in a civil case can impose its own view of punish-

ment independently of the criminal law. An act for which the criminal fine is a few hundred dollars can be punished by the imposition of a civil penalty in the millions of dollars. The defendant is therefore subject to being required to pay judgments on the basis of subjective factors, without having any of the protections that are provided in criminal law (including a higher standard of proof), and without limits tied to the amount of economic damage. In addition, an act that affects more than one claimant can lead to multiple punitive damage awards, as each plaintiff recovers his own punitive damages.

The United States Supreme Court has upheld the constitutionality of imposing punitive damages that are not "grossly excessive."²⁴ The courts, however, have not provided a meaningful definition of what is "grossly excessive" even within the context of review by the trial judge and the appellate courts. Worse, juries are given no meaningful standards in making the awards in the first instance. Punitive damages, therefore, are unpredictable and highly variable.²⁵

Punitive damages are an open invitation to juries, with little effective judicial control, to grant plaintiffs huge awards. Juries do not understand that consumers ultimately pay much of these awards through increased prices.

A recent study analyzed punitive damage awards in five jurisdictions from 1985 to 1994 in cases that did not involve personal injury. Punitive damages were awarded in 14 percent of all verdicts during the period. In the period 1990–1994 punitive damage awards represented almost 60 percent of the total amount of damages awarded; in 1985–1989 they had constituted approximately 44 percent of the total. The average award for punitive damages more than doubled, from \$3.4 million in the earlier period to \$7.6 million (in constant dollars) in the more recent one.²⁶

Another study of punitive damage awards confirmed by the appellate courts in five states (with more than one-third of the U.S. population) found similar increases. It compared the

four-year periods 1968–1971 and 1988–1991 to determine the amount of punitive damages that were affirmed in cases against business enterprises. It found that the total of punitive damages increased from \$1.1 million in the earlier period to \$343 million (in nominal dollars) in the later one. In real terms, this was an increase of approximately 89 fold. Because of its design and the time periods under review, the study is conservative. It did not include judgments that were not appealed. It did not include \$533 million in punitive damages awarded against one defendant in 1992.²⁷ Nor did it include the \$1 billion in punitive damages affirmed against another in 1985 for interference with contractual relations (reduced on appeal from \$3 billion).²⁸

In addition, punitive damages increasingly have been incorporated into regulatory statutes for the express purpose of encouraging litigation. The Civil Rights Act was amended in 1991 to permit recovery of non-economic damages on various theories (including punitive damages), with a sliding scale of limits based on the size of the defendant's workforce.²⁹

The few, dramatically large awards of non-economic damages are particularly well publicized. The attitude engendered by the combination of contingent fee arrangements and peoples' hope they will recover the kind of large judgments for non-economic damages that they read about is summed up in two bumper stickers: "Hit me, I need the money" (displayed by hopeful plaintiffs to potential defendants) and "All you need is an accident and a dream" (displayed by lawyers to attract the hopeful plaintiffs who have succeeded in being hit).³⁰

There is an immediate need to bring some rationality to the process of awarding those damages. We believe that, at a minimum, the award of punitive damages should be subject to the same rules as criminal penalties. They should be imposed only when the conduct at issue is found to have been willful within the meaning of the criminal law. The standard of

proof should be the standard necessary for criminal conviction (beyond a reasonable doubt). Juries should not have essentially uncontrolled discretion to punish as they see fit. The jury's role should be limited to a determination that punitive damages should be imposed. The judge, not the jury, should determine the amount, within pre-determined limits, like the penalties specified in criminal law and sentencing guidelines.

One possible standard would be to tie punitive damages to the amount of damages for economic loss that is recovered, although this provides a continuing incentive to falsify economic damages. A bill in Congress aimed specifically at reforming punitive damages would provide that the amount of such damages could not exceed three times the amount of economic loss.³¹

Finally, in determining the amount of any punitive damages, the amount the defendant has already paid as a result of the conduct at issue should be taken into account. The punishment should not be cumulative from plaintiff to plaintiff.³²

INEFFICIENT AND INEQUITABLE COMPENSATION FOR INJURY

It is telling that in a compensation system operated through litigation, most victims of wrongful conduct do not sue.³³ Rather than compensating people fairly for their actual losses, the system provides no compensation for the majority of injured individuals who do not litigate. When victims do sue, the system typically fails to compensate those who are more seriously injured for their actual damages, but awards excessive damages to those who are only slightly injured. Thus, many injured victims receive no compensation; many are underpaid; and some are overpaid. The system is not rational.

A study by the Insurance Services Office, a service agency of liability insurers, found that one-third of all product liability claims were

closed with no payment. Some unascertainable amount of these were injured parties who were unable to pursue a claim because they could not identify the wrongdoer or because of legal roadblocks. But for those who prevailed, the proportion of economic losses recovered decreased as losses increased. Those with losses less than \$100,000 on average recovered more than 100 percent of their economic loss. Those with losses above \$100,000 recovered less than their full losses, and individuals with losses in excess of \$1 million received only 6 percent.³⁴

The same pattern is found in the system for compensating victims of automobile crashes. There are broad gaps in compensation. Thirty percent of all injured persons recover nothing.³⁵ As shown in Figure 1, victims with economic loss between \$500 and \$1,000 were compensated two and a half times their loss; those with losses between \$25,000 and \$100,000 received 56 percent of their loss; and those who had economic loss over \$100,000 recovered only 9 percent.³⁶

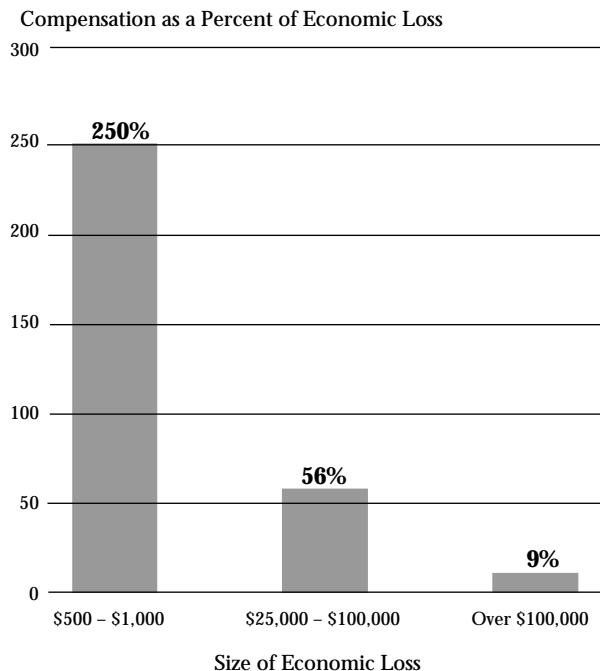
The compensation of injured victims turns on the fortuity of the amount of insurance carried by the wrongdoer.³⁷ Low minimum insurance requirements are a result of the high cost of insurance, driven by the cost of determining who is a wrongdoer and the payment of non-economic damages.

The process produces other anomalies. Female plaintiffs win larger judgments for pain and suffering than males for the same injury; older plaintiffs get more than younger ones.³⁸ And “people with lower incomes and lower educational levels recover less [a smaller percentage of their economic loss] than their middle-class counterparts because they have less access to attorneys, cannot afford to wait as long to recover and *often are not good witnesses*.”³⁹ As Professor Jeffrey O’Connell, a leading analyst of the tort system, sums up the process, “There is no real reason behind it all.”⁴⁰

Running compensation through the litigation system entails transaction costs that are at least as great as the amount of compensation

Figure 1

Compensation for Economic Loss in Automobile Injuries under the Tort System



SOURCE: Joint Economic Committee of Congress, *Auto Choice: Impact on Cities and the Poor*, 1998.

victims receive. It is estimated that for automobile injuries, the net compensation received by winning plaintiffs was 52 percent of total litigation expenditures; for other torts, it was 43 percent; and for asbestos cases, it was 37 percent.⁴¹ Calculated another way, only 28 percent of the insurance dollar actually goes to the victims of medical malpractice, and 33 percent to victims of product liability.⁴² Victims of automobile accidents receive only 14.5 percent of the amount spent for insurance to cover economic losses from bodily injury. Almost double that amount (28.4 percent) is spent in attorneys’ fees.⁴³ See Figure 2, page 10.

The United States Department of Transportation conducted a comprehensive study

of automobile accidents in 1971. It found that the tort system:

...ill serves the accident victim, the insuring public and society. It is inefficient, overly costly, incomplete and slow. It allocates benefits poorly, discourages rehabilitation and overburdens the courts and the legal system. Both on the record of its performance and the logic of its operation, it does little if anything to minimize crash losses.⁴⁴

It has been estimated that the cost of operating the tort litigation system (lawyers' fees, public expenditures, and the time of litigants) exceeds the net recoveries of tort victims by 15 to 19 percent.⁴⁵ In succinct terms, "lawsuits are absurdly slow, capricious, and inefficient: of the money they shift around, more than half gets dissipated in the process of transfer. And much of that winds up in the pockets of what...may be the most prosperous body of professionals in the world."⁴⁶

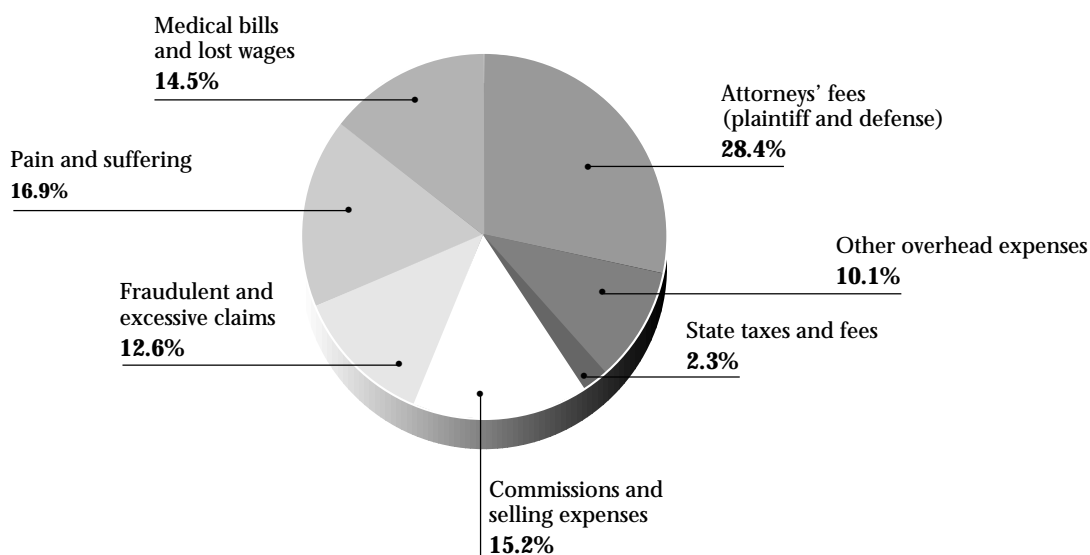
Only a few plaintiffs and their lawyers benefit from the compensation system. But the costs are borne by all consumers in the form of higher prices. This particularly affects the poor. As Professor Priest notes:

...low-income consumers have less money generally and...are more seriously affected in terms of the purchasing power of their limited resources where the price level increases.... [At the same time] low-income consumers, if injured, are less likely to seek an attorney; even with an attorney, are less likely to sue; less likely to recover; and, again by definition, less likely to recover large damage judgments since their lost income is typically low and pain and suffering awards, which are highly correlated with lost income, equally low.⁴⁷

There is, in addition, widespread doubt that juries are capable of making appropriate fact determinations in complex business or techni-

Figure 2

Distribution of Bodily Injury Premiums for Automobile Injuries



SOURCE: Adapted from Joint Economic Committee of Congress, *Auto Choice: Impact on Cities and the Poor*, 1998.

cal matters. The law they are required to apply is often too complex for laymen (and in many cases for judges as well) to apply with credibility.⁴⁸ Jury decisions often appear to be entirely fortuitous or based on inappropriate factors. The substantive law declared by the courts is often complex and to many observers not infrequently defies common sense. The imposition of liability is unpredictable, leading to doubt as to whether justice is served in many cases.⁴⁹ As

Professor O'Connell explains, "The fundamental problem of tort liability, especially in the areas of product liability and medical malpractice, stems from the unpredictability of its imposition."⁵⁰

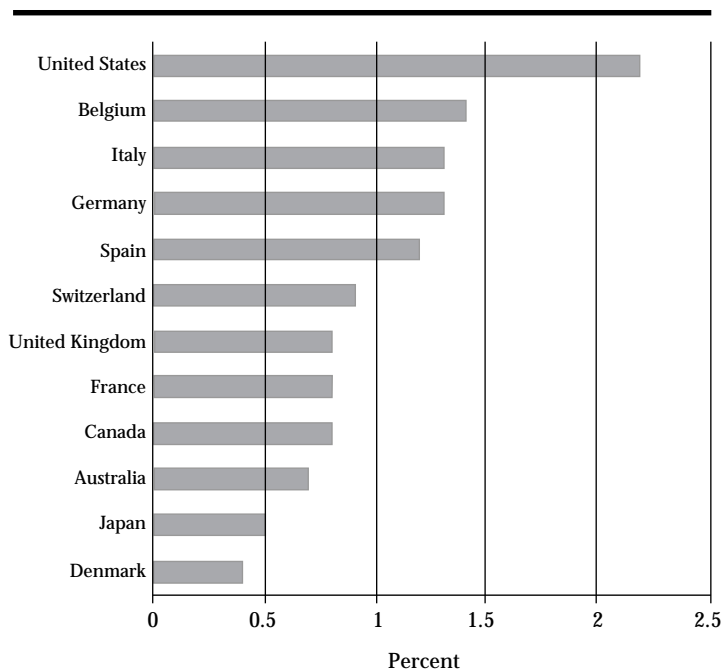
Chief Justice Warren Burger, himself a former trial attorney, described the nature of the litigation system in America succinctly: "Our system is too costly, too painful, too destructive, too inefficient for a truly civilized people."⁵¹ Relying on it to provide compensation comes at great cost.⁵²

HARM TO SOCIETY AS A WHOLE

The costs of the litigation process are not borne only by the litigants. The process ultimately affects all Americans, socially and economically.

Figure 3

Tort Costs as a Percentage of GDP in 1994: An International Perspective



SOURCE: Tillinghast-Towers Perrin, *Tort Cost Trends: An International Perspective*, 1995.

Economic Costs

There are no comprehensive data on the cost of the litigation system. However, the extent of these costs is apparent from several distinct perspectives.

Expenditures of insurance companies to cover tort claims have been tracked for a number of years. (The tort system is only one part of the litigation system and an even smaller part of the overall legal system.) These expenditures include compensation paid to

plaintiffs (both legitimate awards and those that might be inappropriate) as well as transaction costs incurred by insurance companies. Such measures of costs thus include the real economic burden on society resulting from the transaction costs and financial transfers from defendants and their insurers to plaintiffs, and to lawyers on both sides.

The data from these studies indicate that expenditures on the tort system (including transfers) have constantly increased, particularly sharply since 1984. By this rough estimate, tort system expenditures alone represented 2.3 percent of the country's GDP (\$151.5 billion) in 1994, about twice the proportion of 1966 and four times that of 1950.⁵³ As shown in Figure 3, other industrialized countries devote far less of their resources to a tort system.

The amount the United States spends to run a system of individualized fault-determination and compensation is reflected in the cost and thus the price of products sold and used, and services provided, in the United States. "It is," as one commentator has noted, "one of the most ubiquitous taxes we pay, now levied on virtually everything we buy, sell, and use." While it is called a "safety tax," "its exact relationship to safety is mysterious. It is paid on many items that are risky to use...but it weighs even more heavily on other items whose whole purpose is to make life safer."⁵⁴

These cost estimates reflect only the costs caused by the tort system, not the litigation system more generally. Nor do they reflect the legal and management costs incurred in understanding and complying with numerous complex regulatory laws and executing various kinds of contracts, all under the shadow of possible litigation, public or private. The total cost the legal system imposes on the U.S. economy is not known.

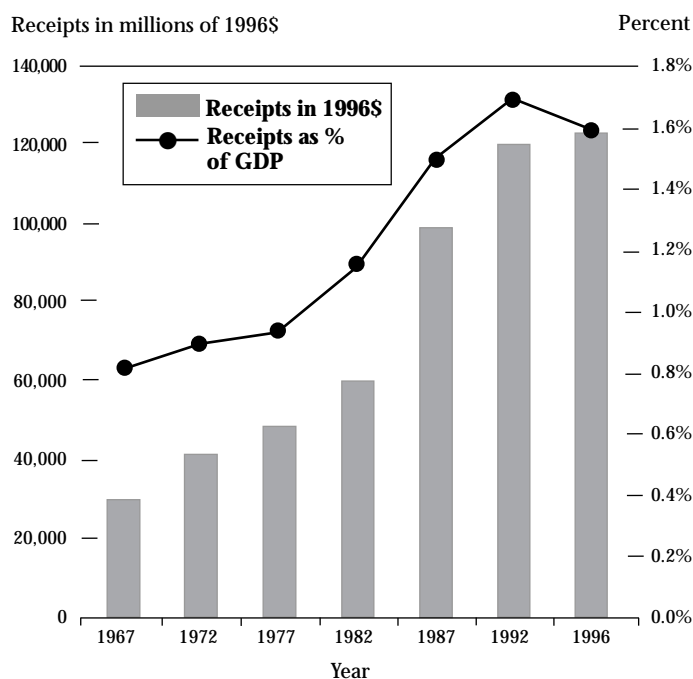
One indicator of the scope of the overall cost of the legal system, however, can be found in Census Bureau statistics on the revenues of profit-making law firms. Just since 1967 (through 1996), their receipts have more than quadrupled, increasing from approximately \$30 billion to approximately \$125 billion in constant dollars.

Their share of GDP has doubled, from 0.8 percent to 1.6 percent in the same time period. See Figure 4. As Derek Bok has observed, the money that is channeled through the legal system attracts some of the brightest and most energetic people to become lawyers, diverting them from other activities with greater economic and social value.⁵⁵

The manner in which the legal system operates also discourages the introduction of new products in the U.S. market and deprives Americans of products that are available elsewhere in the world. We know of no comprehensive study of the impact, but a number of surveys indicate the extent of the problem. Three out of four engineering firms surveyed by the American Consulting Engineers Council in 1994-95 said the threat of lawsuits slowed innovation, and a 1995 study at Duke University reported that

fear of litigation stifled research and development in many major industries.⁵⁶ A survey by the Conference Board found that 47 percent of manufacturers have withdrawn products from the U.S. market because of fear of litigation, and 25 percent have discontinued some product research for that reason.⁵⁷ At the same time, fear of the liability system forces producers increasingly to reallocate resources from new products and innovations to insurance and self-insurance.⁵⁸

Figure 4
Receipts of Taxable Law Firms, 1967-1996



SOURCE: 1967-77 Census of Business; 1978-1996 Service Annual Survey, Bureau of the Census.

The International Institute for Management Development in Switzerland compiles a World Competitiveness Yearbook each year by asking businesses in various countries to evaluate their product liability (tort) systems. In 1999, the United States ranked 32nd worst out of 47 countries with respect to the degree its legal framework is detrimental to competitiveness, and 44th worst on the extent to which its liability systems restricts business.

While there has been strong economic growth and innovation in the United States, litigation costs nonetheless act as a drag on an economy that would have done even better without them.

Social Costs

The emphasis on litigation has broader social consequences. It encourages people to quickly resort to claims and litigation if they are injured or think that some right, or possible right, has been violated. The ordinary slights and frustrations of life too quickly become the grist for litigation. Worse, the promise of easy money through litigation (even though often chimerical) has encouraged people to exaggerate the effect of an injury and their economic loss. The obvious incentive to exaggerate economic loss has been exacerbated by the lure of large non-economic damages in personal injury cases, which typically are awarded at the ratio of 2 to 3 times the plaintiff's proven economic damages.⁵⁹ The temptation to inflate economic losses (mainly medical costs) thus is compounded by the award of non-economic damages. Consequently, 35–42 percent of claimed medical costs in automobile personal injury cases are estimated to be excessive.⁶⁰ The Federal Bureau of Investigation estimates that each American family pays \$200 annually in higher auto insurance premiums to pay for exaggerated and fraudulent claims.⁶¹

A 1997 survey by the Insurance Research Council revealed that the number of Americans who think it is permissible to pad claims doubled in 4 years. Among young people (ages

18-24), almost two-thirds said claims padding was acceptable.⁶² An earlier study by this group indicated that between 1987 and 1992 the number of automobile injury claims for sprains and strains, which are more difficult to verify, was “skyrocketing” and that medical treatment costs increased dramatically even though the claims showed less serious injuries, fewer hospital stays, and fewer disabilities.⁶³ At the same time, outright lying in litigation has increased. A recent newspaper article observed that, “Historically, lying has been most common in criminal cases.... Now it is creeping into civil cases with some regularity.”⁶⁴

Most pervasively, the litigation culture — and the fear of it — has an adverse effect on the spirit and quality of American life. People are, as one example, reluctant to join boards of corporations, even not-for-profit organizations. Employers are wary about giving honest evaluations of former employees, while at the same time they are required to supervise the personal conduct of their workers on the job.

The litigation culture posits that truth and justice are achieved by a process that pits parties against each other in a no-holds barred form of simulated warfare. This sends the message that disputes are best resolved, and even social policy made, by adversarial posturing, contentious argument, and self-serving and exaggerated statements. It inevitably affects how citizens view and deal with each other and consequently the overall tone of society. The litigation culture makes Americans suspicious and institutionalizes a spirit of hostile relationships. Society is organized on adversarial grounds rather than by cooperation or at least civil disagreement. At the same time, ironically, the enhanced role of law and doubts about its efficiency and fairness reduce respect for the law and threaten the rule of law. While giving the impression of doing justice, it too often does the reverse.⁶⁵

Walter Olson has observed that the litigation culture is consistent with no theory of social organization: “No philosophy that champions the rights of individuals should accept

the irresponsible deployment of compulsory process against private citizens or the suppression of free contract.... No philosophy of community and mutual aid should welcome a regime of law that sets people against each other in adversarial bitterness at every turn."⁶⁶

Part II

Incentives to Avoid Litigation



Because of the conditions we have described, we believe it is important to offer Americans alternatives to litigation. Therefore, we recommend below the introduction and use of mechanisms that give injured parties the opportunity and the option to collect fair compensation without litigation. These mechanisms in effect use the money that is now spent in operating the litigation system and paying non-economic damages to provide more victims with compensation for their economic losses without litigation and more quickly than under the current system. They exploit the very inefficiency and injustice of the litigation system, in jujitsu fashion, to construct alternatives to that system.⁶⁷

The Early Offers approach we recommend first encourages potential defendants to offer compensation to claimants and encourages claimants to accept. The second plan we recommend, Auto Choice, reduces the premiums paid by motorists and provides them with more compensation for economic loss resulting from personal injury, more promptly paid.

STRIKING THE APPROPRIATE BALANCE

Compensation can be provided more quickly and more efficiently if the injured party is not required to prove fault. Various arrangements provide compensation for injury in this way. One example is first-party insurance for health, life, disability, and fire risks. The insurer agrees with its policyholders to reimburse them for defined events without considering who or what caused the event.

Compensation without proof of fault has been required by statute in selected areas. Statutes either mandate the purchase of first-party insurance (no-fault automobile insurance) or provide a compensation scheme that is equivalent to first-party insurance, although nominally paid by third persons. Examples of the latter are arrangements such as workers' compensation (paid by the employer), compensation for vaccine injuries (paid by a tax on the manufacturers), and compensation for babies born with neurological defects (paid by a tax on hospitals and obstetricians).

In these instances causation is relatively clear, even before the event. Injury to automobile drivers in most cases is caused by their use of the car. A birth defect in at least one sense was "caused" by the birth. It is usually clear whether an employee's injury is work-related.

However, it has proved difficult in other areas to determine causation before an injury occurs, and mechanisms have not emerged for paying compensation without litigation as to responsibility. The death of a hospitalized patient, for instance, may have been caused by the course of the illness itself or by an action taken by any of the numerous individuals who provided care. Or an injury related to use of a product may have been caused not by a defect but by how it was used or by any of a number of other actions leading to the injury.

The need, therefore, is to balance the goal of efficiently compensating victims by avoiding litigation against the importance of litigating responsibility for injury. The challenge is to provide incentives that make it worthwhile for a potential defendant to enter into an agree-

ment to pay compensation in appropriate cases without requiring the injured party to prove the defendant was at fault. It will often be difficult, however, for the parties to agree on causation and responsibility before an event actually occurs.

One way to avoid the need for a pre-event agreement between the producer and the consumer is for the producer unilaterally to determine, *before* any injury, the conditions under which the producer will offer to pay defined compensation. The consumer then can decide, *after* an injury, whether to accept such an offer. To increase the legal enforceability of the commitment, the producer can enter into a pre-event contract with a third party (such as an insurance company) to make the offer after an injury that meets the defined circumstances.⁶⁸

The pre-event commitment would prescribe the conditions under which an offer would be made, relating, for instance, to the cause, type, and extent of injury. If an event fell within those conditions, the producer (or the insurance company with which he had contracted) would be obligated to make the defined offer. In this way the offer could be accompanied by an explanation that it was being made pursuant to the pre-existing obligation and consequently did not represent an evaluation of the validity of the particular claim. The explanation also could state that the offer was non-negotiable and made pursuant to an obligatory formula. This would mitigate any implication that the offeror thought his case was weak and any inference that the offer was only an opening move in a negotiation process.

Injured parties would have the option to accept or reject the offer. Because they would not be parties to a pre-event agreement, they could decide after the event whether to accept the compensation offer. The opportunity to secure compensation without having to undertake the risk or delay of litigation would often be persuasive. By the same token, the producer avoids the expense, adverse publicity, and dis-

traction of litigation, as well as the risk of a judgment that includes non-economic damages.

This approach has been successfully applied in practice. A number of school districts that were concerned about their potential liability for serious sports injuries contracted with an insurer to offer to pay students' economic losses resulting from a serious injury (defined by the level of medical bills) suffered in the course of school athletics. The students had the option to reject the offer and resort to the tort system. If they accepted, they received an immediate commitment from the insurer to pay their economic losses without having to go through litigation. With rare exceptions, injured students accepted the offers, believing that immediate compensation was preferable to undertaking years of litigation in the hope of establishing liability and eventually collecting compensation for their economic loss and enough non-economic damages to pay their attorneys' fees.⁶⁹

This approach provides incentives to both sides to avoid litigation. It can be done by private agreement and without the need for legislation. However, it requires producers to determine on a general basis and prospectively the circumstances under which they will offer to pay compensation. This is difficult to do.

Compensation is likely to be paid without litigation in more circumstances if potential defendants can decide *after* the event whether to make an offer. This approach avoids the need to predict the conditions under which they believe that compensation is appropriate. However, since they will not have made a pre-event commitment such as that discussed before, producers may not make an offer, particularly because of fear that by doing so they would give a signal of weakness to the claimant. To increase the number of offers, therefore, there must be an incentive for producers to make offers, as well as for claimants to accept them.

EARLY OFFERS OF COMPENSATION

The Early Offers mechanism we describe in this section is designed specifically to provide those incentives for both the consumer and the producer.⁷⁰

Early Offers in General

Under this approach producers who believe a claim might be (or has been) made against them for an event would be encouraged to make, on a case-by-case basis, an early settlement offer after the injury. They would not be required to make an offer and would not have to define before the event the conditions under which they would make an offer. Reciprocal incentives are introduced to encourage the potential defendants to make an offer and the claimants to accept it. The Early Offers compensation arrangement can be implemented by either Federal or state legislation.

A bill to implement this approach was first introduced by Congressmen Henson Moore and Richard Gephardt in 1984.⁷¹ More recently, a revised version was introduced by Senator Mitch McConnell.⁷² To receive the benefits provided by the arrangement, any offer made by the potential defendant has to meet a number of conditions. It must satisfy a formula specified by the statute, such as a commitment to pay all the injured person's economic loss (net of collateral sources) as it occurs over time. An offer would represent a commitment to make payments not only for uncompensated wage loss, medical care, and rehabilitation expense, but also for additional items such as the cost of fixing up claimants' houses to accommodate any disability and the cost of hiring replacement services if they were no longer able to perform household activities.

Compensation would be paid as the loss was incurred over time. The person responsible for making the payments could be required by the legislation to secure the obligation by purchas-

ing a bond or annuity policy from a qualified financial institution.

The offer of compensation would be required to include the reasonable fees of the claimant's lawyer. The value of an accepted offer, therefore, would not be diminished by attorneys' fees; claimants who accepted an offer would receive compensation for all their economic damages.

To further balance the parties' interests, and to give the claimant early relief, an offer would not be a qualifying one unless it were tendered within a certain amount of time (e.g., 120 days). This could be calculated, as provided by the implementing statute, from the event, from the dispatch of a pre-filing notification in cases where the person making the offer could not be expected to know that a claim was possible, or from the filing of a lawsuit.

A pre-filing notification would require prospective plaintiffs to notify potential defendants, before they filed a lawsuit, of the events that they believed supported the suit. In many cases the first notice a party receives is receipt of a summons and complaint starting the lawsuit (often accompanied by demands to begin discovery). Not only may defendants not have any advance notice that they are about to be sued, they may not even know that they have taken an action that might have harmed another person, or done so by not taking an action. This lack of prior warning is unfair, and it raises the anger level of the litigation (and indeed is intended by plaintiffs to be confrontational). Most importantly, it makes settlement more difficult. Requiring pre-suit notification would improve the climate and make settlement under Early Offers more likely. The claimants themselves, not their lawyers, should be required to sign the notice. In this way, the prospective plaintiff would bear more responsibility for the letter, and it would be less threatening to the recipient.

Potential claimants have an incentive to accept a qualifying offer. They receive a rapid

commitment to pay their economic loss without litigation. The Early Offers plan introduces a further incentive for them to accept—and for defendants to make the offer: if a qualifying offer is made and the potential claimant rejects it and goes to court, the resulting litigation would be conducted under rules that were less favorable to the plaintiff. These restrictions would apply only where the claimant had been tendered a qualifying Early Offer to pay economic losses and rejected it in the hope of collecting non-economic damages. Various restrictions can be used as incentives.

Under the McConnell bill, a plaintiff who refuses a qualifying offer would be subject to a higher burden of proof (clear and convincing evidence) and a different standard of liability (intentional or wanton misconduct) for recovery of non-economic damages. The higher standards could apply to the recovery of economic damages as well, to encourage offers and acceptances. Acceptance of an offer also could be encouraged by requiring a claimant who rejects a qualifying offer to pay the defendant's legal fees if the plaintiff does not win the resulting case or does not win as much as was previously offered.

It is possible that a claimant could accept an offer for economic damages and (as is the case whenever one of several defendants settles) then use the assurance of receiving compensation for economic loss to finance a virtually risk-free effort to collect non-economic damages from other participants in the event. To avoid this result and to reduce litigation, the Early Offer could include other people who might be sued. The person making the offer could include the other actors. If the offeror did not do so, the others could demand to be included. The participants typically would be covered by insurance companies that did business with each other on an on-going basis, and they would be expected to decide among themselves how to divide responsibility for payments made to the claimant. If they did not agree, allocation of responsibility for the payment

could be settled by arbitration among themselves and without involving the claimant as a party.

Other Benefits of Early Offers

The Early Offers plan significantly neutralizes the possibility that injured parties will interpret a settlement offer as an opening gambit in negotiations and as a signal that they could eventually recover more, which would spur further litigation. If the qualifying offer is accepted, there is no further litigation. If it is rejected and the claimant goes to court, the statute would provide not only that the Early Offer could not be revealed to the fact finder but also that the rules of the subsequent litigation would be different. Any tactical comfort that the claimant would find in the fact that an Early Offer was made would be offset by the effect a rejected offer has in the conduct of the resulting litigation.

Early Offers requires a potential defendant who wants to use it to make a settlement offer very early in the dispute process — in some cases even before lawyers have been retained but in most cases before they have dug in for a fight. This ensures that victims can receive rapid payment of compensation, when they most need it.

Early Offers also enhances public safety. The need to make a quick offer will encourage rapid reporting of adverse events within an organization, since the opportunity to make a qualifying offer can under certain circumstances be lost if not made quickly after an event. This practice will improve information gathering by the producer and thus facilitate any needed improvements in its operations.

The dynamic of Early Offers confers a further and unique benefit. It may calm the animosities that emerge from an incident, rather than inflaming them as the litigation culture now does. It permits those who cause an injury to admit it and even to discuss what happened—the normal human response—without fear that doing so will nullify their insur-

ance coverage or be used against them in a subsequent liability action if the offer is rejected. Under the current system, on the other hand, an apology, admission of fault, or even an explanation of the event, can at the same time nullify the insurance coverage and increase the claimant's chance of recovery in any subsequent lawsuit.

This process of discussion and explanation could be made mandatory as a further inducement to settlement. The Early Offers plan could provide that if a claimant accepts an Early Offer and wishes to receive an explanation of the incident, the offeror must provide it in order to make the acceptance effective. It could require the offeror, if requested, to meet with the accepting claimant to give the explanation. This would enhance the incentive for claimants to accept an offer and would increase the instances in which the offer is psychologically beneficial to them.

Early Offers, therefore, permits the parties to discuss what happened and makes apologies possible, instead of forcing the potential defendant immediately into a defensively combative posture. It fosters understanding and cooperation rather than antagonism. This is particularly important where there is a personal relationship between the claimant and the producer, as in the case of medical care.

Applications of Early Offers

BASIC PLAN

Early Offers can apply in a broad range of matters. Its basic structure is tailored to tort claims for injury resulting from a product or service. A producer presented with a claim that his product caused injury could make a qualifying offer. Early Offers could also be used in automobile accidents.⁷³ Drivers who believed they were negligent could (presumably through their insurance company) make a qualifying offer to compensate those they injured for the economic loss.

EXTENSION TO NEW RIGHTS

Early Offers could be expanded beyond traditional tort claims to cases involving rights created by legislatures. For instance, in employment cases, if an employee makes a claim of discrimination, the employer could make a qualifying offer, and the employee could either accept the offer or go to court under the changed rules. In each category of case, the qualifying offer would have to be defined by statute. Net economic loss is a standard for tort; for employment discrimination, for instance, it could be lost wages for a stated number of years, or scheduled amounts for various types of conduct.

REFORM OF CONTINGENCY FEES

A variant of Early Offers could be applied to create strong economic incentives to protect plaintiffs from paying contingency fees that are not commensurate with the risk and effort undertaken by the lawyer.

The possibility that the plaintiff would have to pay excess contingency fees can be used to increase the incentives for settlement. At no additional cost to the defendant, more money can be made available to the plaintiff by limiting unwarranted contingency fees. Defendants could make a settlement offer (as fashioned by them and independent of the formula for a qualifying Early Offer) within a short time after a claim was made. The lawyer's contingent fee on the amount of the settlement offer, whether accepted or rejected and subsequently recovered through settlement or litigation, would be limited to hourly charges or to some percentage (e.g., 10 percent of the settlement offer) that would be substantially less than the percentage that would otherwise be permitted (usually 33 percent or more).⁷⁴ This could be accomplished by court rule or legislation. Because more of the settlement offer would be available for the plaintiff, settlement would be more likely.

MASS TORTS

The Early Offers approach also has the potential to resolve cases in which there are a large number of plaintiffs. While one may be dubious about the applicability of the arrangement in cases with such large potential liability for the defendant, it provides benefits to both sides and could work even in such cases. A defendant who faces a large number of claims could make an Early Offer. Or, if some claimants had won a judgment, a defendant who was faced with claims from multiple other alleged victims could make an Early Offer to settle them. To the extent a class lawsuit is driven by plaintiffs' interests, rather than those of their lawyer, they would have the same incentive as other claimants, suing individually, to accept.⁷⁵ A generally applicable statute structuring Early Offers might work in these cases without adjustment. If, however, it did not induce enough offers and acceptances, the statute could be tailored to the particular situation.

There may be cases, however, in which the defendant could not make an offer of economic damages without risking its own destruction. In that case, the legislature could set different terms for a qualifying offer. If the defendant were not willing to make qualifying offers under the defined terms, it would be subject to a mass-plaintiff class action as it is now.

Issues in the Application of Early Offers

Certain criticisms have been raised about Early Offers. One is that it might open the door to more claims than are now being filed. This criticism misses the point of the Early Offers approach, and indeed of the civil justice system. If more wrongfully injured people are compensated more adequately and more quickly for genuine economic loss, while less money goes to pay the transaction costs of the litigation system and the payment of non-economic damages, that is a gain for society. The purpose of Early Offers is not to reduce plaintiffs' recovery. It is designed to avoid the adverse economic and societal effects of litiga-

tion, simultaneously saving money for defendants and providing more net compensation more quickly for more injured parties.

Questionable claims are not likely to receive Early Offers. The decision as to whether or not to make an offer rests in the hands of the (potential) defendants. They will not make an offer unless they believe doing so is more advantageous than spending the money for defense costs under the litigation system and taking the risk of losing the case and ultimately paying large non-economic damages. If a claim clearly lacks merit, the defendant is not likely to make an offer.

Another criticism argues, conversely, that potential defendants will not make enough offers—that they will make them only where they have acted egregiously and anticipate having to pay large amounts of non-economic damages. One defense lawyer, however, has estimated that, given the risks and costs of litigation, defendants would make the offer in 200 of the 250 cases his firm was handling.⁷⁶ Nevertheless, even if offers were made only where the defendant expected to lose, the arrangement would be effective. Claimants have a choice. They can accept the offer and receive a commitment for payment of economic damages quickly and without having to go through the litigation system. Or they can reject it. All they “lose” by accepting the offer is the possibility that they may eventually collect a payoff of non-economic damages, much of which in any event would go to pay the legal fees they avoid by accepting the offer.

We believe that leaving open the possibility that claimants may recover non-economic damages in excess of their lawyers' fees is less valuable and less important than ensuring that they receive full compensation quickly for their economic loss. In any event, if claimants reject the offer, they remain free to go to court to prove, under a higher evidentiary standard, that the conduct was wanton or intentional and to collect non-economic damages. In this way, the tort litigation system is avoided for more routine cases, but left for the serious

cases involving the worst conduct, where it is more appropriate.

It has also been asserted that Early Offers is unfair to those who do not work or who have low-wage jobs and therefore suffer less economic loss.⁷⁷ The contention is that this discriminates against the poor and retired; they have less economic damage to recover, and their ability to collect non-economic damages is affected if an offer is made and rejected. Complaints that poor victims will receive “only” their economic damages betray the distortions of the litigation system. It harks back to the “Hit Me, I Need the Money” bumper sticker. We believe it is better both for individual victims and society as a whole that victims recover economic losses quickly than to be forced into litigation, from which only some will emerge with recoveries larger than their economic loss.

Early Offers would provide poor accident victims significant improvements over the present compensation system. It would encourage speedy compensation for medical costs and lost wages to those who are most likely to need the money immediately. And, as discussed before, poor victims are less likely to pursue litigation than those with higher incomes, and if they do recover are likely to receive lower amounts.

Finally, there is a question of whether Early Offers operates fairly where there is a serious injury that results in insignificant economic damages. The problem is not likely to occur often. A serious injury is likely to result in economic loss (lost wages and medical and rehabilitation expenses). Thus most victims who have suffered a serious injury will be compensated for their economic loss in exchange for giving up the right to pursue non-economic damages.

If, moreover, the defendant’s conduct is egregious (intentional or wanton) and can be established by clear and convincing evidence, the victim can recover non-economic damages, even if an Early Offer is made and rejected. Early Offers provides a mechanism for encouraging settlement of cases of ordinary negli-

gence, while leaving the traditional remedies available for victims of more serious wrongdoing.

There may, however, be cases in which the economic loss is relatively insignificant compared with the potential for recovery of non-economic damages and the particular claimant cannot establish wanton or intentional misconduct under the heightened burden of proof. The question, therefore, is whether qualifying Early Offers should be required to include an amount for non-economic damages.

Early Offers works through a balance. Victims who suffer economic loss are compensated quickly and without litigation in exchange for forgoing the opportunity to pursue non-economic damages. This tradeoff provides the incentive for defendants to make an offer. They give up the chance to establish in court that they are not legally responsible and commit to pay compensation in exchange for avoiding the cost of litigation and possible non-economic damages. If an Early Offer were required to include compensation for non-economic losses, the incentive for potential defendants to make an offer would be reduced. They are more likely to insist on denying liability and litigating if the only Early Offer they can make is one comparable to what they could expect as a worse case outcome from the litigation, particularly since compensation under Early Offers is paid promptly without the deferral that litigation and appeals provide even to a losing defendant.

Prospective defendants thus would have little incentive to make an offer that in effect quickly conceded what the plaintiffs would otherwise be able to recover only if they were successful in litigation after substantial effort and expense over an extended time. As a result, fewer offers would be made, and fewer victims would receive rapid commitments to compensate them for their economic loss.

Workers already are compensated under an even more restrictive tradeoff. Workers’ compensation provides no payment for non-economic loss (except for scheduled payments for

certain defined injuries, such as loss of a limb). Workers do not have the opportunity to reject the compensation and pursue litigation for non-economic damages that is available under Early Offers. In exchange, they receive compensation for work-related injuries without having to establish that the employer was at fault. This exchange has been determined to be socially beneficial and is mandatory on the worker. We believe similarly that it is more important to compensate more victims for their economic loss without litigation than to add compensation for non-economic loss to Early Offers.

Victims of clearly egregious conduct, therefore, are not affected by the tradeoff. At the same time the proposal benefits the majority of victims with more ambiguous claims who may recover nothing or, if they are “successful,” are likely to recover less than their economic loss after a lengthy and costly litigation battle.

Nevertheless, if it is thought appropriate to include non-economic damages, the Early Offers plan could require that a qualifying offer be made with a minimum or scheduled amount for specified grievous injuries in addition to the commitment to pay net economic loss (like workers’ compensation).⁷⁸ In deciding whether to require such offers for non-economic damages, however, it must be remembered that the more such requirements are added to Early Offers, the fewer offers for payment of economic loss will be made.

Early Offers exchanges a rapid commitment by the potential defendant to provide potentially long-range and expensive compensation of the claimant’s economic damages for the claimant’s ticket in the lottery for non-economic damages. Both parties avoid litigation, and compensation is provided more rapidly and more fairly. This mechanism would reduce litigation, for the benefit of the potential litigants and of society in general. It is a principled and practical mechanism that should be applied widely. **We recommend that the legislation necessary to implement Early Offers be enacted, at either the Federal or state level, and that potential litigants use it whenever possible.**

AUTO CHOICE INSURANCE

Another plan for introducing economic incentives to avoid litigation has been worked out specifically for handling personal injuries in automobile accidents. Auto Choice is a second comprehensive scheme that provides rapid compensation of economic loss in exchange for forgoing pursuit of non-economic damages.

Auto Choice gives car owners, for both personal and business use, the option to obtain less expensive insurance that pays economic compensation for personal injury quickly.⁷⁹ The present compensation system, achieved through litigation, pays nearly three times as much for the lawyers who run it and for the fraud that results from the availability of non-economic damages as for real medical costs and lost wages.⁸⁰ The Insurance Research Council has found that auto insurance claimants who hire attorneys receive average net settlements that are lower than claimants who do not, even though they incur larger damages. This is because claimants pay an estimated 32 percent of their gross settlements in legal expenses.⁸¹ By offering a way to provide compensation without litigation in most cases, Auto Choice offers consumers both lower premiums for their insurance and higher recoveries, on average, for serious personal injury than the present system.

The proposal is most recently embodied in legislation introduced in Congress.⁸² Although it is currently the subject of Federal legislation, the proposal also could be implemented by state legislation.

Under the bills now pending before Congress, drivers would be offered a choice between two kinds of personal injury insurance: one would cover their economic losses without proof of fault (Personal Injury Protection, or PIP); the other would cover economic and non-economic damages upon proof of fault under the rules of the conventional tort system (Tort Maintenance Coverage, or TMC).

Under PIP coverage, drivers collect only economic damages, from their own insurer, but

do not have to prove negligence to do so. The PIP driver can neither sue nor be sued for non-economic damages. Injured PIP drivers may sue under the traditional fault-based system for economic damages that exceed their own policy's coverage limits.

With TMC, drivers must prove the other driver's negligence, going through the litigation system as now but naming their own insurer as the defendant, as is currently the case under uninsured motorists coverage.⁸³ If they prevail, they can collect non-economic as well as economic damages.

Because PIP avoids proof of fault and dispenses with non-economic damages, it avoids most of the cost of the litigation system. TMC, however, preserves non-economic damages, requires proof of fault, and thus continues the current litigation system. PIP will be substantially less expensive than TMC. It is estimated that Auto Choice (in the form of the proposed Federal legislation) would on average reduce auto insurance premiums 23-24 percent (55-57 percent for the personal injury component of the insurance).⁸⁴ The Joint Economic Committee of the United States Congress has estimated the savings at \$184 per car per year, implying that total savings would be approximately \$35 billion per year if all motorists selected PIP. (See Figure 5). Of this, \$27 billion would be saved by consumers.⁸⁵

This is particularly important for low-income families. The lowest income quintile now spends 16.3 percent of household income for car insurance. Low-income drivers, in general, could reduce their premiums by 36 percent under Auto Choice.⁸⁶ These savings for low-income consumers would be especially significant for residents of cities. They need cars to work, but the cost of insurance in these areas can be prohibitive. Affordable auto insurance will help city dwellers find work and at the same time alleviate the problem of uninsured motorists.⁸⁷

Business also would benefit from selection of the PIP alternative. Nearly 40 percent of all automobile cases that go to trial are against businesses, and 39 percent of all tort cases

Figure 5

Estimated Savings from Auto Choice in 1998

	Private	Commercial	Total
Average premium savings	22.8%	27.5%	23.7%
Average savings per car	\$184	—	—
Savings for low-income drivers	36%	—	—
Total available savings if 100% switch (billions)	\$27.4	\$8.1	\$35.5

SOURCE: Joint Economic Committee of Congress, *Auto Choice: Impact on Cities and the Poor*, 1998.

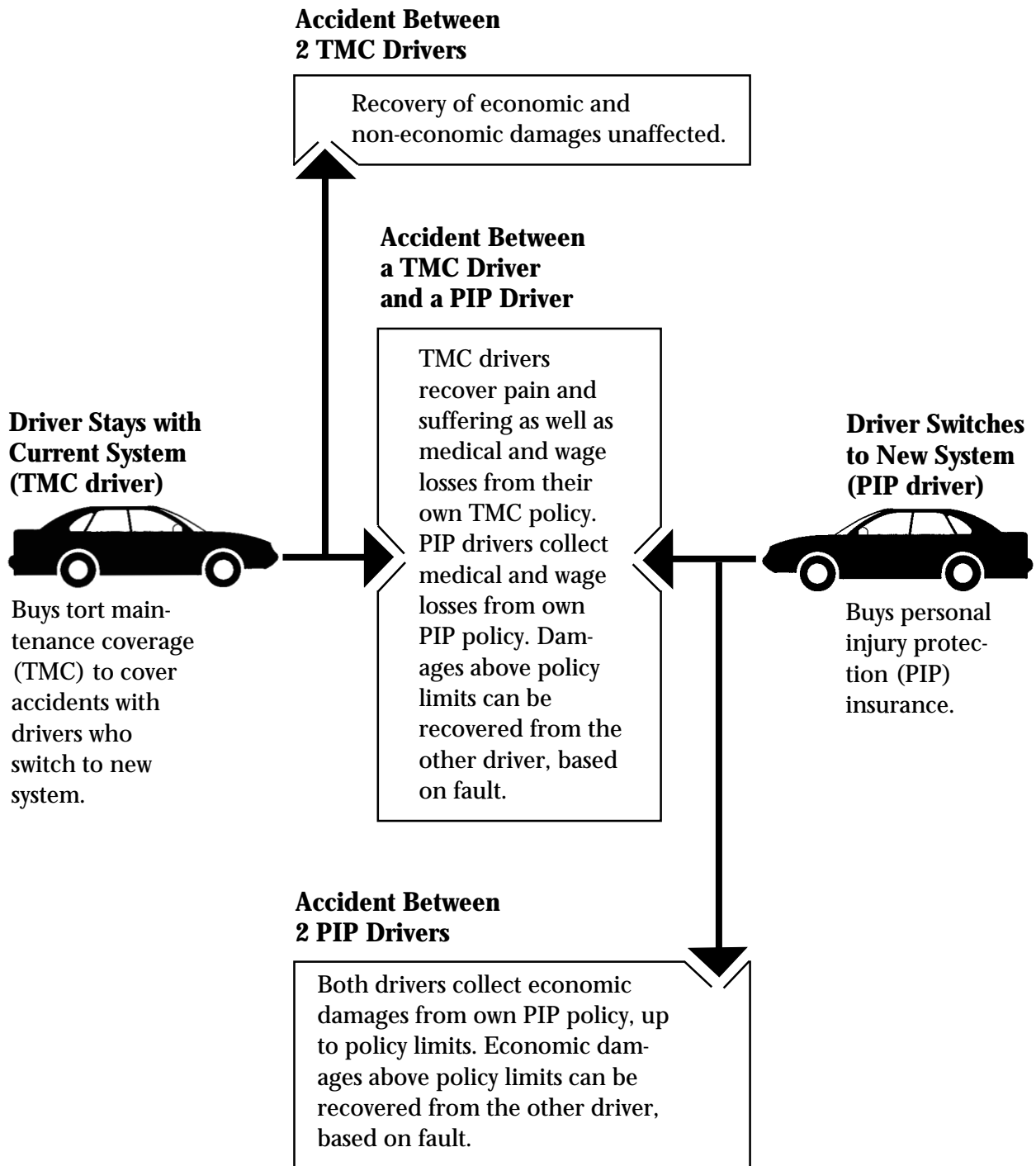
against business are related to car ownership.⁸⁸ With PIP, businesses could save 27 percent of their auto premium costs, or \$8 billion in the aggregate.⁸⁹

Because drivers may choose between the different types of insurance, an accident may involve a driver who has selected PIP coverage and one who has not. This creates complexities that may be handled in different ways. Under the proposal in Congress, PIP drivers would be compensated for their economic loss resulting from an injury whether they were negligent or not and whether the other driver was negligent or not. TMC drivers would collect from their own insurer if they could prove negligence of the PIP driver.⁹⁰ Either a PIP or a TMC driver could sue the other driver for any economic loss in excess of their own first-party coverage; traditional principles of fault would apply. (Figure 6, page 24, is a schematic of how Auto Choice works.)

The approach can include appropriate exceptions. The proposed Federal legislation, for instance, permits recovery for non-economic loss by or against PIP drivers if they or the other driver were driving under the influence

Figure 6

How Auto Choice Works



SOURCE: Joint Economic Committee of Congress

of alcohol or illegal drugs or committed intentional misconduct. In that case the traditional tort system would apply, as it would if two TMC motorists collided; both economic and non-economic damages could be awarded upon proof of fault.⁹¹

Auto Choice would enable drivers to buy the amount of coverage (above state-mandated minimums) that they believe is appropriate to protect themselves from economic loss, including that caused by the negligent actions of others. Under the current system, an innocent driver who is injured by the negligence of another is able to recover damages only if the other person has sufficient insurance coverage to pay the damages.⁹² Auto Choice, on the other hand, enables drivers to determine for themselves the level of insurance payment when they are injured, whether by their own or another driver's negligence, and whether they select PIP or TMC. The injured drivers' ability to be compensated does not turn on the amount of insurance a wrongdoer may carry but is within their own control. The essential features of Auto Choice in comparison with the current system are outlined in Figure 7, page 26.

The Joint Economic Committee has summarized the benefits of the Auto Choice approach, emphasizing the fact that it gives consumers a choice and a chance to realize savings by opting out of the traditional tort system. As its report says, "... pain and suffering premiums are unbundled from economic damage premiums... [and]... insurance is primarily shifted to a first-party basis." By unbundling the tort rights, Auto Choice "constitutes a significant improvement over the current situation in which all individuals are forced to purchase essentially the same type of coverage [requiring proof of fault], regardless of their individual preferences and tastes." At the same time, it compensates for serious injuries better than the present system, because drivers can, in purchasing first-party insurance, determine their own coverage levels, whereas under the current system they are as a practical matter "at

the mercy of policy limits set by" the driver who injures them.⁹³

Auto Choice has been criticized on the ground that bad drivers would not have to pay for the cost they impose on others and hence that more bad drivers would be on the road than under the current system.⁹⁴ Apparently the concern is that since PIP drivers could not be sued for non-economic losses, they would have lower premiums (as indeed is the purpose of the plan) and thus bad drivers could avoid the costs of their bad driving by choosing PIP. In effect, the argument is that awards for non-economic damages are necessary to raise the premiums of bad drivers and discourage them from driving.

However, this criticism overlooks several features of Auto Choice. Insurers can raise the premiums of drivers involved in accidents even if they do not have to cover non-economic damages. The PIP insurer will know of accidents involving its insured drivers. As contemplated by the pending legislation, PIP does not apply if a driver causes only property damage. The PIP insurer will cover claims filed against it for that loss under conventional tort coverage and will learn of the accident when the other driver makes a property damage claim. If PIP drivers injure themselves, they will file claims against their insurers. Only if PIP drivers injure another, but not themselves, and are somehow able to do so without causing property damage, will claims not be filed with their insurers—a rare congruence of events.

Even then, PIP drivers' insurance companies can and will learn of their driving records. The insurer will require the driver to report relevant information as a condition of coverage (with the threat of cancellation for false answers), and it will review the records of the police and motor vehicles departments. In almost every case, therefore, the insurance company will know if a driver it insures presents a high risk, and it can rate accordingly.

In any event, relying on higher premiums may not be the best way to promote safety. The

Figure 7**Comparison of Fault Liability Insurance System and the Personal Injury Protection (PIP) System of Auto Choice**

Fault/Liability Insurance System	Personal Injury Protection System
Pays no benefits to more than 30% of all accident victims (often the victims of single-car accidents).	Pays benefits to all accident victims.
Pays benefits contingent on other driver's fault.	Pays benefits to all accident victims, regardless of fault.
Fraud: more than one-third of all medical claims are fraudulent to support higher non-economic damage awards.	Reduces incentives for fraud by eliminating recovery of non-economic damages.
Recovery contingent on other driver's behavior and auto insurance coverage.	Recovery determined by individual's own choice of insurance coverage.
<ul style="list-style-type: none"> • Minor injuries compensated at an average of 2 to 3 times economic loss. 	<ul style="list-style-type: none"> • All economic loss compensated up to the level of coverage selected.
<ul style="list-style-type: none"> • Serious injuries compensated at an average of less than 50% of economic loss. 	<ul style="list-style-type: none"> • Victim may sue for excess economic loss.
In serious injury cases, pays for losses only after trial or settlement, which can take 2 to 3 years.	In all cases, pays for insured losses within 30 days of submission of a bill.
Pays more dollars for lawyers than for victims' legitimate medical bills and lost wages.	Eliminates the need for most lawyers. Uses the savings to pay more injured people more equitably and to lower premiums.

SOURCE: The Coalition for Auto-Insurance Reform.

higher premiums caused by the current system affect everyone—good and bad drivers alike. In some urban areas, 50 percent or more of the drivers already are uninsured, despite laws requiring the purchase of insurance.⁹⁵ The people they hit have no recourse except to the extent they have purchased uninsured motorists coverage. Auto Choice would enable drivers better to protect themselves at a lower premium. Good drivers, therefore, will be better protected. People who do not now buy insurance because of the cost will be more

likely to buy insurance. High-risk drivers will still pay higher premiums than others, but are more likely to be insured.

Auto Choice is a detailed example of a prevent contract mechanism, implemented through statute, that offers consumers a choice of whether they want to go through the litigation system or accept defined compensation (in this case, economic damages) without resort to litigation. Payment without proof of fault works in this circumstance because the cause of automobile accidents is relatively clear.

Auto Choice appears to work particularly well because insurance is a major purchase and consumers save a significant amount of money immediately. In addition, the person offering the choice (the insurer) is not suggesting that *its* product will injure anyone. The insurer merely agrees that if the purchaser of its product (insurance) is injured in the course of using a product supplied by someone else (the car), compensation will be handled under one scheme rather than another. Further, the choice is offered when the consumer has already decided to buy the product. The driver already is in the market for insurance. Auto Choice offers the consumer a choice of two different models of that product.

Adoption of Auto Choice will benefit the litigation system generally. Litigation relating to motor vehicle accidents is a large part of the courts' caseloads. Approximately 60 percent of all tort cases relate to automobile accidents; 59 percent of those who receive tort liability pay-

ment are injured in motor vehicle accidents, and they receive 75 percent of the total dollar compensation paid to accident victims of all sorts.⁹⁶ Removing a significant number of these cases from the litigation system will reduce the pressure on courts, as well as helping the accident victims themselves. As a result, other types of litigation, which cannot be avoided by Auto Choice or by the Early Offers approach, should receive more rapid and better justice.

We recommend that Auto Choice be implemented, at either the Federal or state level. In its own right, Auto Choice will save substantial amounts of money for drivers. It will reduce the number of cases brought to the courts and thus make justice more accessible to others who need to use the courts. Most importantly, its success would demonstrate the benefits of compensation systems that avoid litigation. We recommend that efforts be made to develop ways of extending this approach to other sectors.⁹⁷

Conclusion



The litigation system is neither fair nor efficient. It is harmful to the participants and to society as a whole. America relies too heavily and too easily on litigation as the way to resolve disputes and provide compensation.

We recommend two mechanisms that offer potential litigants — both plaintiffs and defendants — an option to avoid litigation and economic incentives to exercise it.

1. Early Offers encourages producers to make an offer to pay compensation after an injury and provides an incentive for claimants to accept it. We believe this plan would substantially reduce litigation and provide more victims more compensation for their economic loss than the current system. We urge the legislatures — whether Federal or state — to enact the necessary measures to permit Early Offers to work as designed, and we urge all Americans to invoke the mechanism once it is in place.
2. Auto Choice gives American drivers a choice in the kind of compensation arrangement they want to apply in case of personal injury. Auto Choice would let them buy less expensive insurance that provides first-party coverage of economic loss and avoids litigation of fault and the award of non-economic damages. Because it would be less expensive and provide automobile accident victims compensation more quickly and without litigation, we believe many Americans would choose this course. We urge the legislatures — whether Federal or state — to pass the legislation necessary to give Americans this choice.

These are balanced reforms. They do not give defendants unearned benefits. Instead, they give injured parties the opportunity for speedy recovery and without litigation.

In the case of Early Offers, defendants and plaintiffs are given a way to avoid litigation to the benefit of both. Defendants win this benefit only by making a major commitment—to pay the victim's economic loss (which is the essential purpose of a compensation system). Claimants—in particular severely injured victims — benefit by having this new opportunity. Their rights are changed only if an Early Offer is made and they decline it — an adjustment that is necessary to make the new right available in the first place.

With Auto Choice, drivers can choose to give up the chance to recover non-economic damages in exchange for protection against such suits being brought against them, quicker compensation for themselves without litigation if they are injured, and lower insurance premiums. But they are not forced to take this option. They are given a choice, as they are more generally with Early Offers.

Our recommendations chart a course for reform. But they also reflect questions about the role of law and litigation in American life that should be explicitly addressed by the American people. We urge a wide-ranging and broadly participatory debate about the extent to which the legal system is eroding the essential principles of our society. We hope a debate will lead the American people in the direction of the reform represented by our recommendations and stimulate the development of additional approaches that will restore confidence in our legal system.

Endnotes

1. Derek Bok, "A Flawed System," *Harvard Magazine* May-June 1983, p. 38.
2. "Patients, Doctors, and Lawyers: Medical Injury, Malpractice Litigation, and Patient Compensation in New York," *The Report of the Harvard Medical Practice Study To the State of New York* (1990) pp. 6-7.
3. Walter Olson, *The Litigation Explosion* (New York: Truman Talley Books, 1991) p. 5.
4. Consistent with the recommendations in CED's policy statement on regulation, *Modernizing Government Regulation: The Need for Action* (1998), we urge that legislation be written more precisely and avoid leaving the policy choices to regulatory agencies and the courts; also that the real-world effects of legislation be examined by independent entities.
5. Thus the courts refused to enforce disclaimers of liability for injury suffered from use of a product and expanded the theories on which the producer could be liable, believing that in the absence of a national social insurance scheme, injured parties needed compensation and that producers could spread the costs of compensation most efficiently. See, The American Law Institute, *Reporters' Study on Enterprise Responsibility for Personal Injury*, 1991 ("ALI Study"): Vol. I, "The Institutional Framework," pp. 14, 15, 521; Vol. II, "Approaches to Legal and Institutional Change," p. 16. The Study was not adopted by the ALI itself; see Jerry J. Phillips, "Comments on the Reporters' Study of Enterprise Responsibility for Personal Injury," 30 *San Diego Law Review* 241 (1993). See also, George L. Priest, "The Liability Crisis: A Diagnosis," 34 *Yale Law Journal* 2 (1987).
6. See Jonathan Rauch, "Tunnel Vision," *National Journal* September 19, 1998, p. 2148.
7. See generally, Victor Schwartz, Mark Behrens, and Mark Taylor, *Who Should Make America's Tort Law: Courts or Legislatures* (Washington, DC: Washington Legal Foundation, 1997), discussing judicial nullification of reforms by state legislatures.
8. "When Lawsuits Make Policy," *The Economist* November 21, 1998, p. 17. See also Joseph Nocera, "Who's Running this Country, Anyway? We, the Lawyers" *Fortune* November 8, 1999, pp. 38-9.
9. Quoted in The Brookings Institution, *Justice for All: Reducing Costs and Delay in Civil Litigation* (Portland, Oregon: Booknews, Inc., 1990) p. 35.
10. Lester Brickman, "Will Legal Ethics Go Up in Smoke?" *Wall Street Journal* June 16, 1998, p. A18.
11. Law firms in nine states have thus far opted for negotiation of their fees directly with the tobacco industry, through a liquidated fee arrangement, and have been awarded \$295 million; see Melissa Kozlowski, "Tobacco Arbitration Panel Awards \$8.2 Billion," *Law Journal Extra* December 11, 1998, for the settlements in eight of those states; see Anthony Jewell, "Tobacco companies, law firms reach deal on fees," *Minneapolis Star Tribune* June 22, 1999, for settlement in Wisconsin. Lawyers in Texas, Mississippi, and Florida were awarded \$8.2 billion by arbitration and lawyers in Massachusetts, Hawaii, and Illinois have also been awarded their fees; see Barry Meier, "Lawyers in Tobacco Case will Receive \$8.2 Billion," *New York Times* December 12, 1998. An established Tobacco Fee Arbitration Panel (with two permanent members and one state-selected member) reviews appropriate fees in each state. Although the precise amount which will be recovered in attorneys' fees in all 50 states is not known until the arbitration panel completes its work, estimates range from \$10 - \$65 billion; see Bob Van Voris, "That \$10 Billion Fee," *National Law Journal* November 30, 1998; Lester Brickman, "Want to Be a Billionaire? Sue a Tobacco Company," *Wall Street Journal* December 30, 1998; James Pinkerton, "All Beware: The Lawyers are Coming," *Newsday* January 21, 1999.
12. See James Kakalik, Molly Selvin, and Nicholas Pace, *Averting Gridlock: Strategies for Reducing Civil Delay in the Los Angeles Superior Court* (Santa Monica, CA: The RAND Corporation, 1990).
13. Federal Judicial Center, "Federal Court Cases: Integrated Data Base, 1970-1995," Inter-University Consortium for Political and Social Research (ICPSR), Study #8429 (Ann Arbor, MI: University of Michigan, 1996). Trial rates for civil cases in Federal Courts were calculated from ICPSR data using the "Judicial Statistical Inquiry Form" created by Theodore Eisenberg and Kevin M. Clermont, available at <http://teddy.law.cornell.edu:8090/questata.htm>. Using the same data, the Bureau of Justice Statistics found that in 1994-95, 4.1% of tort cases were resolved by bench or jury trial; see Bureau of Justice Statistics, *Federal Tort Trials and Verdicts, 1994-95* (Washington, DC: United States Department of Justice, 1997). State court trial rates for 1992 are available from the National Center for State Courts, Civil Trial Court Network (NCSC) and can be found in Brian Ostrom and Neal Kauder, eds, *Examining the Work of the State Courts, 1996* (National Center for State Courts, 1997) p. 25.
14. President's Council on Competitiveness, *Agenda for Civil Justice Reform in America* (1991) p. 3.
15. Jeffrey O'Connell and C. Brian Kelly, *The Blame Game* (Lexington, MA: Lexington Books, 1987) p. 126.
16. Walter Olson, *The Litigation Explosion*, p. 229.
17. Derek Bok, "A Flawed System," pp. 38-39.
18. W. Kip Viscusi, "Pain and Suffering in Product Liability Cases: Systematic Compensation or Capricious Awards?" 8 *International Review of Law and Economics* 203, 205 (1988), extrapolating from Insurance Services Office Product Liability Closed Claims Survey.
19. Jeffrey O'Connell and Keith Carpenter, "Payment for Pain and Suffering Through History," *Insurance Counsel Journal* July 1983, p. 411.
20. W. Kip Viscusi, "Pain and Suffering in Product Liability Cases: Systematic Compensation or Capricious Awards?" p. 204; see also, David W. Leebron, "Final Moments: Damages for Pain and Suffering Prior to Death," 64 *New York University Law Review* 256 (1989).
21. W. Kip Viscusi, "Pain and Suffering in Product Liability Cases: Systematic Compensation or Capricious Awards?" p. 217.
22. W. Kip Viscusi, "Pain and Suffering in Product Liability Cases: Systematic Compensation or Capricious Awards?" p. 207;

- ALI Study, Vol. II, p. 201. See also, Deborah R. Hensler et al., *Compensation for Accidental Injuries in the United States* (Santa Monica, CA: The RAND Corporation, 1991), calculating that of the \$15.7 billion in liability payments made in a year, damages for pain and suffering totaled \$5.2 billion (33%).
23. ALI Study, Vol. II, p. 201; W. Kip Viscusi, "Pain and Suffering in Product Liability Cases: Systematic Compensation or Capricious Awards?" p. 208.
24. *BMW v. Gore*, 517 U.S. 559 (1996); *TXO Production Corp. v. Alliance Resources*, 509 U.S. 433 (1993); *Pacific Mutual Life Insurance Co. v. Haslip*, 499 U.S. 1 (1991).
25. Cass R. Sunstein, Daniel Kahneman, and David Schkade, "Assessing Punitive Damages (with Notes on Cognition and Valuation in Law)," 107 *Yale Law Journal* 2071, 2076 (1998).
26. Erik Moller, Nicholas Pace, and Stephen Carroll, *Punitive Damages in Financial Injury Verdicts* (Santa Monica, CA: The RAND Corporation, 1997). The five jurisdictions represented one-quarter of the U.S. population.
27. Stephen Turner, Lawrence Jerz, Robert Fuller, George Branch, and James Miller, *Punitive Damages Explosion: Fact or Fiction?* (Washington, DC: Washington Legal Foundation, 1992).
28. See *Texaco Inc. v. Pennzoil Co.*, 729 S.W.2d 768 (Tex. Ct. App. 1987). See also ALI Study, Vol II, p. 232.
29. P.L. 102-166.
30. See Public Policy Institute, *'An Accident And A Dream'* (Albany, NY: Public Policy Institute, 1998).
31. S. 1554, 105th Congress.
32. We recommend in Part II ways to introduce economic incentives to provide compensation without litigation. The risk of a possible judgment for punitive and other non-economic damages would provide an incentive for defendants to make Early Offers to pay economic compensation. Where an Early Offer was made and accepted, the change in the treatment of claims for punitive damages discussed in text would be irrelevant since a settlement would be reached. If an Early Offer is made and rejected, the Early Offers implementing statute would, as discussed below in the text, change the liability and evidentiary standards for recovery of non-economic damages. The bill that has been introduced in Congress to implement Early Offers would require the plaintiff to prove wanton or intentional misconduct by clear and convincing evidence, rather than establishing willful misconduct beyond a reasonable doubt as suggested in text above.
33. See "Patients, Doctors, and Lawyers: Medical Injury, Malpractice Litigation, and Patient Compensation in New York," *The Report of the Harvard Medical Practice Study To the State of New York* (1990), pp. 6-7; Russell A. Localio, "Relations Between Malpractice Claims and Adverse Events Due to Negligence," 325 *No.4 New England Journal of Medicine* 245, 249 (1991).
34. Christopher J. Dodd, "A Proposal for Making Product Liability Fair, Efficient, and Predictable," 14 *Journal of Legislation* 133, 136-9 (1987). These amounts are net of legal fees.
35. Statement of Peter Kinzler, "The Auto Choice Reform Act of 1997," Hearing before the Subcommittee on Finance and Hazardous Materials, Committee on Commerce, United States House of Representatives, May 20, 1998, Serial No. 105-86, p. 37. This statement and other materials on Auto Choice cited in this policy statement can be found on the web at www.autoreform.org.
36. Stephen Carroll, James Kakalik, Nicholas Pace, and John Adams, *No-Fault Approaches to Compensating People Injured in Automobile Accidents* (Santa Monica, CA: The RAND Corporation, 1991). These amounts represent gross compensation, before payment of attorneys' fees.
37. Lawrence Soular, *A Study of Large Product Liability Claims Closed in 1985* (Alliance of American Insurers and American Insurance Association, 1986) p. 17.
38. Jeffrey O'Connell and Brian Kelly, *The Blame Game*, p. 125.
39. Christopher Dodd, "A Proposal for Making Product Liability Fair, Efficient, and Predictable," p. 139. (emphasis in original); Statement of George L. Priest, "Punitive Damages: Tort Reform and FDA Defenses," Hearings before the Committee on the Judiciary of the United States Senate, Serial No. J-104-16, April 4, 1995, p. 85.
40. Jeffrey O'Connell and Brian Kelly, *The Blame Game*, p. 125.
41. Deborah R. Hensler, Mary Vaiana, James Kakalik, and Mark Peterson, *Trends in Tort Litigation* (Santa Monica, CA: The RAND Corporation, 1987) pp. 25-29. As Justice Breyer stated in his dissent in *Ortiz v. Fibreboard Corporation*, 119 S. Ct. 2295, at 2324 (June 23, 1999), "attorney's fees and other 'transaction costs'...consume an estimated 61 cents [of each dollar paid by the defendant in asbestos cases], with only 39 cents going to victims." Justice Breyer cited the *Report of the Judicial Conference Ad Hoc Committee on Asbestos Litigation* (March 1991).
42. Jeffrey O'Connell and Brian Kelly, *The Blame Game*, p. 127; Jeffrey O'Connell, "Neo-No-Fault Remedies for Medical Injuries: Coordinated Statutory and Contractual Alternatives," 49 *Law and Contemporary Problems* 125, 127 (1986).
43. Joint Economic Committee of the United States Congress, *Auto Choice: Impact on Cities and the Poor* (Washington, DC: United States Congress, March, 1998).
44. *Motor Vehicle Crash Losses and Their Compensation in the United States, A Report to the Congress and the President* (United States Department of Transportation, March 1971), p. 100, cited in the statement of Peter Kinzler, "The Auto Choice Reform Act of 1997."
45. Christopher Dodd, "A Proposal for Making Product Liability Fair, Efficient, and Predictable," p. 140.
46. Walter Olson, *The Litigation Explosion*, p. 343.
47. George L. Priest, "Punitive Damages: Tort Reform and FDA Defenses," Hearings before the Committee on the Judiciary of the United States Senate, Serial No. J-104-16, April 4, 1995, pp. 90-91; see also, George L. Priest, "The Current Insurance Crisis and Modern Tort Law," 96 *Yale Law Journal* 1521, 1527 (1987).
48. Stephen J. Adler, *The Jury: Trial and Error in the American Courtroom* (Times Books, 1994).
49. "The promise was that the more lawyering went on, the better and fairer life in America would be. The signs are otherwise. As the volume and intensity of their output has risen, our courts, rather than converging with new confidence on important truths, have become more random and inconsistent in their pronouncements." Walter Olson, *The Litigation Explosion*, p. 10.
50. Jeffrey O'Connell, "Two-Tier Tort Law: Neo No-Fault & Quasi-Criminal Liability," 27 *Wake Forest Law Review* 871 (1992).
51. Warren E. Burger, "State of the Judiciary" Address to the American Bar Association, February 1984, cited in John Diebold, *Making the Future Work* (Simon and Schuster, 1984) p. 126.

52. As Professor Patrick Atiyah warns: "Given the huge administrative costs of the tort system, and the extraordinary generosity of pain and suffering awards, it must be recognized that every expansion of tort law uses resources totally out of proportion to the numbers assisted by that expansion." Quoted in Jeffrey O'Connell and Brian Kelly, *The Blame Game*, p. 139.
53. Tillinghast-Towers Perrin, *Tort Cost Trends: An International Perspective*, 1995. Tort costs here are reflected through the insurance system and include first-party benefits (cost of legal defense and claims handling), benefits paid to third parties (claimants and plaintiffs), and an administrative component.
54. Peter W. Huber, *Liability: The Legal Revolution and its Consequences* (New York: Basic Books, 1988) p. 3.
55. There has been, he observed, a "massive diversion of exceptional talent into pursuits that often add little to the growth of the economy, the pursuit of culture, or the enhancement of the human spirit. I cannot press this point too strongly....[F]ar too many of these rare individuals are becoming lawyers at a time when the country cries out for more talented business executives, more enlightened public servants, more inventive engineers, more able high-school principals and teachers." Derek Bok, "A Flawed System," p. 41.
56. Cited in *Off Balance: Resetting the Scales for Civil Justice*, National Issues Forums Series (Washington, DC: Public Agenda, 1996), p. 12.
57. President's Council on Competitiveness, *Agenda for Civil Justice Reform in America*, p. 23.
58. Peter Kinzler, "Recent Studies of Punitive Damage Awards," *Journal of Insurance Regulation* 15 (1997), p. 419.
59. Stephen Carroll, James Kakalik, Nicholas Pace, and John Adams, *No-Fault Approaches to Compensating People Injured in Automobile Accidents* (Santa Monica, CA: The RAND Corporation, 1991) p. 21.
60. Stephen Carroll, Allan Abrahamse, and Mary Vaiana, *The Cost of Excess Medical Claims for Automobile Personal Injuries* (Santa Monica, CA: The RAND Corporation, 1995).
61. FBI Director Louis Freeh, cited in Joint Economic Committee, *Auto Choice: Impact on Cities and the Poor*, p. 15.
62. Insurance Research Council poll, 1997, cited in written statement of Judith M. Fitzgerald, Associate Vice President and Director of Government Affairs, National Insurance Crime Bureau, from the "Perspectives on Federal Auto Choice Legislation" Conference, Washington, DC, January 28, 1999.
63. Insurance Research Council, "Auto Injuries: Claiming Behavior and Its Impact on Insurance Costs," 1994. Study was based on 62,000 automobile claims settled by insurance companies in a two-week period in 1992 and compared with similar data from 1987. Further information is available at www.ircweb.org.
64. Richard B. Schmitt, "In U.S. Courts, the Whole Truth is Often Anything But," *Wall Street Journal* October 9, 1998, p. B1.
65. As Derek Bok urged:
 "... judges, lawmakers, scholars will all have to recognize that our conception of the role of law has fallen into disrepair. In its place, they will need to search for a new understanding that is no less sensitive to injustice but more realistic in accounting for the limits and costs of legal rules in ordering human affairs. Such an effort should result in fewer rules, but rules that are more fundamental, better understood, and more widely enforced throughout the society. Lacking such a vision, judges and regulators will continue to drift toward a general willingness to intervene whenever they feel that one person has suffered at the hands of another. That is the logical end of a process that concentrates so heavily on the plight of individual litigants and gives so little heed to the effect on the system as a whole. What emerges from this process is a spurious form of justice. In such a world, the law may seem enlightened and humane, but its constant stream of rules will leave a wake strewn with the disappointed hopes of those who find the legal system too complicated to understand, too quixotic to command respect, and too expensive to be of much practical use." Bok, "A Flawed System," p. 44.
66. Walter Olson, *The Litigation Explosion*, p. 342. The effect of the litigation culture in one state (New York) is described in detail in Public Policy Institute, *'An Accident And A Dream'* (1998).
67. See Jeffrey O'Connell and Brian Kelly, *The Blame Game*, p. 134.
68. Jeffrey O'Connell, "Neo-No-Fault Remedies for Medical Injuries: Coordinated Statutory and Contractual Alternatives," 49 *Law & Contemporary Problems* 125 (1986); see also Jeffrey O'Connell, "A 'Neo-No-Fault' Contract in Lieu of Tort: Preaccident Guarantees of Postaccident Settlement Offers," 73 *California Law Review* 898 (1985).
69. Jeffrey O'Connell, "A 'Neo-No-Fault' Contract in Lieu of Tort: Preaccident Guarantees of Postaccident Settlement Offers," p. 911 n. 52, pp. 914-915. The program ended when the underwriter encountered difficulties unrelated to the program itself.
70. Jeffrey O'Connell, "Offers that Can't be Refused," 77 *Northwestern University Law Review* 589 (1982); Henson W. Moore and Jeffrey O'Connell, "Foreclosing Medical Malpractice Claims by Prompt Tender of Economic Loss," 44 *Louisiana Law Review* 1267 (1984); Henson W. Moore and John S. Hoff, "H.R. 3084: A More Rational Compensation System for Medical Malpractice," 49 *Law & Contemporary Problems* 117 (Spring 1986).
71. H.R. 5400 (98th Congress). This bill, unlike that introduced more recently by Senator McConnell and discussed in text, would not have given a claimant an option to reject a qualifying Early Offer, except in the case of death or intentional injury.
72. Section 6 of S. 300 (104th Congress, 1995), cosponsored by Senator Spencer Abraham; Section 101 of S. 1861 (104th Congress, 1996), cosponsored by Senator Robert Dole. The bill would permit states to opt out by enactment of a statute.
73. The McConnell bill would exclude automobile accidents from the application of Early Offers, relying instead on the Auto Choice mechanism discussed below.
74. See Section 5 of S. 300; Title II of S. 1861; see also, Lester Brickman, "Contingency Fees without Contingencies: Hamlet Without the Prince of Denmark?" 37 *U.C. L. A. Law Review* 29 (1989); Lester Brickman, Michael Horowitz, and Jeffrey O'Connell, *Rethinking Contingency Fees* (Washington, DC: Manhattan Institute, 1994); Michael Horowitz, "Making Ethics Real, Making Ethics Work: A proposal for Contingency Fee Reform," 44 *Emory Law Journal* 173 (1995); Jeffrey O'Connell, "Commentary: Early Offers as Contingent Fee Reform," 47 *DePaul Law Review* 413 (1998).
75. It may prove administratively more feasible for Early Offers to apply after a class is certified.
76. Cited in Jeffrey O'Connell and Brian Kelly, *The Blame Game*, p. 133; Jeffrey O'Connell, "Two-Tier Tort Law: Neo No-Fault &

Quasi-Criminal Liability," 27 *Wake Forest Law Review* 871, 884 (1992).

77. Statements of Patricia Nemore, Staff Attorney, National Senior Citizens Law Center, and Judith Waxman, Staff Attorney, National Health Law Program, at hearings on "Alternative Medical Liability Act," H.R. 5400, before the Ways and Means Committee, Subcommittee on Health, United States House of Representatives, June 28, 1984, pp. 100-110.

78. Alternatively, the proposal could require the injured party to choose the scheduled amount in place of compensation for economic loss. The McConnell bill would permit states to require a minimum dollar offer in defined cases of death or serious bodily injury. The claimant could accept that amount or the offer for economic loss.

79. Jeffrey O'Connell, Stephen Carroll, Michael Horowitz, Allan Abrahamse, and Paul Jamieson, "Consumer Choice in the Auto Insurance Market," 52 *Maryland Law Review* 1016 (1993); Jeffrey O'Connell, Stephen Carroll, Michael Horowitz, Allan Abrahamse, and Daniel Kaiser, "The Costs of Consumer Choice for Auto Insurance in States Without No-Fault Insurance," 54 *Maryland Law Review* 281 (1995); O'Connell, Carroll, Horowitz, Abrahamse, and Jamieson, "The Comparative Costs of Allowing Consumer Choice for Auto Insurance in All Fifty States," 55 *Maryland Law Review* 160 (1996).

80. Joint Economic Committee, *Auto Choice: Impact on Cities and the Poor*, p. 5.

81. Insurance Research Council, *Paying for Auto Injuries: A Consumer Panel Survey of Auto Accident Victims* (1999). The study was based on the reports of 6,000 people injured in automobile accidents from 1995-1998.

82. S. 837, cosponsored by Senators Mitch McConnell, Daniel Patrick Moynihan, John McCain, and Joseph Lieberman, was introduced on April 20, 1999. H.R. 1475 was introduced on April 20, 1999, by Congressmen Dick Armey, and 13 cosponsors.

83. If two TMC drivers collide in a tort state, the injured party would sue the other for negligence and recover on a third-party basis.

84. Stephen Carroll and Allan Abrahamse, *The Effects of a Choice Automobile Insurance Plan on Insurance Costs and Compensation: An Analysis Based on 1997 Data* (Santa Monica, CA: The RAND Corporation, 1999) p. 23.

85. The Committee's estimates are based on Stephen Carroll and Allan Abrahamse, *The Effects of a Choice Automobile Insurance Plan on Insurance Costs and Compensation: An Updated Analysis* (Santa Monica, CA: The RAND Corporation, 1998) and have not been updated to reflect the higher savings projected in the 1999 RAND study cited in note 84.

86. Joint Economic Committee, *Auto Choice: Impact on Cities and the Poor*, p. 38.

87. *Ibid.*

88. Joint Economic Committee, *Auto Choice Relief for Businesses and Consumers*, (Washington, DC: United States Congress, July, 1998).

89. *Ibid.*, pp. 34-36.

90. In a no-fault state, the TMC driver would be covered under the state no-fault law.

91. In addition, a PIP driver would have the right, although it may have little practical effect, to recover non-economic damages from an unlawfully uninsured driver.

92. In theory it would be possible to collect from the other party's assets. But in the case of serious injury, this is rarely feasible.

93. Joint Economic Committee, *The Benefits and Savings of Auto-Choice*, (Washington, DC: United States Congress, April, 1997) p. 6.

94. George L. Priest, "Why Auto Choice is a Lemon" *The Wall Street Journal*, July 21, 1998, p. A14.

95. National Conference of State Legislatures, *Legisbrief*, Vol. 6 #25 (June/July 1998).

96. Deborah Hensler et al, *Compensation for Accidental Injuries in the United States*, pp. 99, 100.

97. At the same time, we recognize that Auto Choice is somewhat complex and involves a set of circumstances and relationships that are not easily replicable. Although we believe the effort should be made, it may turn out that it is difficult to find other transactions in which it is possible to offer pre-event commitments to pay compensation and to give the consumer an economic stake in the decision. The Early Offers approach, as discussed above, avoids these difficulties by providing for a post-event choice for both the producer and the consumer.

Memorandum of Comment, Reservation, or Dissent

On the report as a whole, JOSH S. WESTON, with which STEFFEN E. PALKO, JAMES Q. RIORDAN, and GEORGE RUPP have asked to be associated.

The CED subcommittee and Research and Policy Committee understandably chose to make two very clear, practical, deserving, and significant recommendations to federal and state decision-makers — Early Offers and Auto Choice.

This policy statement also clearly describes the general need for additional alternatives and incentives to reduce litigation. The report's suggested process for identifying and implementing additional legal reform is "broad and informed public debate."

To complement such public debate with structure, process, credibility, and expertise, I recommend that the most senior court in several major states and the U.S. Supreme Court each request funding and directional support from its respective legislature to create and guide a Legal Reform Commission that would be asked to report back to the legislature and the public within eighteen months.

Such a commission's members might be selected by the Chief Justice and his associates. It might include all or most of the Senior Court's justices plus the relevant attorney general, a few leading members of the Bar Association who are not trial lawyers, and leaders from business and other groups.

Their charge would be to make significant recommendations for consequential legal reform by legislatures, courts, and regulatory bodies. They should suggest new processes, incentives, and educational supplements that would permit and encourage judges and courts to judge under the law, rather than create new law and regulations. In addition, they should indicate ways to mobilize ongoing judicial leadership for significant reform.

To this end, pressures from business and the public at large, and perhaps new processes, are required to produce legislation that is clear and unambiguous, so that important policy choices are not left to regulatory and judicial bodies for decision. Clear legislation may require mechanisms that consider the societal costs and benefits of proposed legislation prior to enactment, as recommended with respect to one policy area in CED's 1998 policy statement *Modernizing Government Regulation: The Need for Action*.

We are aware that most ad hoc government commissions do not produce effective and objective legislative or operational changes. However, we are encouraged by the recent significant success of the National Commission to Restructure the IRS in achieving positive legislative and executive branch changes after just one year of hearings and deliberation.

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For more than 50 years, the Committee for Economic Development has been a respected influence on the formation of business and public policy. CED is devoted to these two objectives:

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