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OFFICE OF THE VICE PRESIDENT
WASHINGTON

*Legal
reform*

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☒ FYI

☐ Comment

☐ Action

THE LEGAL PROFESSION

The rule of lawyers

TO BE a professional, said Roscoe Pound, an American legal philosopher and former dean of the Harvard Law School, is to "pursue a learned art as a common calling in the spirit of public service—no less a public service because it may incidentally be a means of livelihood." Lawyers have long clung to such rhetoric and its image of legal life. Pound's current successor at Harvard, Robert Clark, says (rather less eloquently) that lawyers are "specialists in the normative ordering of human relations."

To many of their customers, this talk reeks of a familiar arrogance. Most corporate clients, victims of accidents or couples whose marriages have run aground think that a lawyer is just another businessman selling his services—at best a necessary evil. This is not an idea lawyers like. To make a British barrister cringe, utter the phrase "legal-services industry". One American lawyer says he did not realise he was in a service business until he saw his occupation classified that way on a census form.

Yet the fact is inescapable: the law is indeed a business, one that for the past 30 years has been booming. Since 1960 the world's population of lawyers has probably doubled, to more than 2m (see table on next page). Perhaps surprisingly, this is not all due to America. There the number of lawyers has nearly tripled, to 780,000—about a third of the world total, or roughly the same as America's share of gross world product. And although America has more lawyers per head than other rich countries, the legal professions in Britain, Canada and Germany are growing faster.

With growth has come prosperity. In America, the only country keeping reliable statistics, nominal spending on legal services rose from \$10 billion in 1972 to around \$100 billion last year. That does not include the millions spent by companies on their in-house legal teams. Bradford Hildebrandt, a law-firm consultant, reckons that in most other rich countries too, growth in legal billings easily outpaced inflation. In 1970 it was a rare American or British firm—there was none elsewhere—that had 100 lawyers. Now scores do, and a handful of mega-firms have more than 1,000. Top partners are paid as much as top businessmen; even mediocre lawyers earn more than most of their neighbours.

Like many service industries, the legal business can partly thank the corporate deal and property booms of the 1980s for its spectacular success. Hot-shot merger and acquisition (M&A) lawyers at firms like Skadden, Arps, Slate, Meagher & Flom, in New York, and Linklaters & Paines, in London, became leading combatants in the takeover wars. Martin Lipton, senior partner at New York's Wachtell, Lipton, Rosen & Katz and inventor of the "poison pill" defence, had a hand in the takeovers of all three American television networks.

Lawyers round the world grew busier as law-makers did the same. In America the number of pages added each year to the Federal Register,

which compiles all new laws and regulations, has quadrupled since 1960. In 1970 a similar book of EC rules was three inches thick. Last year the volumes of new rules stretched three feet. East European governments have lawyers, foreign and local, working frantically on their codifications and privatisations. "As the rule of law has been extended," says Marc Galanter, a law professor at the University of Wisconsin, "so has the rule of lawyers."

Repeat offenders

Yet a tour of the world's legal centres does not find their denizens in triumphalist mood. For with success has come unfamiliar scrutiny. Suddenly lawyers are feeling pressures to which most service businessmen are well-accustomed: to be more efficient, competitive, accountable—and less counter-productive. These pressures come not (necessarily) from unthinking lawyer-bashers, but from sober legal reformers, government regulators and powerful clients. After decades in which most of the changes to their business were painless and profitable, lawyers themselves are being put on trial.

This survey looks at the evidence against them and tries to render a tentative verdict. Or rather several verdicts—for lawyers differ markedly from one another, depending on where they live and the kind of law they practise. A British barrister wandering through a Chicago court adorned in wig and gown would be mistaken for a defendant in a transvestite prostitution trial. Few American lawyers ever step foot inside a courtroom. In Japan that is the main job of a *bengoshi* (barrister); and to bring

Lawyers say they are torn between being businessmen and being professionals. Increasingly, argues John Heilemann, they will have to be both



Cicero's heirs, braced for change

Law's empire

country	lawyers*	lawyers* per 100,000 population
Pakistan	46,000	508.4
Singapore	990	396.0
United States	780,000	312.0
Belgium	21,104	214.0
Finland	9,314	191.6
Western Germany	115,900	190.1
Israel	7,500	182.5
Argentina	50,000	169.4
Canada	42,710	168.5
Venezuela	31,400	159.1
Australia	23,000	145.7
New Zealand	4,700	144.6
England & Wales	68,067	134.0
Scotland	6,350	124.5
Chile	12,300	104.9
Japan	124,000	101.6
Spain	32,540	84.6
Italy	46,401	81.2
Costa Rica	1,959	80.3
Ireland	2,500	71.4
Brazil	85,716	69.1
Norway	4,412	68.7
Egypt	30,000	68.2
Nepal	1,000	63.2
Denmark	3,000	58.7
Switzerland	3,300	51.4
France	27,700	49.1
Panama	900	43.1
Turkey	22,395	42.1
Former Soviet Union	100,000	35.3
Holland	5,124	35.2
India	247,373	34.4
Others	66,399	—
World total	2,024,054	—

Source: Institute for Legal Studies, University of Wisconsin
* For latest available years



In the past such derision was tempered by a certain awe for lawyers and the law, nurtured by the mystery that surrounded them. No longer. The media report on trials as contests and lawyers as tacticians manoeuvring for any advantage. Once there was Atticus Finch in "To Kill a Mockingbird"; now there is Arnie Becker in "LA Law". A British former judge, James Pickles, appeared in tabloid photos with topless models. With these and countless other indignities, the law has been demystified.

As it has happened, the suspicions that lie be-

neath popular resentment for lawyers have begun to bubble up in parliaments and boardrooms: that lawyers have a stake in making transactions complicated and prolonging disputes, and in shielding themselves from competition; and that by pursuing their self-interest they inflict huge costs. Carl Sandburg captured the point elegantly: "When the lawyers are through, what is there left? Can a mouse nibble at it and find enough to fasten a tooth in?"

Some differences are too great to take account of: between criminal-justice systems, between the view from behind a steel desk rather than a mahogany one. So this survey will mention criminal and government lawyers only in passing.

Among the lawyers that remain—commercial and civil attorneys of all stripes—there are still differences. Yet it is the similarities that ring out. Start with a long history of public resentment. Advocates in ancient Greece, such as the sophists ridiculed by Aristophanes, were often considered shysters. During the French revolution, *avocats* were condemned as part of the *ancien régime*. In colonial America, lawyerly contentiousness and price-gouging sparked public rioting. Lawyers, said a North Carolina regulator, were "cursed hungry caterpillars" who would "eat out the very bowels of our Commonwealth."

It has only got worse, especially in America. There Dan Quayle, himself a lawyer, loudly echoes the caterpillar complaint. In California, T-shirts read: "What do you call 1,000 lawyers at the bottom of the ocean? A start." But it is not only an American revulsion. Newly unshackled judges in Eastern Europe are being accused of corruption and incompetence. A Japanese lawyer explains that when he tried recently to find office-space for his firm, several prospective landlords refused when they discovered what he does.

Tipping the scales

Change is upon them. To reduce the costs of America's alleged "litigation explosion", Mr Quayle proposes to re-regulate the most free-market legal system in the world. To cut the costs of legal services to consumers, Britain's Lord Chancellor wages a campaign to introduce competition and improve access to a legal system that excludes all but the richest and poorest. Protectionist barriers erected by local lawyers in France and elsewhere to keep out foreign ones are under fire. And in Japan, a quiet movement is afoot to prise open a classic cartel: high barriers to entry, restrictive practices, monopoly pricing. Some Japanese suspect the cost of their happily non-litigious system is a deficiency of justice.

Reformers everywhere refer to how much better things are in other countries. Usually they have little idea what they are talking about. Before charging ahead with ideas borrowed from abroad, they should take a closer look. This is not because (say) Germany has nothing to learn from (say) Canada. Quite the contrary. But regulating lawyers is a tricky task. The law may be a business, but the legal profession is not, as Harvard's Pound put it, "the same sort of thing as a retail grocers' association." Lawyers are most people's only way to use the civil-justice system. With the power to compel costly proceedings, lawyers can besmirch reputations and disrupt social harmony. They can also provide valuable business advice, help vindicate rights, and get compensation for those wrongly harmed. "Lawyers are like doctors," says Charles Sifton, a federal judge in New York. "They have people by the throats. Sometimes they save you. Sometimes they choke you."

Unsurprisingly it is America, where lawyers are most free to ply their trade, which sees the most choking and the most saving. In Japan, where lawyers are most restricted and ostensibly professional (or at least high-minded), there is little of either. Ideally, societies want lawyers to strike the right balance between being businessmen and being professionals. Wherever that "right" balance is, lawyers have too often failed to find it on their own—especially where great wads of cash are there to be made. Luckily, they are starting to get some help.

The client is sometimes right

Being in a service business means knowing who is supposed to serve whom

FOR a clue as to how wrenching it has been for lawyers to become businessmen, listen to the legal profession's elite at big law firms react defensively to the suggestion that the change is only recent. "Any lawyer who hasn't always known that he was working in a service industry", says James

Hurloch, managing partner at White & Case, a New York firm, "has really missed the boat."

Maybe. But until two years ago, the law was an unreal sort of industry: one virtually unaffected by economic cycles, in which growth seemed limitless and big firms rarely failed. Inevitably, these traits

gave lawyers wild illusions of invulnerability. Then, just as inevitably, reality shattered them.

Large law firms devoted to serving business clients have always been an Anglo-American oddity. In other places restrictions have kept law firms relatively small. Even in America and Britain big firms are unusual: 60% of America's lawyers practise with fewer than five partners. In Britain, where the legal profession is split between barristers (who, among other things, have exclusive rights to appear in the higher courts) and solicitors (who join together in partnerships, and have much more direct contact with clients), solicitors are still more likely to work from high-street shopfronts rather than City of London office-towers. But big firms are the most prestigious—and best-paying—in both countries.

In the 1980s their fortunes soared as never before. The furious pace of corporate restructurings, financings and litigation created a voracious appetite for upmarket lawyering. In this sellers' market, fees rose 10-15% a year, to more than \$500 an hour in New York and London. "During the boom," says James Wyness, senior partner at Linklaters, "you could bill what you liked—within reason."

Corporate-law firms mushroomed, either through mergers or enthusiastic recruiting. New York's Skadden, Arps grew, mergerless, from 160 to 1,000 lawyers during the decade. Profits, too, skyrocketed. As revenues at top firms in both countries rose by some 20% a year, scores of partners saw their pay-packets swell past \$1m; thousands were making \$500,000 or more. For the bright young graduates who came marching out of law schools like so many broomsticks in "The Sorcerer's Apprentice", starting salaries climbed to \$85,000.

Serf's up

To partners, the new recruits seemed worth it. Partners, after all, sell not only their own labour but, at a reduced rate, that of salaried underlings who aspire to be partners themselves. Keen to prove their mettle, these legal serfs work 1,800-2,400 billable hours a year. So long as there is work to keep them busy, and especially if hourly rates are rising, it pays for partners to push the ratio of apprentices-to-partners (or "leverage") as high as possible. Indeed, in the 1980s many partners believed that the right hardheaded business strategy was simply to hire more lawyers. And, for a time, they were right.

But the partnership system has a drawback. Every year some associates must win what Mr Galanter calls the "tournament of lawyers" and become partners; if they do not, the prize is devalued. Others lose and leave the firm. All of them must be replaced, but not by one new apprentice each; rather, by as many as it takes to maintain the firm's leverage (and hence profits). Thus have big law firms tended to grow exponentially. This is fine if demand exceeds supply and fees can be ratcheted up. If demand slows, however, it can mean trouble.

And so it has. For the past two years the legal business has been battered by a transatlantic triple-blow of recession, collapsed property markets and a slump in corporate dealmaking. According to the *American Lawyer*, a trade magazine, revenues at America's top 100 law firms rose last year by just 3%, to \$13.9 billion, after a 9% increase in 1990—two successively more painful years for an industry in



Down to single digits now

which anything less than double-digit growth had become a dim memory. British lawyers say they have done no better.

The fall-out has been sobering. A survey in the *National Law Journal* shows that 44% of the 250 biggest American firms shrunk last year. Venerable partnerships, such as Boston's 147-year-old Gaston & Snow, have dissolved. Solicitors have been sacked by the dozen. Even partners, once secure in their life tenure, have been told to go.

The tumult brings to an end one revolutionary stage and begins another in the transformation of corporate law from a staid profession into a savagely competitive business. In America the first stage, says Stephen Volk, senior partner at Shearman & Sterling, a New York firm, centred round "the legal profession's encounters with Adam Smith and Steven Brill." The invisible hand has made its appearance. But what of Mr Brill?

When Erwin Smigel, an American academic, wrote a book about Wall Street lawyers in the 1950s, he found they "thought of their organisations as clergymen think of the church—as an institution that should not be studied." Mr Brill was a heretic. In 1979 he started the *American Lawyer*: prominent partners were profiled; troubled firms exposed. And he printed a yearly list of the country's most profitable partnerships. At first, lawyers were enraged. Now they admit the figures are accurate—except, that is, for the ones on their own firms.

By providing such market information the *American Lawyer* contributed mightily to the erosion of hoary law-firm traditions. Once partners were friends who rarely switched firms and were paid ever-rising salaries in "lockstep" with others of the same seniority. As the law grew more competitive, firms started raiding one another for "rain-making" partners with loyal clients. Soon lockstep compensation was dropped for pay based mainly on the business brought in, a system some lawyers call EWYK—"eat what you kill". Oldtimers complain that all this has stripped the law of its collegiality, discretion and gentlemanliness. But it has also reduced its elitism, secretiveness and sexism.

Until recently, Britain's solicitors smiled smugly at America and declared, "It could never





happen here." Lockstep compensation is still the rule in British firms; "cherry-picking" partners from rival firms is also rare. But two years ago saw the arrival of *Legal Business*, a self-styled British imitator of the *American Lawyer*. Its first report of law-firm profits appeared in March. Solicitors harrumph and refuse to comment—a good sign. The effect of such inside information may prove as powerful as in America. "British lawyers are no more conservative or genteel than Americans," says Mr Brill. "They just have better grammar."

The client bites back

An American-style revolution on the supply side of Britain's legal business may take a while. But the profession's demand-side revolution is already happening on both sides of the Atlantic: once-docile clients are taking charge and shifting the balance of power between them and their law firms.

Leading this revolution are the increasingly savvy lawyers working within companies. As law-firm fees escalated in the 1980s, cost-conscious businesses expanded their in-house legal staffs. With the help of new technology linking them to legal databases, in-house lawyers could do routine work for a third the price of farming it out. Companies started practising "horses for courses": hiring law firms for their specialities rather than sticking with long-term relationships.

Now in-house lawyers are doing even more. In America, aggressive corporate general counsels such as Benjamin Heineman of General Electric have assembled hundreds-strong teams into virtual law firms within company walls. In-house attorneys are becoming specialists, allowing businesses to hire "interior" firms (ie, those not in New York or Los Angeles) for routine work at discounted rates.

The trend is not so far advanced in Britain. Indeed, some big companies, such as ICI and Reed, recently handed business back to outside firms. But as clients get cleverer, London firms are losing business to cheaper, regional upstarts. A study of 100 big British companies by Competitive Marketing, a management consultant, found that in-house legal departments are growing fast.

Once seen as poor relations to their big-firm cousins, in-house lawyers are catching up. "With the challenges of helping a company compete," says Mr Heineman, "it's far more attractive to be at the other end of the 'phone.'" But the new breed of in-house attorneys have also spent time at the law-firm end. That lets them rob outside firms of an advantage held by many professionals: an asymmetry of information. Just as a patient who feels ill can be persuaded to spend great sums for doctoring, busi-

nessmen threatened with litigation or involved in a costly deal will pay almost anything to avoid being "out-lawyered". This creates a moral hazard that few law firms avoid. As John McCloy, a famous American lawyer, put it, "If a client does not complain about a bill, it isn't high enough."

They are complaining. Recently American law firms have been bombarded with brutal memoranda from in-house counsels telling them that bills swollen by routine abuses—overlawyering, pointless meetings and needlessly long briefs—will no longer be tolerated. In Britain, clients are insisting that solicitors give up age-old habits of refusing to discuss fees in advance, then turning in invoices with a vague paragraph beside a whopping sum. Now law firms must strut through "beauty contests" in which they bid competitively for contracts.

In America, cost controls are especially strict. Harry Pearce, the top lawyer at General Motors, is using a computerised fee-tracking system to monitor the productivity of the outside lawyers on which GM spent \$142m last year. To keep law firms honest, companies are paying auditors to scrutinise legal bills. What they find is often ugly. One auditor, Legalgard, has discovered a California law firm that bills for 50-hour workdays; another charged a client for the entire \$17,000 cost of its summer law-clerk programme under the heading "legal research".

Extreme cases? Dubious lawyers? Yes, both. But there are plenty about. The *American Lawyer* reports that even blue-chip firms such as Cravath, Swaine & Moore and Skadden, Arps inflate expenses such as faxes and secretaries' wages, turning overheads into thriving profit centres.

To many lawyers, all this seems petty. "When clients say that 'total quality management' applies to law firms, what do they mean?" asks Mr Hurloch of White & Case. "That we always have to pick up the 'phone in two rings?" Mr Brill argues it means more: that clients are determined to eliminate the "organisational profit" earned by law firms on everything other than top-notch legal work.

Privately, more than a few lawyers say such tactics have made their relationships with clients increasingly adversarial. When demand for legal services returns, lawyers know it will remain a buyer's market. That has them longing for bygone days, when a law-firm partner sat on a client-company's board of directors and was among the CEO's top advisers. When these cosy professional relationships ended, they say, lawyers had to become ruthless businessmen. Clients, too, regret that things are becoming adversarial. But they think that the way many big law firms operate is neither businesslike nor professional. And they are right.

Courts go global

In a clash of legal cultures, the winners will be the lawyers

"JUST as a good airplane pilot should always be looking for places to land," wrote Kurt Vonnegut, "so should a lawyer be looking for situations where large amounts of money are about to change hands." Big British and American law firms have needed no prompting. Facing a future of tighter profits at home, they are setting up in mar-

kets from Jakarta to Jeddah. In the process they are shaking up the leisurely old-world bars of continental Europe and Asia. The "internationalisation of law" is still a faintly McLuhanite fantasy, but the internationalisation of lawyering has begun.

It has come slowly. The first forays of British and American law firms abroad, in the 1950s and

1960s, were tentative—and often temporary. Profits were scarce. Government restrictions kept foreign firms from hiring local lawyers or forming multinational partnerships. They were barred altogether from Japan; in the 1970s American attorneys were turned away at Narita airport. Shielded from competition, European and Asian lawyers stuck to tiny practices, primitive offices and lofty self-regard.

In the 1980s international changes offered fresh opportunities. The single European market has lured some 150 foreign law firms, 70 of them American or British, to open offices in Brussels since 1989. In 1987 Japan lifted its foreign-lawyer ban; 41 firms (all but three British or American) are now in Tokyo to help Japanese companies with takeovers and raising money on foreign capital markets. The tumbling of communist dominoes sent law firms east to advise budding legislators and foreign investors. The former eastern block is as thick with yuppie lawyers as it once was with secret police.

It has not been easy going. Huge overheads and the fall-off in M&A work have made the past two years as tough abroad as at home. Lawyers from Washington, DC, who came eagerly to Brussels to lobby the European Commission were dismayed to learn that its entire staff is smaller than that of the Food and Drug Administration. Nor has EC-law work been plentiful. Since 1990, big European mergers have needed commission approval; but there have been just 97 notifications, handled mostly by British firms led by Slaughter and May. As the flow of Japanese foreign investment slowed to a dribble, so did legal billings.

This will not last. Merger work will pick up—and with it so will lawyering—in places like Paris and Hong Kong. Next year EFTA countries will probably come under EC competition law, and the commission plans to start reviewing smaller mergers. Other areas of EC law also show promise; for example, some 200 environmental directives have been proposed or adopted. Infrastructure investment in South-East Asia could add up to \$80 billion over the next five years, creating lots of project-finance work for nimble foreign lawyers.

Eastern Europe, too, may prove a goldmine. Though some western lawyers are only “riding the privatisation wave”, many will stay. Milan Ganik, a Slovak-born lawyer working in Prague for Squire, Sanders & Dempsey, a Cleveland firm, argues there will be more legal work after privatisation than before. Thousands of companies, many with foreign owners, will need legal services: advice on finance, tax, antitrust, litigation. After riding the first wave, he says, lawyers will find there are more on the way.

Uncivilised

Not all American and British law firms are set to reap huge rewards abroad. Many partners' international strategies consist entirely of the mumbled words “1992” or “Pacific rim”. But others, such as Britain's Freshfields and America's Cleary, Gottlieb, Steen & Hamilton, have integrated local lawyers into their partnerships to turn themselves into genuine international practices.

But even those Anglo-American firms that simply export legal talent have an edge in the international market. Most countries in Europe and Asia have “civil-law” systems. Unlike the “common

law” of Britain and America, civil law is not adversarial: judges rely on detailed codes, not precedents, and run their courts in a stately way. Professionalism means detachment (read aloofness) from clients. Advertising of legal services is thought to be corrupt. Until recently, a big firm was one that had 30 lawyers. Memoranda took weeks to prepare. This, and the lack of financial centres like London and New York, has put civil-law firms at a disadvantage in competing for international clients.

The arrival of American and British firms has caused friction. When American firms announced their arrivals in Brussels with newspaper advertisements, the local bar had fits. So did some commissioners subjected to hard-sell lobbying from American lawyers convinced that Brussels is the “Washington of Europe”. In Eastern Europe the contrast is starker. Wander up a crumbling, dusty stairwell, push open an American law firm's door and find Park Avenue: oak floors, black-leather sofas, Pollock prints. The brash behaviour of lawyers in such digs has raised eyebrows among locals. Says an American lawyer in Prague: “I'll call up a potential client cold and say, ‘You're going through pri-



Haven't I seen you on L.A. Law?

vatisation, you need a lawyer, how 'bout us?”

Such aggressiveness has provided a pretext for protectionism. In France, where lawyers grumble about the “Anglo-Saxon threat”, a law took effect this year requiring all foreign lawyers not already in France to pass a French exam if they want to give advice there, even if only on their home-country law. No new American firms can open offices in France—ever. As for Japan, foreign lawyers there still cannot employ *bengoshi* to advise foreign clients. If a British company wants to open a subsidiary in Osaka, a pricey local firm must be consulted.

Both these restrictions will almost certainly fall. Quiet threats from the EC commission seem to have persuaded the French to reverse themselves and support a proposed EC directive letting lawyers from anywhere practise any law—save probate, conveyancing and advocacy in court—in any country. Similarly in Japan, Carla Hills, America's trade representative, is swinging her crowbar. Some local



commercial-law specialists are resisting. One, Kunio Hamada, compares the presence of American law firms in Tokyo to that of Saddam Hussein in Kuwait. Despite such talk, change looks likely.

Indeed, the European and Asian legal markets are becoming more, not less, competitive. A spate of mergers has expanded the number of lawyers in several Dutch firms to more than 200; German firms are also growing fast. European alliances have been formed, for lawyers to serve their home-country clients and to compete for international business. Accountants, too, are involved: Fidal, the legal arm of KPMG in France, is continental Europe's biggest supplier of legal services.

The clash of legal cultures has taken civil-law lawyers into the modern age. Faxes and word processors are *de rigueur*. Legal memoranda are ready in days. In Japan, where the lawyers' code of ethics is so idealistic that strict adherents believe an attorney should not serve business clients, the number of English-speaking international lawyers has doubled since 1980. Around the world the civil-law bar is becoming more like the common-law one.

Hyperlexophobia

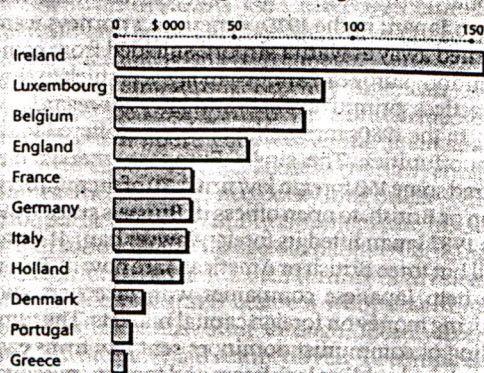
Not everyone is thrilled by all these hard-driving lawyers. After all, they do more than give advice and write contracts. They also fight. To most people, that is the main thing that lawyers do—which is fair enough. Litigation is only one arrow in a lawyer's quiver, but it is poison-tipped. Acrimonious, time-consuming, costly: an increase in lawsuits is one side-effect of common-law heritage that many Europeans and Asians could do without.

It will probably prove unavoidable, for two simple reasons. First, as people and businesses grow richer, the stakes of conflict rise: there is more to argue about. Second, as economies spill across borders, parochial relationships give way to cosmopolitan ones. Strangers are more prone to sue each other than neighbours are. Contracts lengthen; suspicions spread. The more law, the more lawsuits.

In America they call it "hyperlexis", a disease inducing vulnerability to lawyers. Overseas there are worries it could be a spreading sickness. In Europe the number of medical-malpractice cases is rising. Business litigation in Britain has increased 30% in each of the past two years. And then there is

EC average injury awards

Loss of sight in one eye
For medical student, single woman, aged 20, 1990



Source: Davies Arnold Cooper

the EC factor. As directives are passed, the commission encourages lawsuits to test them—and hence help ratify its authority. Companies are urged to press antitrust complaints in local courts.

The peculiarities of the single market may exacerbate the trend. Consider product liability. In 1985 an EC directive told states to adopt stricter, consistent product-liability laws. That they have done. But verdicts in personal-injury lawsuits differ widely between countries (see chart). Under EC law the manufacturer of a defective product can be sued where it is based, where the product was bought or where the buyer lives. A good lawyer, says David McIntosh, a partner at Davies Arnold Cooper, a London solicitor, will look at the table and file his suit where the pay-off is likely to be biggest. Such "forum-shopping" is common among American contingency-fee lawyers. Mr McIntosh thinks Europe will soon have its own personal-injury bar.

Japan, too, is thinking of writing a new product-liability law. Having studied the American system, however, Japanese lawmakers thought it an unsuitable model. "America", says Mr Hamada, "believes that justice will somehow come about through a free market in accusation." The view is widely held. Since many countries are worried that their systems are being infected with America's hyperlexis, it is worth asking: is Mr Hamada right?

Order in the tort

Are America's lawyers a competitive disadvantage?

DAN QUAYLE seems to think so. "Does America", he asked a year ago at a convention of the American Bar Association (ABA), "really need 70% of the world's lawyers? Is it healthy for our economy to have 18m new lawsuits coursing through the system annually?" Mr Quayle called America's legal system "a self-inflicted competitive disadvantage" costing \$300 billion a year. Outraged lawyers charged him with savaging them to score political points. They were partly right: administration insiders say that with the attorneys Clinton (Bill and Hillary) as opponents, the Republican campaign will feature more such speeches. But political attacks work only if they find an echo with voters. In

America, lawyer-bashing does. Deafeningly.

America has always been, as de Tocqueville observed, a peculiarly legalistic place. A high-street bookshop in Britain might stock a smattering of legal tomes. American ones have shelves of legal paperbacks, many of them how-to manuals: "Probate Made Easy," "Divorce Without Lawyers". Whether this reflects enthusiasm or fear is hard to say. Probably it is both. Like incredulous foreigners, many Americans think their legal system has gone haywire. They recount the crazy cases that litter the popular press—the man who jumped in front of a subway train and won \$650,000 because it did not stop before hitting him; the shopkeeper who sued a

customer for \$100,000 for emotional distress caused by his persistent flatulence. Mr Quayle's statistics support what people already believe: that America is in the midst of a "litigation explosion".

Actually those statistics are rum. First, recall that America accounts for a third, not 70%, of the world's lawyers. It is true that there were 18.4m new lawsuits filed in state courts in 1990, 30% more than in 1984; federal courts added another 250,000. But in state courts, two-thirds of civil cases involve small claims, divorces and wills (see chart on next page). Death and divorce are lamentable, but they are not symptoms of runaway litigiousness.

One type of lawsuit is what causes most of the fuss: torts. Torts are suits, such as product liability and medical malpractice, in which an injured person tries to recover money for damages that are economic (medical expenses, lost wages) or non-economic ("pain and suffering"). Since the mid-1970s, product-liability suits in federal courts have grown five-fold, to 12,400 last year. Usually at least half of them involve asbestos, a known carcinogen. Not counting these, product liability has declined 36% since 1985. Medical-malpractice suits, which soared from one per 100 doctors in 1960 to 17 per 100 in 1986, are also falling. The growth of personal-injury suits in state courts has levelled, too.

There is plenty of evidence that Americans do not, as is supposed, sue at the drop of a hat. Most people injured by a doctor or product never even see a lawyer. Still, American tort litigation dwarfs that of other countries. Britain has fewer than 500 product-liability suits a year; Holland has had five since 1940. Malpractice insurance across Europe costs less than 10% of the \$16,000 annual average in America (where some specialists, such as obstetricians, pay up to \$250,000 a year in premiums).

Gary Schwartz, a professor at UCLA, argues that the disparities have little to do with differences in liability law, which are minimal. He points to differences in legal systems. In America, as almost nowhere else, lawyers can take "contingency fees": if they win, they are paid a percentage (usually a third or so) of the award; if not, they get nothing. Groups of plaintiffs alleging damages caused by the same defendant can file "class actions". Pre-trial "discovery", in which each side demands from the other information relevant (in theory) to the case, has few limits; other civil procedures are lax. America does have the world's freest litigation market.

The crucial difference, however, is that juries decide cases and set damages; elsewhere judges do the job. American juries can even award "punitive" damages to punish defendants for heinous behaviour. Studies by Rand's Institute for Civil Justice, a California think-tank, show average jury awards rising sharply in real terms since the mid-1970s. Little of this is due to punitive damages; Michael Rustad, a professor at Suffolk University, has found there have been only 355 such awards since 1965.

Instead the cause is mainly "pain and suffering" awards. Juries have no idea how to put a price-tag on such things: one recently gave the wife of a man killed in an aeroplane crash \$600,000 purely for the anguish he suffered in the minute before his death. More commonly, says Rand's Stephen Carroll, juries award plaintiffs about 2½ times their claimed medical expenses. As medical costs have

risen, "pain and suffering" awards have soared.

Most lawsuits never come to trial, and few huge awards survive appeal. But "pain and suffering"—and, to a lesser extent, punitive damages—have made America's legal system at once more costly and more unpredictable. Coupled with minimally restrictive civil procedures (what Walter Olson, author of a recent book on American litigation, calls "deregulated combat"), they create a legal structure that practically invites abuse.

Guilty

For contingency-fee attorneys, who handle the vast majority of personal-injury cases, the combination has deliciously skewed the market incentives that govern their choices of which cases to take. When multi-million-dollar jackpots are possible, long shots are more worth the time. With legal uncertainty, the settlement values of such cases rise. Meanwhile defence lawyers have every incentive to stall and haggle as long as possible.

Unpredictability also induces some frivolous cases. The plaintiffs' bar is infamous for its nuisance suits, some of which border on extortion: for example, many shareholder "derivative" suits alleging fraud or breach of fiduciary responsibility after corporate takeovers. Some lawyers have mastered procedural tricks, such as forum-shopping for jurisdictions with sympathetic juries (Texas is a favourite) and using dubious "expert witnesses".

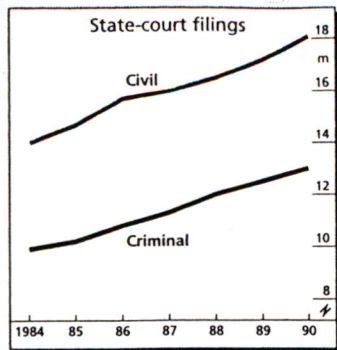
But ambulance-chasers have no monopoly on frivolous litigation. Businesses are equally guilty. One top American M&A lawyer says that a target company's first response to a hostile takeover should be to sue the bidder—whether or not it has done anything wrong. When employees of a high-tech firm leave to start a new company, they are often hit with a trade-secret suit before they have even opened their new offices. Businessmen do not call such litigation frivolous; they call it "strategic".

Indeed, it is business litigation—not torts—that is growing fastest. Complex cases involving intellectual property, contracts and antitrust consume years and millions of dollars in legal fees. Corporate litigators, who are paid by the hour, have as much incentive as contingency-fee lawyers to drag cases out. Calling himself a "born protractor", a

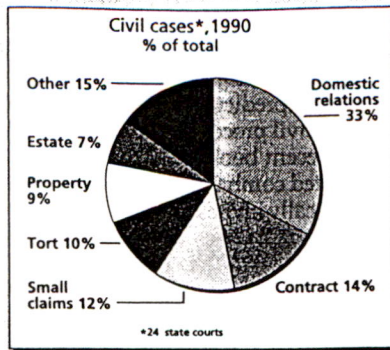


70%, a third: who's counting?

Not as bad as it seems



Source: National Centre for State Courts

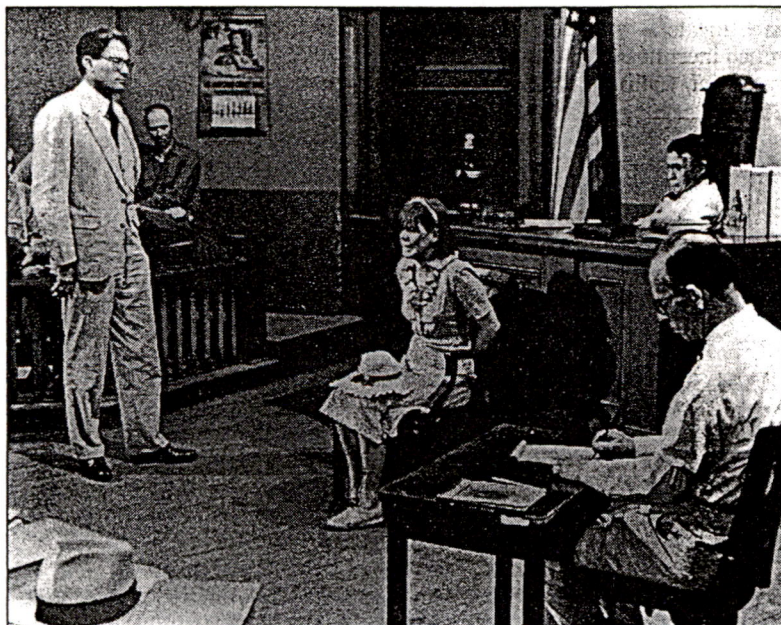


partner at one big firm brags to law-school audiences of a long antitrust case: "My firm's meter was running all the time—every month for 14 years."

The root of such fiascos is discovery, which accounts for 60% of the time and money spent on lawsuits. In a 1988 survey by Louis Harris, a big majority of litigators for both plaintiffs and defendants said that discovery is used as a weapon to increase a trial's cost and delay to the other side (nearly half said lawyers use it to drive up their own charges). Car companies have been asked to submit every complaint they have ever had about faulty headlights. In an IBM antitrust suit, discovery took five years and produced 64m pages of documents.

All this might be acceptable if the American legal system proved, in the end, an efficient means of resolving disputes or compensating injuries. But it isn't. Of the billions of dollars paid out each year for liability (more on this later), just half goes to plaintiffs. The other half—or two-thirds in complicated cases such as asbestos—pays for "transaction costs", for which read "lawyers' fees". In Superfund pollution cases, fully 80% of the money goes to lawyers instead of cleaning up the environment.

Courts are clogged. The average suit takes over a year to finish. In Chicago, the backlog for civil cases



Even Atticus Finch's fees were painful

is eight years; in New Orleans, courts are so overcrowded that a judge recently declared the system unconstitutional—no one, he said, was getting a fair trial. Part of the problem is due to increases in criminal cases, which take precedence over civil ones. But the antics of civil lawyers do not help.

Highway patrol

Enter Mr Quayle, a right-wing Republican making an ironic plea for re-regulation: a set of proposals to toughen the rules that govern the civil-justice system. They have not got far in Congress. But the solicitor general, Kenneth Starr, America's top government lawyer, believes that legal reform is in the air. Robert Litan, of the Brookings Institution, a Washington think-tank, agrees. He likens America's legal system to a jammed motorway. Ideas to get it unstuck fall into several categories.

- The ABA's big idea is to **build more lanes** by pumping more money into the court system. No doubt some courts are woefully underfunded. But as any transport economist knows, as new lanes are built, traffic will invariably increase to fill them.

- Conservatives would rather **block access roads** by making it harder to sue. They would introduce, as Mr Quayle proposes (in certain kinds of cases), the "English rule" of costs: the losing side pays the winner's legal fees. This would deter phoney claims. But it would also discourage risk-averse plaintiffs with legitimate but not air-tight cases. If any class of legal actions deserves the English rule, it is business litigation where both sides have deep pockets. Judges should more frequently use their power to award costs when cases are frivolous; but it is lawyers, who basically decide whether and how to fight a case, who should pay—not their clients. A better British custom to imitate: if a plaintiff turns down a defendant's concrete offer of a settlement and then wins a smaller amount at trial, he must pay the defendant's legal costs.

- Mr Litan prefers to **build exit roads** so people can leave the motorway quickly. Judges should set firm, early trial-dates, thus keeping lawyers from cranking up the "discovery machine" to run indefinitely. A 1990 law has federal judges trying this. State courts should, too. Other ideas to limit discovery—Mr Quayle is pushing some—should be considered.

- Opening **secondary routes** would help too. Practically everyone from Mr Quayle to the ABA agrees that various forms of alternative dispute resolution (ADR)—formal mediation, arbitration, negotiation—should be encouraged. So should "early neutral evaluation", where cases go to an impartial observer for feedback before pressing ahead.

- Increasingly, businesses are simply using **private helicopters** to fly over the motorway. Often this means hiring retired judges to rule on disputes. The drawback of "rent-a-judge" for the public (if not for businesses) is that cases are confidential, so controversial goings-on can be kept secret. But such private courts are still appropriate for many routine business-to-business disputes.

The most valuable reform does not fit neatly into Mr Litan's analogy. It is advanced by a group who studied the tort system for five years for the American Law Institute: a uniform scale for juries that puts a price on "pain and suffering". Caps on such damages have been tried in some states. But

ceilings mean that serious injuries can go undercompensated, while minor ones can win big cash from eccentric juries. Better to provide a schedule that tapers downwards. Juries could disregard it; but if they did, the scale would be a sound basis for appeal. Writing it would be hard. But once it was done, it would create considerable predictability in a system whose main failing is a lack of it.

Taxing torts

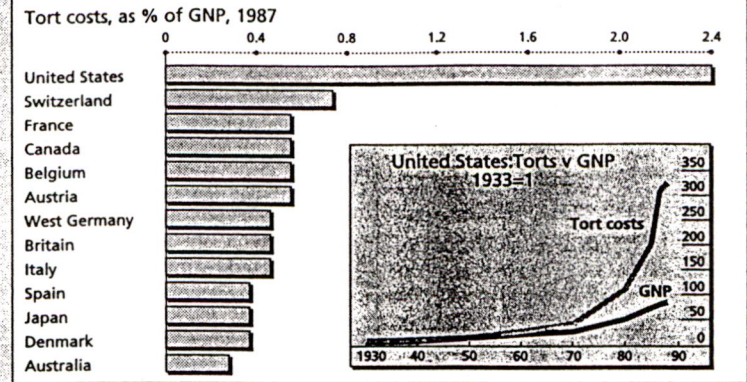
The best of these ideas (few of which lawyers like) would work by making the legal system more rational, not less accessible. Courts in America have been powerful protectors of individual liberties and agents of social change—think of civil rights, or consumer protection. For all their complaints, Americans hold dear the ease with which they can use their courts. And well they should. People in many countries would dearly love to be so litigious.

But more than a few Americans think that lawsuits and lawyers are imposing unnecessary costs on the economy, especially through the tort system. The debate over the precise size of this "tort tax" is as polarised as the one over abortion. On one side there is Mr Quayle, whose \$300 billion figure has no discernible connection to reality. On the other is the Association of Trial Lawyers of America (ATLA), the pressure group for the personal-injury bar. ATLA's view is simple: money paid out in tort suits goes to compensate injuries; most of it comes from insurance companies; insurance companies make profits; thus the system does not cost a cent.

Somewhat more plausibly than this astounding logic, Tillinghast, an insurance-industry consultant, calculates that liability-loss payments in America totalled \$117 billion in 1987, about 2.5% of GNP. That is three times more than in any other rich country (see chart). Calculating the net "tort tax" is, however, more complicated. To start with, some of the money goes to compensate victims. Defenders of the tort system also say that lawsuits encourage safety by deterring businesses from making defective products. Critics, including most businessmen, argue that the risks, costs and capriciousness of the tort system deter innovation.

A recent book* published by the Brookings Institution indicates that both claims are shaky. Because the legal system is so unpredictable, it seems

America's first



Source: Tillinghast

to fail to give manufacturers useful information about how (as opposed to whether) to be safe. But it is also difficult to find much hard evidence of lawsuits stifling innovation, apart from a few isolated examples: litigation over Bendectin, a morning-sickness drug, stopped development of that type of medicine; America's small-aircraft industry has virtually collapsed because of lawsuits.

Whatever its effects on business, tort litigation is an easy target because its costs are so visible—the headline jackpot verdicts, the Tillinghast estimates. Many other countries simply internalise these costs through tougher regulation or more generous social programmes, neither of which many American businessmen would be keen to accept or pay for. Nothing would do as much to dampen litigation in America as national health insurance.

But those who worry that overlawyering is eroding America's competitiveness say the problem is deeper. Would America not be better off, they ask, if it spent more time innovating instead of litigating? If more of its brightest young minds became engineers rather than lawyers? These are not idle questions. When "declinists" ask them, they are not dreaming of some unreachable utopia. They are, as usual, looking enviously across the Pacific.

* "The Liability Maze", edited by Peter Huber and Robert Litan. The Brookings Institution, Washington, DC



Tested but untried

LIKE so many things Japanese, the country's legal system is shrouded in myth. Most westerners believe litigation is shunned in Japan as too disruptive; that legal self-interest is sacrificed at the altar of social harmony; that lawyers are disrespected for being quarrelsome. The Japanese are happy to have these things believed about themselves—who wouldn't be? The trouble is, they are all half-truths.

The first half-truth is that there are virtually no lawyers in Japan. There are indeed just over 14,000 *bengoshi*—11½ for every 100,000 Japanese, compared with 312 lawyers for every 100,000 Americans. But *bengoshi* are mainly litigators; they handle only a small portion of Japan's lawyering. The

rest falls to a hotchpotch of licensed judicial scriveners, administrative scriveners, patent attorneys and tax attorneys. On top of that are in-house corporate legal staffs filled with law graduates who never bothered to pass the bar exam; Sony, for example, employs 120 of them. Add it all up and Japan has around 125,000 suppliers of legal services.

Nor does the dearth of *bengoshi* have anything to do with an aversion to contentiousness. It is a result of government policy. Each year about 23,000 Japanese (more per head than in America) take a tortuous three-part bar exam to win a place at the Legal Training and Research Institute (LTRI), the state-run training facility for *bengoshi*. Just 600,

Law without lawyers has its drawbacks

Japanese litigation fees

amount in controversy or awarded, Yen	Retainer % of amount claimed	Success fee % of amount won
up to 500,000	15	15
500,000 to 1m	12	12
1m-3m	10	10
3m-5m	8	8
5m-10m	7	7
10m-50m	5	5
50m-100m	4	4
100m-1 billion	3	3
over 1 billion	2	2

source: Japan Federation of Bar Associations



or 3%, pass. (In America the bar exam pass-rate is almost 70%.) Few succeed on the first try; the average entry age into the LTRI is 29. Most would-be *bengoshi* spend millions of yen on "cram schools" to help them pass. Of those 600 who do, about 400 become practising lawyers, the rest prosecutors or judges.

This formidable barrier to entry is the first component of a potent cartel. Consumer information is restricted by an advertising ban; prices are set by *Nichibenren*, the Japanese Federation of Bar Associations (see table). Foreign lawyers, remember, are prohibited from

advising on local law or hiring *bengoshi* to do so, thus protecting a valuable monopoly for Tokyo's commercial-law specialists.

They turn it into stacks of cash. A 1987 study for Rand based on tax records showed the average take-home pay of Japanese international lawyers was more than \$100,000—50% higher than hospital directors, four times that of university professors. Non-international lawyers do worse, though still better than many professionals. And these lawyers are often paid in cash. Income-tax data are unlikely to capture every cent that ends up in their pockets.

Prospective litigants do not do so well. In 1989 there were about 1.8m civil cases filed in Japan, the vast majority of which were small claims and other minor matters. Fewer than 250,000 were tort or sizable contract lawsuits. A survey of 194 big Japanese manufacturers found that only 24 had ever faced a product-liability suit at home (just seven lost); one car company was hit with 250 such suits a year in America, two in Japan. Medical-malpractice insurance premiums for doctors average about \$320.

The received wisdom that the Japanese do not sue because their culture is non-adversarial is easy to believe. When a Japan Air Lines (JAL) pilot deliberately plunged his jet into Tokyo Bay in 1982, killing 24 people, JAL's president knelt in apology before the families of the victims. No lawsuits followed. Such acts of contrition are not unusual. To pundits, they are proof that Japan is a place where conciliation trumps confrontation.

Others are not so sure. They point to the lawyers. Look again at the fee schedule. To hire a lawyer for a suit, alleging, say, \$1m in damages, the retainer would be \$30,000. Since there are no contingency fees in Japan, it would have to be paid in advance. Also there are steep filing fees that must be paid to the court in advance—\$5,000 in this case. Such high upfront costs might not matter if justice were speedy. But because the supply of judges is so small, they are brutally overburdened; cases usually proceed at a pace of one day in court each month. The average case takes more than two years; complicated ones can run to five or ten.

Revisionists point to cost and delay as the real reasons the Japanese do not sue. They label the traditional view "the consensual myth". "The idea that Japanese people do not pursue their self-interest in the courts because of a cultural preference for harmony", says Yukio Yanagida, a Tokyo commercial lawyer who has taught at Harvard, "does not

make sense to anyone who knows many Japanese."

There is another possibility: that the Japanese do not sue because they are rational, not reluctant. Rather than fighting in court, they use alternative ways to seek compensation. Insurance companies run claims centres to adjudicate car-accident cases. Consumer centres negotiate on other personal-injury disputes. Some industries have set up funds to pay product-liability claims; if a product marked with an SG (Safety Goods) seal causes an injury, a consumer can apply to the SG Association for up to \$165,000 in damages. Customers also negotiate with companies directly. JAL is said to have paid victims' families \$450,000 each for the 1982 crash.

Those avenues are cheaper and faster. But are they fair? Alternative procedures often produce awards consistent with what claimants would have got had they troubled to go to court. Japanese judges use clear, detailed formulae to calculate negligence and damages. These criteria are published; there are even Japanese comic books detailing how much you can expect for, say, an arm lost in a car wreck that was 50% your fault. Mark Ramseyer, an American law professor who studies Japan, found that in fatal traffic accidents, families who dealt with insurance companies directly did as well as those who went to trial. Because Japanese legal rules are predictable, he says, justice is done efficiently without courts and judges—or lawyers.

This is fine as far as it goes. The Japanese civil-justice system admirably avoids the uncertainty trap that has made such a mess of America's system. Alternative means of resolving disputes are desirable. But an alternative is only an alternative if it is freely chosen. Many Japanese are compelled, by delays in the legal system and the scarcity and price of lawyers, to find other ways of seeking redress. Sometimes it works. But sometimes it doesn't.

The cartel's cost

On an island off Japan's southern coast, a run-down fishing village called Minamata shares a bay with Chisso, a chemical company. In the mid-1950s, Minamatans noticed something odd: the village cats began twisting with spasms and tossing themselves into the sea. Soon people began doing something similar, and children were being born with deformities. Chisso, it seems, had been dumping raw mercury into the bay. The company denied wrongdoing and blamed the government for lax regulation. Protests were staged, followed by lawsuits in 1967. After more than 20 years of failed negotiations, mistrials and dead victims, one case ended in February. Chisso was ordered to pay damages to the families of 42 victims—of \$30,000 each.

The Minamata affair, which goes on (Chisso has appealed), is a dramatic example of the failings of Japanese justice. Courts and lawyers exist to level the playing field in a dispute. Cases in which the two sides have drastically unequal bargaining power can be hard to settle fairly through negotiation, especially if there is little credible threat of them ending up in court. With the shortage of judges, courts in Japan are in worse shape than in America. That is one consequence of enforcing the lawyers' cartel by keeping the number of *bengoshi* (and hence judges) artificially small.

There are other consequences. The costs of hir-

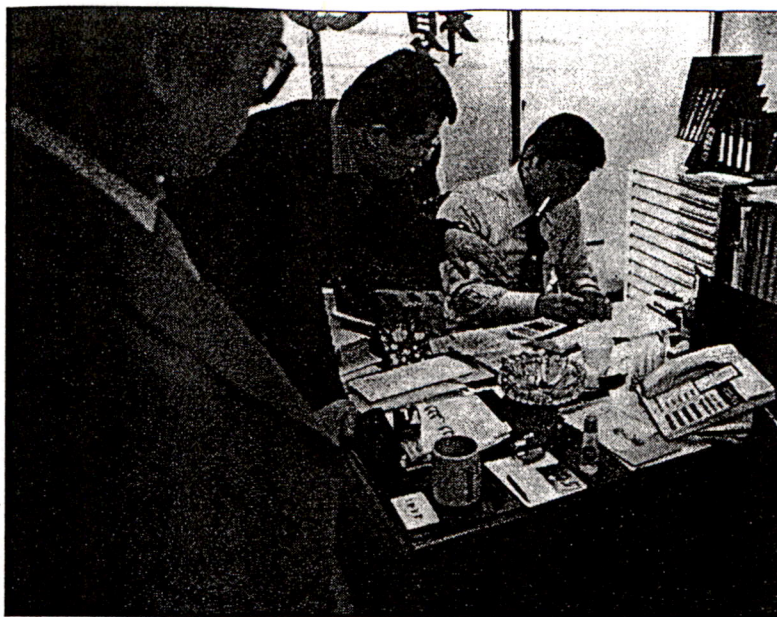
ing a lawyer have made some Japanese turn to less laudable methods of alternative dispute resolution. Japan's notorious gangsters, the *yakuza*, provide services performed elsewhere by lawyers: debt collection, contract negotiations, help with corporate restructuring. "In Britain, solicitors send a letter in these matters," says Mr Hamada. "Japanese send *yakuza*. They are lawyers' biggest competition."

Trying to spot unmet legal needs is like listening for the dog that doesn't bark. Yet reformist lawyers say that if lawyers were more plentiful and less costly, customers would appear. When local bar associations set up telephone hotlines—for complaints about employment discrimination, sex discrimination, immigration troubles—they are flooded with calls. Alleged criminals can rarely find a lawyer before their trials; in 90% of cases they confess after days of police interrogation.

Under pressure, the Ministry of Justice recently increased the number passing the bar exam—to a whopping 700, starting in 1993. Reformers want to go further, perhaps as high as 2,000. Some in the justice ministry agree, citing the shortage of judges. Demand will increase even more if foreign lawyers are eventually allowed to hire *bengoshi*.

Daunting obstacles remain. Despite problems with clogged courts, the government has no appetite for more litigation, which can, as Minamata shows, be embarrassing. Of the consumers of legal services, "repeat players" might be expected to be a powerful constituency for change. But by employing non-*bengoshi* legal staffs, Japanese businesses have found a way round the cartel.

Most important, few lawyers want this lucrative arrangement dented. Of the world's lawyers, the Japanese are the most self-righteous, condemning America's *sosho shakai* ("lawsuit society") and



They'll make you a settlement offer you can't refuse

quoting their lawyer's law that their only mission is to "protect the fundamental human rights and to realise social justice". In fact they are devoted to protecting their status and realising fat profits.

Indeed, only one group would gain from greater access to lawyers: their would-be customers. But because people seldom use lawyers, they do not think of themselves as consumers of legal services. That is why lawyers rarely face popular demands for change—and not just in Japan. For reforms to be successful, they must come from the top down. To see why, consider Britain.



Lord Mackay's legacy

RAISE a glass for Betty Boothroyd. Earlier this year Miss Boothroyd became the first woman speaker of Britain's House of Commons; also the first to take the chair unadorned by the traditional speaker's wig. Her decision made headlines in London, then overseas, and revived a long-simmering debate among barristers and judges over whether to shed their horsehair toupees. After days of heated argument came the decision: more debate was needed before taking so bold a step.

Change does not come easily to the British legal profession. Outside the slick solicitors' offices of the City of London, life for many lawyers has remained much as it was 100 years ago. There is still more than a whiff of "Bleak House" about barristers' cramped, creaky chambers. The wigs, the gowns, the haughty judges refusing to acknowledge women barristers whose shoes are not quite right—to visitors, and to many Britons, it all seems archaic.

But much of the anachronism is not so quaint. The profession is split, as in fewer and fewer countries, between barristers (4,000 of them working for businesses, 6,900 practising independently) and solicitors (57,000). For centuries the profession was riddled with restrictive practices: only barristers

could appear in higher courts, but their clients had to go through solicitors to hire them; solicitors had a monopoly on the legal end of housebuying; for barristers, partnerships with one another or other professionals were not allowed; neither was advertising; judges could not speak to the press.

Then, in 1987, Margaret Thatcher appointed Lord Mackay of Clashfern as Britain's Lord Chancellor. It is a powerful position: presiding over the House of Lords, appointing all judges and ruling on cases in the court of final appeal—imagine a member of George Bush's cabinet simultaneously being Senate majority leader and a sitting Supreme Court justice. Lord Mackay brought an outsider's perspective to the job. A radical, a Calvinist and a Scot whose father was a railway signalman, he was not much like his sniffer brethren at the bar. Immediately he set about a series of reforms intended to be the legal profession's Big Bang.

Dickens wrote that "the one great principle of the English law is to make business for itself". Lord Mackay sought to introduce another: that the interests of customers should be put ahead of lawyers', and that consumers of legal-services would benefit from competition among suppliers. The barristers'

*He shook up
Britain's lawyers
once. He should do
it again*



Mackay rules in favour of the customer

monopoly meant that a client had to pay both solicitor and barrister for a service that, often, either one could do alone. The solicitors' monopoly kept banks and building societies from offering cheaper "one-stop shopping" for homebuyers. Both monopolies were justified as preserving "independent" advice. In fact what they preserved was (barristers') snobbery and (solicitors') self-interest.

In 1989 Lord Mackay published three "green papers" with proposals to bust the monopolies. After specialised training and study, any lawyer would be able to appear before any court. Financial institutions would be allowed to handle conveyancing. Barristers could advertise, take instructions from clients directly and form partnerships with solicitors and other professionals. Solicitors would, for the first time, be eligible to become judges.

Barristers and law lords (all of whom are ex-barristers) lashed out at Lord Mackay with the ferocity of French farmers defending their subsidies. The lord chief justice said the green papers were among "the most sinister documents ever to emanate from government." Lord Hailsham said the government was "thinking with its bottom". Others compared Lord Mackay's ideas to those found in South Africa and Nazi Germany. One said he was—horrors—"treating judges like civil servants".

Solicitors were subtler. The right to appear in court was to them a symbol of equality with barristers. But the conveyancing monopoly was bread-and-butter. Walter Merricks, of the Law Society, reckons that 10% of solicitors would be affected by the first reform, 90% by the second; provincial solicitors get 40-60% of their income from conveyancing. The apoplexy of the bar—and its patrons in the House of Lords—made clear that Lord Mackay would have to do some retreating on rights of audience. So, while campaigning to let solicitors into court, the Law Society lobbied quietly to link concessions on this to a compromise on conveyancing.

That is what they got. Two years after the Courts

and Legal Services Act of 1990 was passed, solicitors still have an effective monopoly on conveyancing. With the collapse of British property markets, financial institutions lost interest in providing the service; but Lord Mackay still has statutory authority to create a new regulatory body to authorise them to do so—which he says he will use if demand returns. Also shelved were direct access to barristers and multi-disciplinary professional partnerships.

Yet these losses pale beside what Lord Mackay won. It might not seem so. His main victory, giving courtroom rights to most solicitors, has been slow in coming. It will be a few more years before any of them set foot in court. But enter court they will, and then, eventually, the judiciary. Because of him all lawyers can advertise and talk with the press. They are also open to unprecedented scrutiny.

Equally profound is his establishment of a permanent advisory committee, with a majority of non-lawyers, to formulate policies on educating and training lawyers. True, a four-judge panel retains veto power over the committee's plans. But as Lord Mackay points out, giving these judges such prominence also makes them more publicly accountable. The advisory committee, he says, is "the machinery of continuing reform". Such institutional mechanisms are the stuff of lasting change.

Many of the goals once sought by radical reformers are now within reach. Chief among these is the merger of barristers and solicitors into a single profession, which is happening already by stealth: the ranks of barristers employed by businesses is growing; the number of solicitors appearing in court will do the same when City firms are asked by big clients, as they will be, to develop advocacy skills. This should not worry the best barristers. They will survive, even thrive, as top litigators do in America. The merger should be sped along by relaxing restrictions and, eventually, forging a unified legal-training system. Partnerships between lawyers and other professions should be allowed.

Lord Mackay claims he never expected all the ideas in the green papers to be adopted immediately. But insiders say the drubbing he took from his peers left him deeply dispirited. The rumour mill grinds out gossip that he will soon go. He denies it. It is to be hoped that he is telling the truth. Much remains to do.

Costs, m'lud?

At the turn of the century Max Weber observed that in England, justice turned on class. It still does. Britain has far less litigation than America, but going to court in London is costlier than it is in Los Angeles. In America contingency fees gives access to the courts to those who could not otherwise afford a lawyer. In Britain this falls to a public legal-aid scheme: a plaintiff whose disposable income and capital are below certain limits can apply for aid; if his claim is thought worthy, his lawyer is paid by the government (and ultimately by the other side if he wins). But the system has run into double trouble. First, its cost, £760m (\$1.4 billion) last year, has more than doubled since 1986. Second, the proportion of people eligible for aid has shrunk, according to some estimates, from 70% to 40%. The great middle, neither rich nor poor enough to afford a lawyer, is growing.

Thus is legal aid Lord Mackay's new firestorm. Keen to control its costs, he has floated some controversial ideas: pay flat fees to solicitors in criminal cases, require most civil legal-aid recipients to pay some of their own fees. All have raised howls of protest from lawyers. They say such cost controls will compel an already dwindling number of solicitors to give up legal-aid work. Rubbish, says Lord Mackay, who cites statistics showing the number of solicitors' firms earning £120,000 a year or more from legal aid has quadrupled since 1984.

The civil legal-aid system is a perfect target for Lord Mackay: inefficient, demand-led but producer-run, rife with vested interests. It deserves to be shaken to its core. The best idea on offer is a "contingency" legal-aid fund, where those who apply for support agree to pay a percentage of their damages, should they win, back into the fund. That money is then used to subsidise other cases. So long as cases are checked, as now, to weed out likely losers, the scheme should be self-financing.

But even such a radical solution will not solve the whole problem. Millions of middle-class Britons will still fear the potentially ruinous costs of their legal system. That is not an entirely bad thing. Making losers pay winners' legal fees serves a purpose by deterring frivolous litigation. But as any barrister will attest, it also deters legitimate claims by those who cannot afford the risk, however small, of losing. Even winners rarely get back all their costs from the loser; the average figure is around 60-70%.

There is an answer, one which also has the word "contingency" in it: contingency fees. The mere mention of it is enough to make many British lawyers wince. Lord Mackay flirted with the idea, and rejected it. Instead he favours the "conditional fees" used in Scotland, in which the lawyer is paid only if he wins—but his normal fee, not a percentage of the damages. Lord Mackay says there should be a small "uplift" to compensate the lawyer for his risk—of, say, 10% of the total fee.

Few lawyers would take that paltry bait. And if they did, it is unlikely they would then offer to pay the other side's legal bill if their clients lost. Such



I've got this great new idea for paying your fee

arrangements might prove rare anyway, but that is no reason to oppose contingent fees. Even if a plaintiff had to risk covering the other side's costs, that would still be half the risk he faces now. To encourage lawyers, some suggest a bigger uplift—of, say, 100%. Few are bolder. They look to America and think they see contingent fees degrading professionalism and turning litigation into a lottery.

Yet if they understood the true strengths of their own system, British lawyers would realise that it is not contingency fees that are the problem in America. It is the unpredictability of the legal system, which distorts the incentive effects of contingency fees. In Britain—where awards are lower and consistent, where decisions are taken by judges not juries, where a small bar means lawyers' reputations matter more—contingency fees would not make much mischief. If they did, lawyers would have only themselves to blame.



What price justice?

"A SOCIETY in which all human and social problems were regarded as apt for legal remedy would not be one in which we would find it agreeable to live." So stated the British Royal Commission on Legal Services in 1979. The conclusion is unexceptionable, but unenlightening. Which problems should fall to the law? Which should not? And who decides? These are political questions, not legal ones, to which there are no easy answers. But note: legal remedies are often the best available; the alternatives can be unfair, sometimes violent. As the world grows richer and more democratic, people turn increasingly to the law to sort out conflicts: no place is getting less litigious. In the sweep of history this is, to say the least, a positive development.

But not one without costs, monetary and human. The desire to cut these has led to the Big Idea set to dominate legal-reform agendas into the next

century: alternative dispute resolution. ADR dispenses with formality and cumbersome procedures and aims to settle cases faster than, but just as fairly as, normal courts. Typically ADR is administered through private arbitration or mediation services. It is catching on. America's biggest "rent-a-judge" company, in California, handles 30,000 cases a year; the membership of Britain's 18-month old Centre for Dispute Resolution includes many of the country's biggest companies; arbitration clauses in contracts are a commonplace.

ADR is no magic solution. In some of its forms it is as expensive as traditional litigation. Nor is it clearly benign. Rich litigants and big companies are influential constituencies for much-needed reforms in court systems around the world. As they switch to ADR, there is a risk that valuable democratic institutions will erode further, not unlike

It is never free



what has happened to America's public schools.

Yet there is something powerful about ADR. Like no-fault insurance schemes, worker's compensation and other bold, if flawed, attempts to deal with the problems of personal injury without litigation, ADR tries to conjure a world where costs can be cut without people having to sacrifice their own interests. It tries, in the words of the 18th-century Norwegians who first dreamed up courts of conciliation, to offer access to justice without "the glutony of lawyers". In the years ahead, as lawyers are pressed to lose the worst of their many bad habits, that ambition may become less fanciful.

End of a guilded age

I dined at my Lord Chancellor's, where three Serjeants at Law told their stories, how long they had detained their clients in tedious processes by tricks, as if so many highway thieves should have met and discovered the purses they had taken. This they made but a jest of: but God is not mocked.

John Evelyn scribbled those words into his diary in 1686. Back then, the Almighty had an inside scoop: Evelyn's diaries were not published for decades. Today thousands of New Yorkers can pick up the *Observer*, a weekly newspaper, and find this quote from the chairman of a top law firm:

I have two expensive houses, three expensive cars and two daughters who came out as debutantes with expensive balls. As long as I go home with a lot of money in my pocket, that's all I care about.

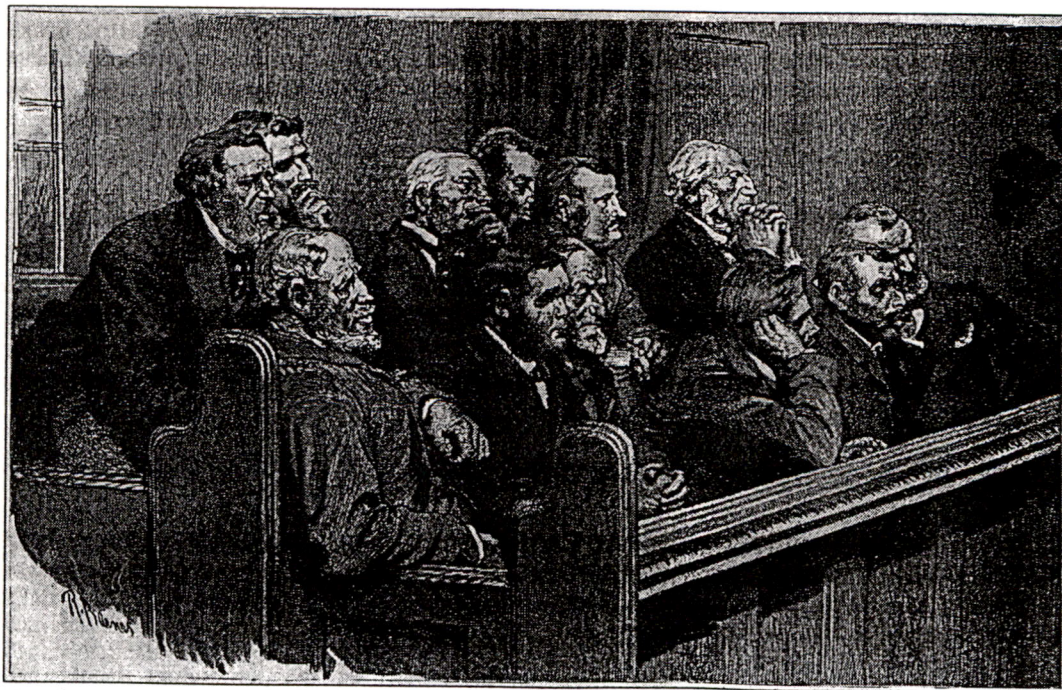
The law is no more an ass now than it was 300 years ago. It is just less able to keep its venalities (and worse) a secret. Alan Dershowitz, a flashy Harvard professor and *avocat celeb*, calls it the end of the legal profession's "Wizard of Oz syndrome". As the doings of lawyers have become more visible, so too has the gap between lofty ideals and grubby reality. Echoing in that gorge, the rhetoric of professionalism is ever more hollow.

Too often lawyers have used their professional status simply to protect their privileges. Lawyers' guild-like pressure groups, known politely as professional organisations—the ABA, the Law Society, *Nichibenren*—talk of justice and rights while resisting any reform that might cost their members a penny. There is more than a grain of truth in the words of Eliot Freidson, an American sociologist: "Professionals differ from trade unions only in their sanctimoniousness."

To varying degrees, public scrutiny and competition are imposing on lawyers a more demanding definition of professionalism: one dealing not with privileges, but with obligations. This is not necessarily idealistic stuff. In America, letting lawyers advertise has produced some pretty tasteless commercials. It has also helped to spawn unpretentious chains of shopping-mall law offices offering basic legal services to those who, not long ago, could never have afforded such help. The law becoming a business will have its ugly side; but more often it will bring an emphasis on efficiency and service, two elements essential to professionalism.

It may even lead to more—perhaps to lawyers trying to minimise the costs of litigation, or to avoid it in the first place. A handful of the best attorneys are doing this already. No sudden surge of altruism lies behind it. Rather, as clients grow more sophisticated, they are giving lawyers incentives to be less counter-productive, while at the same time some lawyers are realising that professionalism can be a selling point: best practice as good business.

Less remunerative obligations will be accepted less graciously. In two rare shows of selflessness, the ABA and *Nichibenren* are thinking of requiring their members to do some *pro bono*, public-service work each year. "Lawyers won't do it on their own," says a Japanese attorney, "so they must be forced." It is not exactly what Roscoe Pound had in mind. But it is a start.



"And so, to conclude . . ."

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Legal Reform

OFFICE OF THE VICE PRESIDENT
WASHINGTON

TO: DMM Anne
Richard John McConnell

FROM: John L. Howard
Counsel to the Vice President

☒ FYI

☐ Comment

☐ Action

Product Liability Reform
according to Hollings
and Gore.

ADDITIONAL VIEWS OF SENATORS EXON AND LOTT

We voted to report S. 640 the Product Liability Fairness Act of 1991. However, we have grave concerns about the implications to employers, particularly small business employers, of Section 305 known as the workers' compensation offset provision. Unlike other sections of the bill, this section does not directly involve product liability lawsuits. Rather, section 305 involves the economic relations between employers and manufacturers in the aftermath of such lawsuits.

As it is still early in the legislative process for S. 640, we urge that section 305 be given close further scrutiny with the hope that the concerns of employers, can be addressed. If those concerns cannot be addressed, we would urge that section 305 be deleted from S. 640 in the interests of the overall legislation.

Our concerns are based on the fact that most State and Federal workers' compensation laws give employers the right to recover, through a subrogation lien, their workers' compensation expenses paid to employees injured by defective products, in cases where an injured employee successfully sues the product manufacturer. The benefit to employers of the system of workers' compensation subrogation liens under present laws is obvious. This system reduces the burden on the individual employer's workers' compensation costs, reduces the burden overall workers' compensation system, and thereby reduces the pressure for workers' compensation insurance rate increases. However, this system would change under section 305 of S. 640, except in those situations where the employer had the financial ability to pursue a lien through the litigation process in the courts.

Not surprisingly then, the business community is not united in support for Section 305. Many business groups have expressed reservations or opposition to this section, including the National Federation of Independent Businesses (NFIB), the Associated General Contractors of America (AGC), the American Subcontractors Association (ASA), the Shipbuilders Council of America, and the National Association of Stevedores (NAS).

We urge that those problems arising from Section 305 be satisfactorily addressed prior to Senate floor consideration of S. 640.

MINORITY VIEWS OF SENATORS HOLLINGS AND GORE

INTRODUCTION

In the past, we have urged our colleagues to reject Federal product liability laws as unwise Federal legislation. Since then, the proponents of this legislation have had many years to make their case, and they have completely failed to do so. After this extended examination of the facts, we believe that, not only is this legislation unwise, but to enact it would amount to a complete distortion of the proper legislative process.

This measure would federalize an area of law that always has been the province of the States. Such an action should never be undertaken lightly. Those who propose such dramatic change through the legislative process should, at a minimum, bear the burden of proving that such change is both warranted and likely to be effective. Unfortunately, the Committee has ordered this bill reported without requiring anything close to a demonstration that either factor is present. On the contrary, the factual record clearly demonstrates that each stated basis for this legislation cannot withstand even minimal scrutiny. What is deeply disturbing about this legislation is the total lack of verifiable, objective data which supports the proponents' claims.

In fact, the stated basis for this legislation is a constantly moving target. A new reason that this bill is necessary is suggested periodically, the facts are examined, and that reason evaporates when exposed to the light of day and to the objective facts.

Contrary to the claims of the bill's supporters, the Committee's work on this issue has demonstrated that (1) there is no litigation explosion, and the number of most kinds of product liability cases is decreasing; (2) the insurance crisis (which has now ended) was not due to product liability; (3) the current system generally works properly to fairly compensate injured victims; (4) the competitive position of U.S. business is affected very little, if at all, by product liability; and (5) products kept off the market by product liability concerns are not necessarily safe, innovative products, but rather are examples of the product liability system deterring unwarranted risks to consumer. Each of the issues discussed above has been the basis, over the years, for the almost frenzied cry for Federal product liability law, but none of them withstands scrutiny.

This year, "competitiveness" is the buzz word on which the legislation is based. We are asked to pass this legislation to make U.S. business more competitive in world markets. However, these are the facts: less than 1 percent of the price of products is attributable to product liability; the Office of Technology Assessment (OTA) does not list product liability as a primary problem for U.S. manufacturers competing in world markets; this bill will not reduce product liability claims or insurance costs; our competitors in the

European Community are moving toward a product liability system more like ours, which appropriately reflects the need for consumer protection; and the General Accounting Office (GAO) says that this bill will not reduce transaction costs, but could actually increase them. The facts show that product liability is not the cause of competitive problems, nor is this bill the cure.

This year the President's Council on Competitiveness, headed by Vice President Quayle, has added its voice to the fray. Using political rhetoric instead of objective reality, it has made unsupported or inaccurate claims about the civil justice system and particularly the costs of the tort system. The cost figures cited by the Vice President cite no credible authority and have no explanation for how they were calculated or what is included in the general term "tort costs." Yet those cost figures are the centerpiece of the Vice President's call for a major overhaul of the civil justice system. It is troubling that even the executive branch, like the business advocates of S. 640, would base its arguments for such a major change on unsubstantiated, arbitrary numbers.

The proponents of S. 640 have represented that this bill is not as draconian as earlier Federal product liability measures, and will not impact as drastically on consumers. First, it should be noted that, despite efforts to characterize this as a bill that will impact similarly on plaintiffs and defendants, it is written for the benefit of the business community, and in most areas changes only the laws of the States that currently favor plaintiffs. We should not misunderstand the purpose of this bill.

The current form of this bill gives us little comfort in any event, since the primary effect of this or any such measure would be to begin the federalization of product liability law. Once that process has begun, Congress will never hear the end of the clamor for additional changes in this law, and will be spending an ever-increasing portion of its working time on this issue. Moreover, the form of even this bill is not cast in stone until enactment into law, and the administration and others are already calling for more stringent amendments. In addition, many of the substantive provisions of this bill are unwise or unworkable and the bill is riddled with ambiguity and conflicts for court practice and procedure.

Supporters of this bill are fond of implying that its only enemies are trial lawyers. It is important to note who the opponents of this bill really are. It is opposed by every major consumer organization, a wide range of health organizations, the American Bar Association, the National Conference of State Legislatures, and the Conference of State Supreme Court Justices. Over 70 law professors from all over the country have written to the Committee in opposition to this bill, stating that it is "unwise, unfair and ill-conceived." (See letter to Chairman Hollings from Andrew Popper, Deputy Dean, Washington College of Law, dated September 27, 1991, reprinted in record of Consumer Subcommittee hearing on S. 640, September 19, 1991.) These are the experts in health, consumer protection, and legal jurisprudence. They are concerned not with fees, but with product safety, justice and the proper functioning of the legal system. So, it is not just the trial lawyers who are concerned about the bill's effects.

We are being asked to enact legislation when there has been no credible demonstration that there is a problem that will be addressed by that legislation. At the same time, enactment of such a law would alter, in one stroke, the fundamental federalism inherent in this country's tort law, and would add to the difficulties already faced by the victims of defective products.

We yield to no one in our desire to assist American business in every way, and to ensure its viability in ever-changing world markets. However, we urge our colleagues to insist, at a minimum, on some objective demonstration that Federal product liability law is a reasonable means to address the problems of the business community. We have not yet seen such a demonstration, and in our view the legislative process is ill-served by taking such dramatic action in these circumstances. Legislative proposals of this type have been much ado about nothing for over a decade, but the "much ado" has been a considerable drain on the limited resources of the Congress. We have very limited time, and we must insure that it is spent on work that can be most productive for the nation. It is time to recognize where the burden of proof on this issue lies, to recognize that it has not been met despite 10 years of work, and to turn the resources of the Committee and the Senate to work on other more useful matters.

In the discussion below, we will set out in more detail the facts that have been developed on this issue. These facts demonstrate why we should not move forward on this bill.

THERE IS NO FACTUAL BASIS FOR THIS LEGISLATION

I. The Current System Achieves Fair Results, and There Is No "Explosion" of Litigation

Before we make dramatic changes in the product liability law, we should, at the least, have information to demonstrate that the current system needs fixing—that it is not achieving its purpose of fairly and properly compensating victims of defective products, and of deterring the marketing of unsafe products. As each additional piece of objective data becomes available, it becomes more clear that the system is working. The number of nonasbestos product liability cases is actually declining, punitive damages are a rare occurrence, and the compensatory awards are reasonably related to the cost of the injuries involved.

Prof. Marc Galanter of the University of Wisconsin Law School has completed the most recent review of statistics from the Federal courts, and found that, if asbestos cases are excluded, the number of product liability cases in the Federal courts has declined in the last 5 years—from 8,268 cases in 1985 to 4,992 in 1991, a 40-percent decrease.¹ He points out that asbestos filings account for all recent increases in product liability filings, and that asbestos cases are quite distinct in that they involve a product of "unparalleled dead-

¹ Testimony of Professor Marc Galanter, Director, Institute of Legal Studies, University of Wisconsin Law School, before the Consumer Subcommittee September 19, 1991, transcript at 86-87. See also Galanter and Rogers, "A Transformation of American Business Disputing? Some Preliminary Observations," working paper # DPRP 10-5, Institute for Legal Studies, University of Wisconsin (April 1991).

liness to which there was massive exposure that continued long after the dangers of its use were suspected and suppressed."²

Moreover, the Rand Corp. this year issued a report reviewing the way in which victims of accidental injuries are compensated and found, contrary to popular belief, that only 10 percent of those injured ever use the tort system at all to seek compensation for their injuries.³ The report further found that only 7 percent of all compensation for accident victims is paid through the tort system. The report concluded that "[m]ost Americans who are injured in accidents do not turn to the liability system for compensation. . . . In this respect, Americans' behavior does not accord with the more extreme characterizations of litigiousness that have been put forward by some."⁴

Similarly, the National Center for State Courts recently published updated statistics from State courts that reviewed civil court filings in 13 general jurisdiction State court systems from 1984-89. The Center concluded that "the most dramatic increases in the civil caseload tended to be for real property rights cases or contract cases, not torts."⁵ These statistics showed that tort filings make up less than 1 percent of all cases filed in State courts, and less than 10 percent of most States' civil caseload. Product liability cases, which are a subset of tort cases, would make up an even smaller percentage of the total.⁶

As Professor Galanter also has found, the real increase in litigation in recent years has been business suing business, not consumers seeking compensation through product liability litigation. For example, contract filings in Federal courts increased by 232 percent between 1960-88, and by 1988 were the largest category of civil cases in the Federal courts.⁷

Additionally, GAO last year completed one of the first extensive reviews of data related to State court product liability cases.⁸ Since most product liability cases are litigated in State court, and most of the past data has been only from the Federal courts, this report is very significant. GAO found that the size of compensatory awards varied by type and severity of injury in a manner consistent with underlying economic loss, so that compensatory awards were neither erratic nor excessive.⁹ It further found that plaintiffs won fewer than 50 percent of the cases litigated, that awards were based on negligence in almost three-quarters of the cases (even in the States that permit recovery based on strict liability without a demonstration of negligence), and that the amount of punitive damages awarded was highly correlated with the size of compensatory damages.¹⁰

² Galanter testimony, *supra*, transcript at 88.

³ Honaler, et al., "Compensation for Accidental Injuries in the United States," Rand Corporation, Institute for Civil Justice (1991), Executive Summary at 18. See also testimony of Dr. Deborah Honaler, Consumer Subcommittee hearing on S. 640, September 12, 1991, statement at 6.

⁴ *Id.*, Executive Summary at 18, 20.

⁵ National Center for State Courts, "State Court Caseload Statistics: Annual Report 1989," (February 1991) at 46.

⁶ State Court Caseload Statistics, *supra* n. 5, at 45-6.

⁷ Galanter and Rogers, "A Transformation of American Business Disputing?", *supra*, at 1, 5-6.

⁸ U.S. General Accounting Office, "Product Liability: Verdicts and Case Resolution in Five States," GAO/HRD-89-09 (September 1989). Hereafter referred to as "1989 GAO Report."

⁹ *Id.* at 27.

¹⁰ *Id.* at 29-31.

Another significant research effort concludes that, even if product liability cases could be characterized as unfairly favoring plaintiffs in the past, the current trend is clearly favoring defendants. Prof. James A. Henderson Jr. and Prof. Theodore Eisenberg of Cornell Law School performed an extensive study of all reported product liability decisions and found a "quiet revolution . . . away from extending the boundaries of products liability and toward placing significant limitations on plaintiffs rights to recover in tort for product-related injuries."¹¹ Specifically, they found that in 1976 and continuing to 1983, defendants benefited in roughly 51 percent of product liability cases. By 1988, the figure had risen by 12.2 percent, so that defendants prevailed in 63.4 percent of product liability cases.

Similarly, GAO¹² and Rand Corp.¹³ studies have indicated that, despite increases in absolute numbers of Federal product liability filings during the 1970s and 1980s, the data does not support the suggestion, made in past years, that there is an "explosion" of product liability cases from which business must be protected. Rather, GAO found that one product, asbestos, accounting for approximately 60 percent of the growth in filings between 1976-86.¹⁴ GAO further found that, since 1981, product liability cases have grown at about the same rate as other civil filings and at the same rate as personal expenditures on goods, with growth of product liability cases at 4 percent, personal expenditures on goods at 4 percent, and civil filings at 6 percent.¹⁵ The author of the Rand study has stated that "[m]y feeling is that the available evidence doesn't support the notion that products liability is crippling American business."¹⁶

Prof. Lawrence Mann from Wayne State University Law School performed a similar study for the Governor of Michigan in 1988-89. He began by noting that ". . . much of the debate surrounding products liability litigation has been based upon anecdote and intuition. Hard data describing the products liability litigation landscape are scarce." He conducted his research by surveying over 2,000 businesses as well as attorneys of record in closed cases for the year 1987. His general conclusion was that "[v]erdicts and settlements in products liability cases are not erratic and appear reasonably related to economic losses sustained and injury severity."¹⁷

His research found a "phenomenal concentration of litigation among a handful of defendants who are 'repeat players' in civil litigation." In 1987, four companies accounted for 92 percent of the

¹¹ Henderson and Eisenberg, "The Quiet Revolution in Products Liability: An Empirical Study of Legal Change," 87 U.C.L.A. Law Review 479, 480 (1990).

¹² U.S. General Accounting Office, "Product Liability: Extent of 'Litigation Explosion' in Federal Courts Questioned," GAO/HRD-88-36BR (January 1988).

¹³ Dugworth, "Product Liability and the Business Sector: Litigation Trends in Federal Courts," Rand Corporation, The Institute for Civil Justice, R-3668-ICJ (1988).

¹⁴ GAO Report, *supra*, note 12, at 32, 43.

¹⁵ *Id.* at 32, 43.

¹⁶ Wall Street Journal, "Survey Questions Liability Crisis at U.S. Companies," January 18, 1989.

¹⁷ Testimony of Professor Lawrence C. Mann, Wayne State University School of Law, Consumer Subcommittee Hearing on S. 1400, February 22, 1990, statement at 1-2.

cases filed. In 1982, four companies accounted for 91 percent of the cases filed, and in 1979, four companies accounted for 83 percent.¹⁸

Professor Mann concluded that " * * * fewer and fewer litigants are accounting for an increasing share of the litigation pie." He further found that " * * * the distribution of cases filed for the years covered in the * * * survey yield a picture of products litigation that is inconsistent with the conclusion that the business community in general is the victim of a products liability explosion."¹⁹

Additionally, according to one study by the Insurance Services office approximately 73 percent of the bodily injury claims and 83 percent of the property damage claims are settled without the filing of a lawsuit. Only 3.5 percent of claims go all the way to a court verdict, and in these cases, fewer than 25 percent of defendants are found liable. Thus, according to this study, 96.5 percent of product liability claims are resolved before the verdict.²⁰

Much has been made of the unpredictability of results in product liability trials. However, it has been recognized, as it must be, that most of this is due to our jury system.²¹ We cannot believe any of our colleagues want to tamper with that system. When a product liability case goes to trial, the jury is not impaneled for the purpose of giving away someone else's money. Rather it is charged with the administration of justice. These juries are composed of our friends and neighbors, who conclude, some of the time, that the defective products involved and the injuries sustained require compensation. And it is our friends and neighbors—who work for a living and know the value of a dollar—who occasionally conclude that punitive damages are justified when the defendant has engaged in outrageous behavior.

In addition, with respect to punitive damages, the extent to which they are awarded has been the subject of outrageous exaggeration. Much new data is available on punitive damages, which shows, among other things, that very few punitive damage awards have been made in all State and Federal product liability cases over the last 25 years. Punitive damages simply are not a factor in any but the rare product liability case, and have little effect on the business community. Dr. Stephen Daniels of the American Bar Foundation conducted a nationwide study of over 25,000 civil jury awards between 1981 and 1985. He concluded that the debate over punitive damages "changed in the 1980s as a part of an intense, well-organized, and well-financed political campaign by interest groups seeking fundamental reforms in the civil justice system benefiting themselves." He went on to state that this "politicization of the punitive damages debate * * * makes the debate more emotional and manipulative, and less reasoned. The reform-

¹⁸ *Id.*, at Report to the Governor of Michigan 2.

¹⁹ *Id.*, at Report to Governor 1, 2.

²⁰ See Insurance Services Office Product Liability Closed Claim Survey: A Technical Analysis of Survey Results at 96 (1977); 1986 Hearings on Product Liability, before the Consumer Subcommittee, 99th Cong. 2nd Session (Statement of the Public Citizen's Congress Watch, Consumers Union, U.S. Public Interest Research Group, Consumer Federation of America). Testimony on file at Senate Committee on Commerce, Science, and Transportation.

²¹ See Testimony of Peter Huber, Consumer Subcommittee Hearing on S. 1400, April 5, 1990, transcript at 119, 141; testimony of Professor Mark Hager, Consumer Subcommittee Hearing on S. 1400, April 5, 1990 transcript at 137.8.

ers appeal to emotions, fear, and anxiety in this political effort while avoiding reason and rational discourse." * *

His review of the data on punitive damage awards found that punitive damages were not routinely awarded, were awarded typically in modest amounts, and were awarded more often in financial and property harm cases [business v. business] than in product liability cases.²³ His research also pointed up the errors in the data from Cook County, IL, and San Francisco, CA, which have in the past been used by supporters of bills like S. 640 as indicative of the nationwide pattern on punitive damages. He found that there were flaws in the method of data analysis used, and that it was inappropriate in any event to generalize from data in two counties to a nationwide trend.²⁴

Dr. Daniels' findings were similar to those by Professor Michael Rustad of Suffolk University Law School and Prof. Thomas Koenig of Northeastern University. They reviewed all product liability awards from 1965-90 in both State and Federal courts. During that time, punitive damages were awarded in only 355 cases—only 355 total punitive awards in 25 years! One-quarter of those awards involved one product—*asbestos*. Another one-quarter of those cases was reversed or remanded upon appeal. He further found that the amount of punitive damage awards were not skyrocketing, and in 35 percent of the cases in which punitive damages were awarded they were less than the amount of compensatory damages. He concluded that "[t]here is a widespread misperception that punitive damage awards are skyrocketing because of frivolous lawsuits * * *." ²⁵

By reviewing the data representative of the entire system, as opposed to the few anecdotes of high damage awards often cited by the supporters of this bill, we see that the system is not out of control in terms of numbers of cases filed or amount of compensation awarded. It also is important to note the beneficial aspects of the current system that stand to be undermined if this bill is enacted, as discussed below.

II. The Current System Promotes Product Safety

One of the primary effects of the current system is to promote product safety—to make manufacturers more careful in the design and production of their products. We know this because manufacturers themselves have told us. The 1987 Conference Board survey of risk managers of corporations found that "[w]here product liability has had a notable impact—where it has most significantly affected management decisionmaking—has been in the quality of the products themselves. Managers say products have become safer,

²³ Daniels and Martin, "Myth and Reality in Punitive Damages," 75 Minn. Law Review 1, 10-12 (Oct. 1990). See also testimony of Dr. Stephen Daniels, Consumer Subcommittee Hearing on S. 640, September 12, 1991, transcript at 122.

²⁴ 74 Minn. L. Rev., *supra*, at 43.

²⁵ *Id.* at 22-27.

²⁶ Rustad and Koenig, "Demystifying the Functions of Punitive Damages in Products Liability: An Empirical Study of a Quarter Century of Verdicts," Executive Summary at 11-15, 1. See also testimony of Professor Michael Rustad, Consumer Subcommittee Hearing on S. 640, September 19, 1991, transcript at 74-78.

manufacturing procedures have been improved, and labels and use instructions have become more explicit."²⁶

Indeed, according to the Consumer Federation of America (CFA), only a small minority of companies had a product safety management position in the early 1970s. By the end of the 1970s, virtually all companies had a very strong product safety presence in their management structure. CFA further stated that there has been a dramatic change in the rate of accidental injuries and deaths in the United States, so that "approximately 6,000 deaths and millions of injuries have been prevented on an annual basis now because of product liability and other forces toward greater safety in our society."²⁷

Moreover, Professor Rustad in his survey of punitive damage awards found that 190 of the 252 nonasbestos defendants who were subject to punitive damage awards between 1969 and 1990 "have taken some safety step in the wake of punitive damages litigation. In 80 percent of these cases, there were steps such as fortified warnings, product withdrawals, and safety features added to products which followed shortly after the [litigation]."²⁸

A similar finding was made by Prof. Nicholas Ashford and Prof. Robert Stone of MIT, in work done for inclusion in "The Liability Maze," and a collection of articles on product liability, innovation, and safety. This book is often mischaracterized by proponents of S. 640 as a monolithic study reaching results supportive of their position. Rather, it is a collection of research articles reaching various conclusions on the issue of innovation and safety in assorted industries.

Professors Ashford and Stone researched the effect of product liability on the chemical industry. They found that manufacturers pay "no more than 5 percent, and often less than 0.1 percent, of the corresponding social costs" of the chronic injuries caused by chemicals.²⁹ They concluded that, although the system is not stringent enough on the manufacturers to provide appropriate deterrence to prevent all unsafe products, it still has helped in the development of safer products. They recommend, however, that if the liability system were more, not less, stringent with respect to manufacturers it would be even more effective in promoting safety and innovation.³⁰

The editor of "The Liability Maze," Peter Huber, has suggested that the work by Professors Ashford and Stone is somehow unique. However, Professor Ashford has responded that he and other authors of the book found it impossible to separate innovation and safety, and found that "the liability system can both promote safety and innovation of desirable products and discourage unsafe products though they may be innovative." Professor Ashford goes

²⁶ "Product Liability: The Corporate Response," The Conference Board Report No. 893 (1987) at 2.

²⁷ Testimony of Gene Kimmelman, Legislative Director, Consumer Federation of America, at Consumer Subcommittee Hearing on S. 1400, April 5, 1990, transcript at 77-78.

²⁸ Rustad, *supra*, executive summary at 28.

²⁹ Ashford and Stone, "Liability, Innovation, and Safety in the Chemical Industry," in *The Liability Maze* (Brookings 1991) at 414.

³⁰ *Id.* at 415-417.

on to state that "we believe most scholars would subscribe to our methodology." * * *

The effect of product liability in promoting product safety relates not only to consumer protection, but to competitiveness. As Prof. Mark Hager of American University testified,

* * * our products, because of their superior reputation for safety, due in part to the effects of product liability over the last 20 years, have a superior reputation in the international marketplace. * * * [W]e cannot compete at this time with the low labor costs of newly industrializing countries, but we can compete very effectively * * * in safety, and it would be a grave risk to our international competitiveness to toy with the tort system that helps bring about that competitive advantage.³²

III. The Current System Promotes Important Principles of Federalism

The value of the principles of federalism embodied in our current system of tort law should not be overlooked. As Congressman Mike Box, of the Alabama House of Representatives, has testified:

[t]he issues of proper compensation for injured persons and suitable protections for businesses are matters of social values and public policy that should be addressed at the state level, in the absence of a national economic crisis. * * * Arguments for uniform laws as a means of promoting competitiveness ignore the advantages of a decentralized and federal system of civil justice. * * * Remember why we developed as a federal nation * * * Our founding fathers recognized the importance of having governments responsive to the electorate. Broad powers were reserved to the states so they would serve as bulwarks of freedom, an antidote to an overpowerful national government. * * * S. 1400 [the identical predecessor to S. 640] is radical because it opens the door to substantially greater federal intrusions.³³

These concerns were reiterated at this year's Subcommittee hearing by Delegate Bernard Cohen on behalf of the National Conference of State Legislatures. Delegate Cohen pointed out that Federal "preemption should not occur unless it could be proved that the variation in State laws is significantly impeding commerce among the States and unless the specific legislative response is the only way to resolve the conflict." * * * [T]his burden has not been met with respect to product liability laws." Delegate Cohen went on to note that, not only had the burden of proof not been met, but "the

³¹ Letter from Professor Nicholas Ashford to Senator Ernest Hollings, October 1, 1991, submitted for the record of the Consumer Subcommittee hearing on S. 640, September 19, 1991.

³² Testimony of Professor Mark Hager, Assistant Professor of Law, Washington College of Law, American University, at Consumer Subcommittee Hearing on S. 1400, April 5, 1990, transcript at 126.

³³ Testimony of Rep. Mike Box, Alabama House of Representatives, at Consumer Subcommittee Hearing on S. 1400, April 5, 1990, Statement at 1-3.

basic rationale for this bill, the underlying rationale for it, is fallacious."³⁴

Professor Eisenberg from Cornell Law School also has raised these concerns, and pointed out the practical problem with Federal tort law that we believe should provoke serious concern.

The changing nature of products liability law make me cautious about wishing for Congress to implement a single rule. For the rule Congress adopts had better be a good one, since it may preempt further experimentation and change by the states. I see no basis for believing that the rules embodied in S. 1400 [predecessor to S. 6401] are superior to the collection of rules embodied in various state laws and to the ability of the states to adopt the best rules of their sister states, as those rules evolve over time. The one thing we do know is that state product law does change. I worry that Congress may freeze the law with the wrong set of rules at a time when there is no clear reason to [do so].³⁵

We have the same concern. We are constantly surprised that some are willing to take their chances with Congress setting the rules over the long haul. Such an effort would limit flexibility, and could eventually result in rules more oriented toward plaintiffs than those the states would craft. In any event, we only should tinker with the fundamental principles of federalism in the most extreme circumstances—a record such as we have on this issue is insufficient to take such action.

IV. The Current System Did Not Cause The Insurance "Crisis"

In past years, the cry for product liability law has been based on a "crisis" in the availability and price of insurance. That argument has become nonexistent, since virtually everyone agrees that insurance is now generally available and well-priced—we are in a "soft" market.³⁶ Even before that occurred, however, it was clear that the product liability system was not responsible for insurance availability problems.

The primary allegations concerning the existence and magnitude of this crisis have proved vastly exaggerated. In 1976, the Federal Government created a Federal Interagency Task Force on Product Liability (hereinafter the Task Force) to examine the problem. The Insurance Study commissioned by the Task Force found that, while insurance costs did increase in the mid-1970s, insurance premiums exceeded 1 percent of the total sales for only three industries.³⁷

³⁴ Testimony of Delegate Bernard Cohen, Virginia House of Delegates, Consumer Subcommittee Hearing on S. 640, September 12, 1991, transcript at 85-86; 87.

³⁵ Testimony of Professor Theodore Eisenberg, Professor of Law, Cornell University, in response to post hearing questions of Senator Rockefeller, from Consumer Subcommittee Hearing on S. 1400, April 6, 1990, at 2.

³⁶ See Testimony of J. Robert Hunter, President, National Insurance Consumers Organization, Consumer Subcommittee Hearing on S. 1400, April 5, 1990, transcript at 133-4; testimony of Deborah Bullen, Vice President, American Insurance Association, Consumer Subcommittee Hearing on S. 1400, April 5, 1990.

³⁷ U.S. Department of Commerce, Interagency Task Force on Product Liability, Final Report VI-20 (1977) [hereinafter cited as Task Force Final Report].

By 1983, evidence indicated that product liability insurance costs had stabilized or decreased, and that the insurance crisis had disappeared. A 1983 Institute for Civil Justice study concluded not only that reports of a product liability crisis in the mid-1970s were greatly exaggerated, but that even the perception of a crisis had receded because it had become evident that product liability claims had not imposed unreasonable costs on most manufacturers.³⁸ Costs increased and availability decreased again in the mid-1980s.

The increases in product liability insurance costs were a result not of product liability but of the cyclical nature of the insurance industry and the industry's rate-making practices. The Congressional Research Service (CRS) has described the repeating cycles of high and low premiums as an historical alternation between soft and hard insurance markets, and has discussed the management practices of the companies which contribute to this cycle. In a soft market, rates are adequate, and risk selection careful, and the industry generally performs well. New capital is attracted from a number of sources and capacity increases. Price cutting of premiums results when new sources of capacity begin to generate increased competition for available premium volume. Underwriting standards (the standards for deciding whether to insure a particular manufacturer) for risk selection diminish with increased competition, and insurers take on riskier business endeavors. According to CRS, this practice results in rising claims losses.

At the point that competition is severe and that losses are too high, insurers withdraw from the market and the capacity shrinks, resulting in a hard market. Availability and affordability problems ensue as the remaining insurers raise prices and tighten the underwriting standards. Eventually the market stabilizes, a soft market emerges, and the cycle begins again.³⁹

Interest rates, which reached historic heights in the late 1970s, aggravated the cycle. Companies engaged in price wars in order to obtain a larger volume of premium income for investment.⁴⁰ Basically, companies were willing to accept lower premiums for certain insurance lines in order to encourage sales and obtain funds for investments.⁴¹

On February 19 and March 4, 1986, the Committee held hearings to conduct a more comprehensive examination of the availability and cost of liability insurance. Testimony was presented at hearings on the reasons for the insurance crisis. Witnesses noted that the insurance crisis has arisen during a period of falling interest rates, prior to which competing insurance companies had been underpricing their product in order to maximize cashflow and enhance investment income. When interest rates began to fall, companies were forced to increase premiums because investment

³⁸ Rand Corporation, The Institute for Civil Justice, "Designing Safer Products: Corporate Responses to Product Liability Law and Regulation 121" (1983) [hereinafter cited as Designing Safer Products].

³⁹ See Congressional Research Service, "Property Casualty Insurance Market Operation", CRS Report No. 85-629E (March 20, 1985).

⁴⁰ See "A Rate War Rips Casualty Insurers," Business Week, December 8, 1980.

⁴¹ Hearing on Product Liability before the Consumer Subcommittee, 99th Cong. 2d Sess. (1986) [hereinafter cited as 1986 Product Liability Hearing]. (Statement of Johnny C. Finch, Senior Associate Director, General Government Division General Account Office) (Testimony on file at Senate Committee on Commerce, Science, and Transportation).

income was no longer compensating for underwriting losses. The Committee report accompanying S. 2129, the Risk Retention Amendments of 1986, states that "[t]his practice of cashflow underwriting was linked directly to the current crisis."⁴²

GAO testified in May 1986 before the Consumer Subcommittee that the underwriting cycle turned again and "is now moving in a positive direction." The property/casualty industry will enjoy "an expected net gain before taxes of more than \$90 billion over the years 1986-90."

GAO also found a profitable industry over the last 10 years, stating that "the property/casualty companies have used a pricing strategy which sacrificed underwriting profit margins in order to generate cash for investment purposes. As a result of the strategy, the property/casualty industry has made between \$52 and \$79 billion in net gains over the last 10 years."⁴³

The irony of the continuing debate over a Federal product liability bill is that insurance costs were emphasized by the proponents as the reason for passage of a Federal product liability bill in the 96th and 97th Congresses when premiums were high, and were de-emphasized as a reason for passage of product liability legislation during the 98th Congress when insurance premiums were reduced. In the 99th Congress, the proponents again pointed to the high premiums as a justification for a Federal bill, but these arguments have disappeared in the 101st and 102d Congresses.

V. Product Liability Is Not A Major Factor in The Competitiveness of U.S. Business

This year's stated reason for this legislation is that product liability inhibits the ability of U.S. business to compete in world markets and to market innovative products. The facts are to the contrary.

OTA has recently completed a study of the competitiveness of U.S. manufacturers.⁴⁴ The study concluded that American manufacturing clearly is being challenged by competitors, particularly from Japan, and that there is no single solution. However, the recommended policy options for Government activity to address this challenge did not include Federal product liability law. Rather, OTA listed as the four most important steps that the United States could take to improve competitiveness: (1) lower the cost of capital; (2) improve the quality of human resources through education and quality of workforce; (3) improve the diffusion of manufacturing technology to small- and medium-sized business; and (4) provide Government funding of risky but promising long-term research and development.⁴⁵

Additionally, in 1987, the Conference Board surveyed risk managers of 232 major U.S. manufacturing, trade, and service corpora-

⁴² S. Rep. No. 294, 99th Cong., 2nd Sess. 4 (1986).

⁴³ 1986 Hearing on Product Liability, *supra* note 25 (Statement of Johnny C. Finch, Senior Associate Director, General Government Division General Account Office) (Testimony on file at Senate Committee on Commerce, Science, and Transportation).

⁴⁴ U.S. Congress, Office of Technology Assessment, "Making Things Better: Competing in Manufacturing," OTA-ITE-443 (Washington, D.C.: U.S. Government Printing Office, February 1990).

⁴⁵ Testimony of Dr. Julie Fox Garte, Office of Technology Assessment, Consumer Subcommittee Hearing on S. 1400, April 6, 1990 at transcript pp. 61-2.

tions about the effect of product liability on their companies.⁴⁶ Risk managers are the corporate employees that have the greatest corporate responsibility for addressing product liability issues—40 percent, as compared to a 6-percent responsibility by Chief Executive Officers (CEOs).⁴⁷ Two-thirds of the risk managers said that product liability contributed 1 percent or less to the final prices of their products. For another 11 percent of the companies, the liability cost was only 2 to 3 percent of the final price.⁴⁸ Additionally, most of the companies surveyed said that the area in which product liability had most significantly altered management decision-making was in the quality of the products themselves.⁴⁹

GAO made similar findings in a 1988 report on the issue.⁵⁰ GAO found that insurance costs represented a relatively small proportion of businesses' annual gross receipts—0.6 percent for large businesses, and about 1 percent for small businesses.⁵¹

The Institute for Civil Justice of the Rand Corp. concluded in 1983 that product liability costs in most cases were only a minute percentage of costs to business:

It appears safe to conclude that for most large manufacturing firms, product liability costs—including the cost of defending litigation and certain product liability prevention activities—probably amount to much less than 1 percent of total sales revenue.⁵²

Also, the Rand Corp. has found that only a small percentage of U.S. manufacturers are even involved in product liability litigation. In 1986, only 0.9 percent of all manufacturing concerns in the United States were defendants in product liability litigation.⁵³

The only claims to the contrary regarding the competitiveness of business are based on self-serving anecdote or unsupported claims. For example, the Vice President's Council on Competitiveness has claimed that the cost of the tort system is crippling U.S. business, using various dollar amounts for the total cost of the system. Upon scrutiny, these dollar amounts are completely without factual basis.

The Vice President asserted that the "direct" costs of the tort system are \$80 billion per year, and that indirect costs were considerably higher. The "authority" cited for that figure is *Forbes* magazine, which in turn cited no authority. The figure can be located in only one other place we have been able to uncover—Peter Huber's book, "Liability: The Legal Revolution and Its Consequences." However, as an analysis of this book for the Stanford Law Review points out, this number was simply lifted from a comment made by Robert Malott, Chairman of the Business Roundtable's product liability task force and CEO of the FMC Corporation, in the 1986

⁴⁶ Weber, "Product Liability: The Corporate Response," The Conference Board, Report No. 893 (1987).

⁴⁷ *Id.* at v.

⁴⁸ *Id.* at 13.

⁴⁹ *Id.* at 2.

⁵⁰ U.S. General Accounting Office, "Liability Insurance: Effects of Recent 'Crisis' on Businesses and Other Organizations," GAO/HRD-88-64 (July 1988).

⁵¹ *Id.* at 5.

⁵² Designing Safer Products, *supra* note 22 at 121.

⁵³ Dugworth, "Product Liability and the Business Sector: Litigation Trends in Federal Courts," *supra* at 53-56.

issue of Chief Executive magazine. Mr. Malott was quoted as saying, "insurance liability costs industry about \$80 billion per year" with no documentation for that remark.⁶⁴ These "authorities" speak for themselves about the extent to which we should rely on these estimates in deciding to overhaul the civil justice system.

The only other discordant note in the general agreement that product liability has a very small impact on business comes from a 1988 Conference Board survey of 500 chief executive officers of corporations, 42 percent of whom stated that product liability had a major impact on them.⁶⁵ Some components of the Conference Board apparently were dissatisfied with the results of their 1987 survey, cited above, which did not support their theory of product liability. So, they decided to ask different people, in hopes of a different result. This is virtually the only piece of information cited by the supporters of this legislation for the proposition that product liability affects competitiveness.⁶⁶

However, as Prof. Theodore Eisenberg of Cornell Law School has stated with respect to this survey, "... the case for reducing defendant liability seemed rather weak. It depended in large part on a survey of CEOs in which they were asked whether products liability was a problem for their companies. The flaws in such a survey are so substantial and obvious that no self-respecting legislature should act on the basis of the results."⁶⁷ We could not have said it better ourselves. We cannot responsibly move forward on this legislation based on a self-serving survey of corporate executives, particularly when it is contrary to all other data. The data demonstrates that the actual impact of product liability on businesses' bottom line is very small.

What is truly troubling about this debate over competitiveness is not the effect of the tort system on business, but the total lack of reliable information on which this competitiveness claim is based. As Dr. Deborah Hensler of the Rand Corp. testified, "[p]roduct liability litigation has been a source of controversy and public policy debate for almost a decade in this institution. I think it is remarkable that we still lack very basic information about the extent and nature of that litigation and the costs of resolving claims."⁶⁸

When the debate on this bill first began in this Congress, the supporters declared that the product liability system must be altered because of the changes taking place in the European Economic Community (EEC). It was argued that the EEC was moving toward a uniform product liability system, and the United States must do the same. It also was argued that other countries in the world had lower product liability costs than the United States, implying that this country should somehow emulate those other sys-

tems. However, like so many arguments on this issue, when the facts were examined, the argument disappeared.

The Council of the European Communities issued a directive in 1985 "concerning liability for defective products."⁶⁹ Despite the August 1, 1988, compliance deadline in the directive, only five member states—the United Kingdom, Italy, Greece, Luxembourg, and Denmark—had adopted the Directive as of March 15, 1990.⁷⁰ More significantly, the Directive by its terms does not preempt existing law in the various countries, but merely provides an additional cause of action in those countries in which remedies for harm already exist, and therefore is not likely to establish a more uniform system. As Prof. Lawrence Mann of Wayne State University School of Law testified, "[the Directive] is not in derogation of each member state's substantive tort law. And so, side by side, they will have a dual system operating."⁷¹ Additionally, while the Directive establishes certain rules of law, it leaves many issues optional with the member states.⁷²

Equally interesting, it is apparent that the EEC is moving toward a system of substantive product liability that is more consumer-oriented than that which is currently in place, and more like that in the United States. For example, its directive introduces the concept of strict liability for defective products,⁷³ expands the scope of potential defendants,⁷⁴ and institutes joint and several liability.⁷⁵ Since product liability is being expanded, insurance premiums are likely to go up, with an accompanying significant additional cost for producers in the EEC.⁷⁶

Thus, the EEC Directive does not provide an incentive for changing U.S. product liability law. Rather, it is a recognition of the value of current U.S. law in protecting consumers and promoting safe products. As Wendell Wilkie, General Counsel of the Department of Commerce, has testified, "... the protection [other countries] afford their consumers is so radically smaller than is the case in this country [that] the disparity in the costs associated between our system and theirs is inordinately great."⁷⁷ We do not believe we should sacrifice the greater degree of consumer protection we enjoy for some unsubstantiated hope of greater competitiveness.

It also has been argued that product liability costs are much higher in the United States than in the countries of some of our foreign competitors. However, a direct comparison of the costs of the tort systems in various countries, without more, is not valid because it ignores other types of compensation systems available in other countries. For example, in the Netherlands several social in-

⁶⁹ 28 O.J. Eur. Comm. (No. L 210) 29 (1985) (hereinafter cited as "Directive").

⁷⁰ Letter of Robert C. Holland, Committee for Economic Development, to Senator Richard Bryan, Chairman, Consumer Subcommittee, dated March 15, 1990, in response to post hearing questions at 1.

⁷¹ See Directive, Article 13; Testimony of Professor Lawrence D. Mann, Wayne State College of Law, Consumer Subcommittee Hearing on S. 1400, February 22, 1990, transcript, p. 167.

⁷² See, e.g., Dielmann, "The European Economic Community's Council Directive on Product Liability," *The International Lawyer*, Vol. 20, No. 4, 1391 at 1400 (1986).

⁷³ Directive, Article 1.

⁷⁴ Directive, Article 3. See also Thieffry, Doorn, and Lowe, "The Single European Market: A Practitioner's Guide to 1992," 7 B.C. Int'l & Comp. L. Rev. 357 at 383.

⁷⁵ Directive, Article 5. See also, Thieffry, Doorn and Lowe, *supra*, at 383.

⁷⁶ Dielmann, *supra*, at 1399.

⁷⁷ Testimony of Wendell Wilkie, General Counsel, Department of Commerce, at Consumer Subcommittee Hearing on S. 1400, February 22, 1990, transcript p. 30.

⁶⁴ Hager, "Civil Compensation and Its Discontents: A Response to Huber," 42 Stanford L. Rev. 639, 647-650 (January 1990).

⁶⁵ McGuire, "The Impact of Product Liability," The Conference Board, Report No. 908 (1988).

⁶⁶ See, e.g., Testimony of Wendell Wilkie, General Counsel, Department of Commerce, Consumer Subcommittee Hearing on S. 1400, February 22, 1990.

⁶⁷ Responses of Professor Theodore Eisenberg, Professor of Law, Cornell University, to post-hearing questions of Senator Rockefeller, April 19, 1990, response to question 1.

⁶⁸ Testimony of Dr. Deborah Hensler, Consumer Subcommittee, September 12, 1991, hearing, transcript at 106.

insurance programs are available which may preempt the need for compensation through the litigation process—the ZW/Sick Statute; the ZFW/Sick Fund Law; the WAO/Workers Disability Act of 1967; the AAW/General Act on Disability of Work; and the AWBZ/General Act on Special Medical Costs. The ZW is funded by collecting 5 percent of employers' gross income and 1 percent of employees' gross income. An injured employee may receive up to 70 percent of earned wages for 1 year. AAW and WAO continue funding if further assistance is needed.⁶⁸

Moreover, the tax burden on business in the various countries must be included in any calculus of the relative competitive status of business. Taxes on business are higher in virtually every advanced country than they are in the United States.⁶⁹

Thus, while business' costs related directly to the tort system may be lower in other countries, the relevant comparison is between the overall cost of compensation, which is likely to be similar to that in the United States. The proof of the fact that U.S. laws do not unduly burden companies doing business here is that foreign businesses are increasingly trying to locate here. In fact, foreign direct investment in the United States has increased from \$83 billion in 1980 to \$530 billion in 1990.⁷⁰ They would not do that if the tort system were the crippling burden that has been suggested by the proponents of S. 640.

It is clear that the facts do not support this contention that the current product liability system puts American businesses at a competitive disadvantage. If we are going to legislate to assist American business, we should do it in a way that will be effective, and S. 640 will not be.

VI. S. 640 Will Not Reduce Product Liability Costs for Business

Even if we assume that product liability is a significant barrier to the ability of U.S. firms to compete in world markets, that barrier cannot be reduced by any legislation unless the legislation somehow reduces businesses' costs. The Committee received virtually unequivocal testimony that enactment of bills such as S. 640 will not have any such effect.

First, the insurance industry testified before the Committee about the identical predecessor to S. 640 in no uncertain terms that " . . . the bill is likely to have little or no beneficial impact on the frequency and severity of product liability claims. . . . [I]t is not likely to reduce insurance claim costs or improve the insurance market." ⁷¹

No explanation has been offered, and none could logically be offered, for any way in which a bill could improve competitiveness if it does not reduce product liability claims or costs. As J. Robert Hunter, President of the National Insurance Consumer Organization,

⁶⁸ Mann and Rodriguez, "The European Directive on Products Liability: The Promise of Progress?" 18 Ga. J. Int'l & Comp. L. 399, 410.

⁶⁹ Testimony of John G. Wilkins, Director of Tax Policy for Economic Analysis, Coopers and Lybrand, before the House Committee on Ways and Means, hearing on factors affecting U.S. international competitiveness, July 18, 1991.

⁷⁰ Bureau of Economic Analysis, Department of Commerce (1991).

⁷¹ Testimony of Deborah T. Ballen, Vice President for Policy Development and Research, American Insurance Association, at Consumer Subcommittee Hearing on S. 1400, April 5, 1990, transcript p. 110.

tion, testified, "[m]ake no mistake about it, if insurance costs and availability are not improved, competitiveness is not affected." ⁷²

Indeed, that the bill will not have its purported effects becomes clear when its actual impact is reviewed. For example, it is claimed that the bill will provide additional uniformity in product liability law nationwide. However, the bill only selectively preempts State law, leaving much of State law in place to be interpreted with the new Federal law. Additionally, it provides a Federal rule of law to be interpreted by both the State and the Federal courts, although the State courts are not bound by the decisions of Federal courts other than the Supreme Court.

As Professor Eisenberg testified,

" . . . for a period of time, at least, predictability may be reduced rather than increased. Each state will have to decide the scope of S. 1400's [the identical predecessor to S. 640] preemption and its relation to state tort law. The interaction between state and federal law in tort will be made more rather than less complex. . . . [U]niformity will not be quickly, if ever, achieved. . . . [W]e are at risk of having not just 55 jurisdictions but an additional dozen federal courts of appeals making products law. At least before enactment of S. 1400 the [federal] courts of appeals should have felt bound by state law. Until the Supreme Court speaks, it is not clear that state supreme courts would or should be bound by federal interpretations of S. 1400 as it interacts with the relevant state law." ⁷³ With respect to punitive damages, S. 640 provides a standard of proof for punitive damages that is more restrictive than that in many states. However, punitive damages are not a significant factor in product liability cases. As Professor Eisenberg has stated, "[t]here is a widespread perception that punitive damages are awarded frequently and in great amounts. Yet every serious study of the area finds that punitive damage awards are relatively infrequent, that they usually are commensurate with the defendant's wrongdoing and that they bear a substantial relationship to the size of the compensatory awards. . . . [P]unitive damages are awarded in not more than one percent of filed cases. . . ." ⁷⁴ The 1989 GAO Report also looked at punitive damages, and found that, on the few occasions when they were awarded, their amount had a high correlation with the amount of compensatory damages. ⁷⁵

In fact, regardless of the scope of the product liability legislation enacted, the record indicates that it will be ineffective in reducing product liability insurance costs. For example, Florida passed very

⁷² Testimony of J. Robert Hunter, President, National Insurance Consumer Organization, Consumer Subcommittee hearings on S. 1400, April 5, 1990, at 182.

⁷³ Testimony of Professor Theodore Eisenberg, Cornell Law School, Responses to post hearing questions of Senator Rockefeller at 3. See also Note, "Authority in State Court of Lower Federal Court Decisions on National Law," 48 Columbia L. Rev. 943, 954 (1943); Stern and Grossman, *Supreme Court Practice* (5th ed. 1978 at 280; *Testa v. Katt*, 330 U.S. 385 (1947)).

⁷⁴ Testimony of Professor Theodore Eisenberg, Responses to Post-hearing questions of Senator Rockefeller *supra*, at 4-6 and authorities cited therein.

⁷⁵ 1989 GAO Report, *supra*, at 27.

strong changes in its tort law in 1986, and also required the insurance industry to make rate filings indicating the effect of the changes on its rates. The Florida law eliminated joint and several liability, limited noneconomic damages to \$150,000, and limited punitive damages. Nevertheless, when Aetna's rate filing came in, it listed the effect of each change on its rates as "zero."⁷⁶ There was no change in insurance costs, despite the dramatic changes in tort law, and we could expect none with enactment of S. 640.

When this is pointed out, the supporters of the bill often fall back on "transaction costs," and suggest that the bill may not reduce damages paid but will reduce transaction costs, or the costs of litigation such as attorneys' fees. Of course, if transaction costs were reduced, they should be reflected in reduced insurance costs, and insurance costs will not be reduced by this bill. In any event, the available evidence demonstrates that the bill will not reduce transaction costs, either.

GAO has stated unequivocally:

[w]e believe that S. 1400 [the bill in the 101st Congress identical to S. 640] is unlikely to reduce transaction costs in product liability suits. For cases that are litigated, the procedural features of the tort system would not be changed by the bill. It is also not clear that the bill provides strong incentives for alternative dispute resolution, which could cut litigation costs. Moreover, the alternative dispute resolution mechanisms that may be used are left to the discretion of the states. If these mechanisms are not binding, then they may add to rather than substitute for litigation. If this happened, costs could actually increase.

GAO went on to note that transaction costs are largely a function of the length of litigation, and that delays caused by defendants are common. However, if a complete and accurate record is necessary to insure a fair outcome of the case, "lengthy litigation and its attendant costs might be justified."⁷⁷

One justification offered for Federal product liability legislation in that legal fees paid to plaintiffs' attorneys are too high. However, this bill would not have any effect on attorneys fees. In any event, it is important to understand the value of the current system of compensation for plaintiffs' attorneys. Plaintiffs' lawyers who accept product liability cases work on a contingency fee basis. If they win the case they get a percentage of the case (which is usually about 30 percent); if they lose, they get nothing. This system allows injured plaintiffs who are not wealthy to obtain a lawyer. At the same time, the system acts as a deterrent to frivolous cases because attorneys are spending their own time and money in the case.

Figures from the Institute for Civil Justice state that plaintiffs receive approximately one-half of the cost of litigation.⁷⁸ Any prob-

⁷⁶ Testimony of J. Robert Hunter, *supra*, transcript at 135.

⁷⁷ Testimony of Joseph F. Dolfo, Director, Income Security Issues, General Accounting Office, Consumer Subcommittee Hearing on S. 1400, February 22, 1990 in response to post-hearing questions of Senator Bryan at 2.

⁷⁸ *Id.* at 2-3.

lem with the cost of the system is not with the cost of the attorney who is "investing" his or her own time and money to win a case. The problem is with the defense attorney who has an incentive to delay the case with dilatory motions, and thereby encourage severely injured plaintiffs to settle for less in order to get an expedited payment of the plaintiff's medical and other costs. Meanwhile, the company is making interest on money that would otherwise be in the hands of the prevailing plaintiff.

Moreover, defendants' attorneys are apparently better paid, on average, than plaintiffs' attorneys. According to calculations derived from a 1977 survey conducted by the Insurance Services Office, for every dollar paid to claimants, insurers paid an average of an additional 42 cents in defense costs, while for every dollar awarded to a plaintiff, the plaintiff pays an average contingent fee of 33 cents out of that dollar.⁷⁹ Thus, in cases in which plaintiffs prevail, out of each \$1.42 spent on litigation, half of that goes to attorneys' fees, with defendants' attorneys, on average, paid better than plaintiffs' attorneys. Of course, defendants' attorneys are paid regardless of the outcome of the case, while plaintiffs' attorneys are paid only if they win their case. Otherwise, they take a loss for the time and expenses they have incurred. Thus, existing transaction costs are not inappropriate, and in any event would not be reduced by this bill.

The facts lead to the conclusion that no reduction in costs will occur through changes in the current tort liability system, and thus that no competitive advantage for American business can result.

VII. The Product Liability System Does Not Stifle Innovation, but Can Encourage Innovations in Safety

Another theme sounded in support of the bill this year is that the current system deters innovation, and discourages new products from being brought to market. Of course, this effect is, by its nature, somewhat subjective and very difficult to examine. However, witnesses at the Consumer Subcommittee hearing examined the effects of the tort system on the chemical industry. In this case study, they noted that desirable innovation must mean safe innovation, and that if the tort system discourages unsafe innovation, that is valuable. They also found that, even in the chemical industry in which manufacturers pay a minuscule percentage of the costs of the injuries caused by their products, the tort system works to encourage the innovation of safer products.⁸⁰

Business can, and often does, say it is discouraged from bringing innovative products to market, but they do not say what those products were, so the claim cannot be analyzed. However, the actual products that have been cited by witnesses in support of this claim subsequently had legitimate questions raised about their safety. In such cases, until such questions are resolved, we do not

⁷⁹ Hearing before the Subcommittee on Trade, Productivity and Economic Growth of the House Joint Economic Committee, 99th Congress 2d Sess. (1986) (Statement of James S. Kukulik).

⁸⁰ Ashford and Stone, *supra*, at 415, 417.

think we should presume that the product liability system has not worked properly to keep those products from the market.

Some examples of products cited as unfairly kept from the market by the system are set out below, together with the facts as they developed through the Committee's hearing process.

Monsanto Asbestos Substitute—Calcium sodium metaphosphate was cited by several supporters of S. 640 as a primary example of a safe product kept from the market by the product liability system. However, an Environmental Protection Agency (EPA) Status Report dated August 19, 1986, reviewed studies of this product submitted by Monsanto, and stated that "EPA believes that the evidence obtained from Monsanto's * * * study in rats offers reasonable support for the conclusion that calcium sodium metaphosphate fibers can cause cancer." (Report p. 9). Dr. Philip Landrigan, Chairman, Department of Community Medicine, Mt. Sinai Medical Center, reviewed the EPA and Monsanto documents, and stated: "I am extremely concerned about the potential carcinogenicity of sodium calcium metaphosphate."⁸¹ Monsanto's CEO, Richard Mahoney, subsequently wrote to the Committee stating that later tests of the fiber showed no evidence of health problems, that the first test was not done to determine the health risk to humans, and that the products was kept off the market solely because of concerns about "unwarranted litigation."⁸² However, this letter does not explain why the first test would have been done if not to examine risks to human health.

Copper 7 IUD—Supporters of S. 640 claim that this product, although safe, was taken off the market because of unwarranted product liability suits. The court in *Kociemba v. Searle*, 707 F. Supp. 1517 (D. Minn. 1989), (settled w/out appeal), a Copper 7 case, stated that the plaintiff "presented evidence which would have allowed a reasonable jury to conclude that defendant knowingly placed millions of American women, especially [women who have not had children], at risk of serious infection, loss of fertility, and surgery for removal of internal organs" and that "responsibility for this conduct was shared throughout defendant's corporate hierarchy, and that the conduct continued for over ten years." Michael Ciresi, the lawyer who litigated many Copper 7 cases for plaintiffs, has written to the Committee stating that his firm spent millions of dollars on discovery of documents that Searle resisted through litigation to the Supreme Court. Cases litigated before completion of that discovery were not successful because of the lack of documentation. According to Mr. Ciresi, the documents ultimately obtained demonstrated that the company knew the product was dangerous to women who have never had children, but continued to market the product to those women. That action was the basis for punitive damages against the company.⁸³

Sturm Ruger "Old Model" Single Action Revolver—This product was cited as one which was the victim of unreasonable verdicts

based on injuries that were really due to plaintiff negligence. However, documents submitted at the Committee's May 10, 1990, hearing demonstrated that since 1962 Ruger had received reports of serious injuries and deaths resulting from accidental discharges of this gun. In 1968, the gun failed a test for accidental discharge performed by the Bureau of Alcohol, Tobacco and Firearms, and it subsequently failed Ruger's own tests. Ruger did not redesign the gun to add a transfer bar safety device until 1973, and estimated that between 1968 and 1973 more than 150,000 "old models" were sold. Bill Ruger, CEO of the company, testified during product liability litigation that no safety device was put on the gun because a revolver "is supposed to be designed in the traditional way." The Court in *Sturm Ruger v. Day*, 594 P.2d 38 (Alaska 1979) found Ruger liable for punitive damages for failure to add a safety device. According to testimony before the Committee, by 1989 about 230 product liability claims had been filed against Ruger for this defect, but the gun has never been recalled.⁸⁴

Puritan-Bennett Anesthesia Gas Machines—This was cited by some witnesses as a product unjustly removed from the market by the product liability system. The machines were implicated in four deaths in 1983-84 hearings in the House Subcommittee on Oversight and Investigations, September 24, 1984, found that the company failed to notify the Food Drug Administration (FDA) of deaths that were caused by an overdose of anesthesia due to swelling of "O" rings and resultant sticking of a valve. This problem was known in the 1970s, and reflected in an appendix to the 1979 voluntary standard for anesthesia machines. The FDA, testifying before the subcommittee in 1984, stated that the company "appears * * * [to have] failed to conduct adequate design review of certain critical components" including use of certain rubber-like materials in the presence of high concentrations of anesthetic gas. The company instituted a limited recall, and the FDA required the recall extended to all valves distributed through July 1984.⁸⁵

CJ-5 and CJ-7 Jeeps—These vehicles were cited by hearing witnesses as examples of products subjected to unjust litigation. In response to this assertion, other witnesses said that these Jeeps are designed with narrow track width, a high center of gravity, and short length, and consequently have a propensity to roll over, even at low speeds. The Federal Trade Commission (FTC) in 1982 issued a complaint charging AMC with unfair and deceptive advertising because the Jeeps were portrayed as safe for reckless, off-road driving. The Insurance Institute for Highway Safety found these Jeeps to have a rollover risk between 12 and 19 times greater than regular passenger vehicles. Testimony indicated that AMC continually denied any problem, and continued to market the Jeeps until they were subjected to product liability suits. This model Jeep has now been taken off the market.⁸⁶

⁸¹ S. Rep. No. 476, 98th Cong., 2d Sess. 7 (1984) (citing Insurance Services Office, Product Liability Closed Claim Survey: A Technical Analysis of Survey Results at 11 (1977)).

⁸² Letter from Richard Mahoney to Senator Richard H. Bryan dated May 17, 1990, reprinted in record of Consumer Subcommittee Hearing on S. 1400, May 10, 1990.

⁸³ Statement of Michael Ciresi, submitted for record of Consumer Subcommittee hearing on S. 1400, April 5, 1990.

⁸⁴ Supplemental Statement of Linda Lipson, submitted for record of Consumer Subcommittee Hearing on S. 1400, May 10, 1990.

⁸⁵ Supplemental statement of Linda Lipson, *supra*, reprinted in record of Consumer Subcommittee Hearing on S. 1400, May 10, 1990.

⁸⁶ Supplemental Lipson statement, *supra*, reprinted in record of Consumer Subcommittee Hearing on S. 1400, May 10, 1990.

Ortho Contraceptives—Witnesses at the Committee's hearings claimed these products were unfairly subjected to product liability actions, citing *Wooderson v. Ortho*, 681 P.2d 1038, cert. denied 105 S.Ct. 365 (1984). It was claimed that, in that case, the company was held liable for failure to warn even though the FDA had determined that the warning was not necessary. However, an examination of the Court's decision reveals that the Court held that there was no clear determination by the FDA as to whether such a warning was necessary, so that the defense was not valid. Ortho was held liable by the Court for punitive damages because it ignored substantial evidence that its product caused renal failure.

Taking all the evidence presented on both sides of these issues, we are not prepared to conclude that the current product liability system is not working properly to insure the safety of new products.

S. 640 IS SUBSTANTIVELY FLAWED

Enactment of S. 640 would amount to legislation which dramatically revises our current legal system without any serious factual predicate for such a change. In addition to this flaw as a matter of policy, it has numerous substantive legal problems. A few examples are set out below.

I. Non-uniform Selective Preemption

S. 640 is touted as a move toward a more uniform system of product liability law through Federal preemption of State law. It is important to look carefully at how this preemption would work, because it is not uniform, and, more significantly, it is one-way preemption. It covers only certain areas of State law and, in those areas it addresses, it revises the law only in the States that currently have law favorable to the plaintiffs. It would leave the State law intact if that State law currently favors defendants.

For example, section 303 of the bill purports to establish "Uniform Standards For Award of Punitive Damages." It establishes the burden of proof for punitive damages, and provides a defense to punitive damages for drugs or aircraft that have been approved by Federal authorities. However, by its terms, it applies to punitive damages only "if otherwise permitted by applicable law." * * * Thus, in States which have, through State law, eliminated or limited punitive damages, this bill would not restore the availability of such damages. In some States, there would be no right to punitive damages; in some States they would be capped at a stated amount; and in others they would be available if the burden of proof in S. 640 is met. We do not call that uniformity in the law of punitive damages. If we truly wanted uniformity we would, at a minimum, restore punitive damages in the States that have limited them so that the law would be consistent nationwide.

Another example of this selective preemption of State law is in the area of joint and several liability for damages. Section 306 states that "the liability of each defendant for noneconomic damages shall be several only and shall not be joint." However, it does not restore the availability of full noneconomic damages in States in which such damages have been capped at a certain amount. It

does not restore joint and several liability for economic damages in States in which such liability has been limited by State law. So, again, we will not have uniform nationwide law on joint and several liability. We will have some States that have no joint and several liability, some that have joint and several liability only in certain circumstances, and some that follow the rule of S. 640.

Additionally, the bill provides a Federal rule of law to be interpreted by both the State and the Federal courts, although the State courts are not bound by the decisions of Federal courts other than the Supreme Court.

As Professor Eisenberg testified on the identical predecessor to S. 640,

* * * for a period of time, at least, predictability may be reduced rather than increased. Each state will have to decide the scope of S. 1400's preemption and its relation to state tort law. The interaction between state and federal law in tort will be made more rather than less complex * * * [U]niformity will not be quickly, if ever, achieved. * * * [We] are at risk of having not just 55 jurisdictions but an additional dozen federal courts of appeals making products law. At least before enactment of S. 1400 the [federal] courts of appeals should have felt bound by state law. Until the Supreme Court speaks, it is not clear that state supreme courts would or should be bound by federal interpretations of S. 1400 as it interacts with the relevant state law.⁸⁷

II. Defense Based On FDA Or FAA Approval

Section 303 creates an absolute defense to the award of punitive damages ("[p]unitive damages shall not be awarded") if a drug or medical device has received pre-market approval by the FDA (so long as that approval was not based on misrepresentations or bribes by the manufacturer to the FDA). Section 303 also creates an absolute defense against punitive damages for aircraft if the aircraft were subject to pre-market certification by the Federal Aviation Administration (FAA). In effect, this section makes the FDA and the FAA the first and last line of defense against manufacturer misconduct that is harmful to consumers. These agencies were never created to function in this manner, and there are numerous examples of their inability to afford this protection to consumers. Federal standards are minimum standards in most cases, and it is inappropriate to establish categorically this level as the only necessary level of safety that must be met in all cases.

A. Food and Drug Administration

The House Subcommittee on Human Resources and Intergovernmental Relations has devoted considerable time and resources, from 1983 to the present, conducting extensive investigations into the FDA's activities with respect to particular drugs. The Chair-

⁸⁷ Testimony of Professor Theodore Eisenberg, Cornell Law School, Responses to post hearing questions of Senator Rockefeller at 3. See also Note, "authority in State Court of Lower Federal Court Decisions on National Law," 48 Columbia L.Rev. 943, 964 (1948); Stern and Grossman, Supreme Court Practice (5th ed. 1978) at 280; *Testa v. Katz*, 330 U.S. 386 (1947).

man of that Subcommittee, Congressman Ted Weiss, has written to the Committee expressing serious concern about section 303 of S. 1400 [the identical predecessor to S. 640] stating: "I believe that any proposal that would deprive parties injured by drugs and devices of punitive damages relief currently provided by State law would diminish manufacturers' incentives to produce safer products, thereby putting consumers at greater risk."⁸⁸

Congressman Weiss' letter contains numerous examples of drugs which were approved by the FDA despite the existence in FDA files of information about harmful effects of the drug. For example:

The FDA failed to review all significant safety information in its possession concerning the new drug *Oraflex* prior to approving the drug for marketing. FDA had received several reports of *Oraflex*-associated liver and kidney disease during premarket clinical trials of the drug. Nevertheless, the agency approved labeling that * * * mentioned nothing about liver disease and * * * denied altogether any evidence of kidney disease * * *.⁸⁹ Only 3 months following FDA approval, the manufacturer withdrew *Oraflex* from the market after it was implicated in numerous reports of serious and sometimes fatal liver and kidney disease.⁹⁰

Similarly, the FDA approved the new drug *Versed*, a sedative, in 1985, at doses that were substantially higher than those shown to be effective in published studies dating back to 1982, and without knowing how the drug was regulated in foreign countries. The FDA finally lowered the recommended dose in 1987 to levels that had been in effect in Europe for several years.⁹¹

The defense established by S. 640 also overlooks the fact that "important evidence regarding drug safety problems sometimes does not surface until after FDA approval."⁹² Indeed, GAO recently issued a report on this issue which contained some alarming statistics. GAO found that:

* * * of the 198 drugs approved by FDA between 1976 and 1985 for which data were available, 102 (or 51.5 percent) had serious post-approval risks, as evidenced by labeling changes or withdrawal from the market. * * * The serious postapproval risks are adverse reactions that could lead to hospitalization, increases in the length of hospitalization, severe or permanent disability, or death.⁹³

These are only a few of the examples which amply demonstrate why we cannot responsibly rely only on the FDA to protect con-

⁸⁸ Letter dated May 7, 1990, from Congressman Ted Weiss, Chairman, Subcommittee on Human Resources and Intergovernmental Relations of the Committee on Government Operations, to Senator Ernest F. Hollings, Chairman Committee on Commerce, Science, and Transportation, at 1. Letter available in Consumer Subcommittee files.

⁸⁹ Weiss letter, *supra*, at 2 (emphasis in original). See also H.R. Rep. No. 98-511, "Deficiencies in FDA's Regulation of the New Drug 'Oraflex,'" 98th Cong., 1st Sess. (1983), at 4-6.

⁹⁰ Weiss letter, *supra*, at 2. See also H.R. Rep. No. 98-511, *supra*, at 3-13.

⁹¹ Weiss letter, *supra*, at 2. See also, H.R. Rep. 100-1086, "FDA's Deficient Regulation of the New Drug *Versed*," 100th Cong., 2d Sess. (1988), at 10-27.

⁹² Weiss letter, *supra*, at 2.

⁹³ U.S. General Accounting Office, "FDA Drug Review: Postapproval Risks 1976-85," GAO/PEMD-90-15 (April 1990) at 3.

sumers from all the dangers of drugs. It is argued that S. 640 only protects manufacturers from the award of punitive damages, and that this is reasonable once they have achieved FDA approval for their product. It is certainly true that, in many cases in which defective drugs are approved by the FDA, the manufacturer should not be held liable for punitive damages. Indeed, awards of punitive damages in product liability cases are exceedingly rare.⁹⁴ However, problems with drugs that have achieved FDA approval are prevalent, and there are documented cases in which the manufacturers' misconduct was a primary factor in the continued marketing of such products.⁹⁵

Given these facts, it is unreasonable to conclude, as S. 640 does, that there could never be circumstances in which punitive damages should not be awarded for pharmaceutical manufacturers' misconduct. The proper course is to leave that decision where it is now—with the jury and the court.

B. FAA

Similarly, it would be inappropriate to eliminate any potential for punitive damages for aircraft based on FAA approval of the aircraft design. The possibility of punitive damages provides an important deterrent which helps insure that manufacturers police themselves, and do not rely on the FAA to uncover any defects. Moreover, the FAA is required to set only minimum safety standards "in the interest of safety". See 49 U.S.C. 1423(a)(1). The FAA also has a duty "to promote air commerce," 49 U.S.C. 1346. Thus, the FAA arguably may balance safety standards against the interests of commerce. Moreover, compliance with FAA standards indicates no more than that the manufacturer performed the minimum required. See *Wilson v. Piper Aircraft Corp.*, 577 P.2d 1322 (D. Or. 1978).

Additionally, there are real questions about the effectiveness of the FAA's safety inspection management system. GAO, in a report released on November 13, 1989, is extremely critical of this system, noting that: "[i]nadequate oversight of the inspection program resulted in (1) FAA headquarters management's being upward that its inspection policies were not always followed by local FAA staff and (2) inaccurate reporting to Congress of FAA achievements."⁹⁶

The effect of this inadequate inspection system on the defects in aircraft was recently recognized by the Chairman of Cessna Aircraft who stated that: "[W]ith tougher airworthiness requirements implemented aggressively by the FAA, and with type-specific flight standards, I believe it is realistic to reduce the level of accidents by at least 50 percent."⁹⁷ If even the aircraft manufacturers believe

⁹⁴ Landes and Posner, "New Light on Punitive Damages," (October 1986). See also, Public Citizen's Congress Watch, et al., "The 'FDA Excuse'" (May 1990) at 3; Notes 54 and 56, *supra*.

⁹⁵ For example, the evidence is strong that the Copper 7 HUD, which was approved by the FDA, was known to the manufacturer to pose dangers for women who had not had children but continued to be marketed by the manufacturer to such women for many years. The Court reviewing this conduct upheld the award of punitive damages. See *Kociemba v. Searle*, 707 F. Supp. 1517 (D. Minn. 1989) (settled without appeal); "The 'FDA Excuse'", *supra*, at 1-2; Letter of Michael Ciresi, *supra*.

⁹⁶ U.S. General Accounting Office, "FAA's Inspection Management System," GAO/RCED 90-36 (November 1989) at 8.

⁹⁷ AOPA (Aircraft Owners and Pilots Association) "Pilot" magazine, "G.A. Manufacturers Propose New Inspections," (June 1989).

there is room for a 50-percent improvement from the FAA, it would not be appropriate to leave the FAA as the only line of defense for the safety of the flying public. We must require continued maximum vigilance from the manufacturers themselves.

III. Statute of Repose

Section 304(b) of the bill would bar liability for any harm caused by a capital good more than 25 years after its original delivery. This would shield from liability a significant number of products in use. Howard Fark, a member of the Board of Directors of the National Machine Tool Builders Association, testified that over 50 percent of the claims filed against machine tool builders involve machines over 25 years old.⁹⁸

It is argued that, if machines are defective, the defects will show up before the expiration of a 25-year period, so that manufacturers typically should not be liable for such products after that time. We have no reason to dispute that, but, by the same token, there has been no demonstration that there could never be a defective 26-year-old product. As long as that possibility exists, it is appropriate to leave the responsibility to decide who should be liable for harm from a product where it now exists in most States—with the jury and the court.

It is also often suggested that this will be a proplaintiff change in the law, since some States have statutes of repose shorter than 25 years. What those suggestions do not say is that only 17 States, a small minority, has any statute of repose.⁹⁹ This is not a proplaintiff change, because it would enact statutes of repose in the vast majority of States that currently have chosen not to have such bars to filing suit.

IV. Worker's Compensation Offset

Section 305 purports to establish uniform standards for offset of worker's compensation. Among other things, it would do away with the traditional lien on awards of damages from third-party manufacturers that is currently available to employers who have paid workers' compensation payments for an injury. This provision is opposed, and understandably so, by the National Association of Stevedores, the Association of General Contractors, and the Shipbuilders Council of America, among others, who point out that it shifts these costs, without justification, from manufacturers to the industry that uses machinery and equipment.¹⁰⁰

It has been recognized that the workers' compensation insurance systems in many states are having difficulty meeting their finan-

⁹⁸ Testimony of Howard Fark, Vice President, Minster Machine Company, Response to Post-Hearing Questions of Senator Rockefeller at question 2, Consumer Subcommittee Hearing on S. 1400, February 22, 1990.

⁹⁹ Only 17 states currently have valid statutes of repose in effect. In those states, the statutes of repose are typically shorter than 25 years. However, the majority of states have not enacted such statutes and, in some states, the statutes have been struck down as conflicting with state constitutional rights to access to the courts or equal protection. See, e.g., *Dungrad v. Baltic Co-operative Building Supply Association*, 349 N.W. 2d 419 (S.D. 1984); *Heath v. Sears, Roebuck & Co.*, 464 A. 2d 288 (N.H. 1983).

¹⁰⁰ Testimony of Thomas D. Wilcox, Executive Director and General Counsel, National Association of Stevedores, Consumer Subcommittee Hearing on S. 1400, May 10, 1990, statement at 2.

cial obligations.¹⁰¹ The cost-shifting required by S. 640 only will exacerbate that problem for the no-fault workers' compensation system in the vain hope of reducing the costs of the tort system for third-party manufacturers.

This cost-shifting also will affect the federal government in its position as employer, because it will be unable to obtain reimbursement from liable third parties for payments made to workers under the Federal Employees Compensation Act and the Longshoremen and Harbor Workers' Compensation Act.¹⁰² The Congressional Budget Office has stated that, in a 2-year period, the Government recovered \$9 million in such situations from liens against liable third parties. At least a sizable portion of that money will be lost to the Government under this bill.

V. Alternative Dispute Resolution

Section 202 purports to encourage parties to use alternative mechanisms of resolving cases prior to going to court. That may sound good, but in the heavy-handed way that it is written, this provision really discourages parties from exercising their constitutional right to a trial by jury. It creates a presumption that if a party refuses to pursue alternatives to trial, exercises his or her right to trial by jury, and loses his or her case, that party has not acted in good faith and may be required to pay the litigation costs of the other party.

As Consumer Subcommittee testimony from the South Carolina Jury Trial Foundation pointed out, we must be particularly vigilant about inroads into the constitutional trial by jury.

From its inception as a safeguard of individual liberty in the Magna Carta, those who would wield the tools of tyranny have tried to undermine or destroy the institution of trial by jury. King John attempted to revoke the Magna Carta. Henry VIII and Elizabeth I would have abolished it if they could. Charles I circumvented jury trials through the Star Chamber. * * * George III denied the right of trial by jury to colonists through expansion of the jurisdiction of admiralty courts and the state of Rhode Island attempted to deny the right altogether in suits under the State Bank Act.¹⁰³

As the representative of the South Carolina Jury Trial Foundation further pointed out, "[c]an I guarantee my intimidated client that if he declines a defendant's offer to arbitrate and exercises his constitutional right to a civil jury trial he will not wind up having to pay the attorney's fees of a small army of Philadelphia lawyers?"¹⁰⁴ Section 202 of S. 640 creates too great a risk that, by exercising the right to a jury trial, an injured party can be punished for acting "unreasonably" or in "bad faith" and thereby required to pay defendants' costs.¹⁰⁵ This same party could run the same

¹⁰¹ *Id.* at 2-3.

¹⁰² *Id.* at 1-2.

¹⁰³ Testimony of J. Kendall Few at Consumer Subcommittee hearing on S. 640, September 19, 1991, statement at 21-22.

¹⁰⁴ *Id.* at 23-4.

¹⁰⁵ *Id.* at 6.

risks under section 201 of S. 640, which creates "incentives" for accepting settlement proposals, by requiring the payment of costs if the case is litigated and the claimant receives less than the settlement offer.¹⁰⁶ These provisions create a chilling effect on the exercise of the Seventh Amendment right to trial by jury which is unacceptable in our system of government.¹⁰⁷

As testimony at the Consumer Subcommittee from the South Carolina Jury Trial Foundation demonstrated, an injured consumer, often without resources, can hardly risk the possibility that he or she may have to pay the legal fees of a corporate defendant in order to allow his or her case to be heard by a jury. By requiring plaintiffs to run that risk or forgo their right to trial, S. 640 runs counter to the Seventh Amendment of the Constitution.¹⁰⁸

That these provisions have a chilling effect on the exercise of plaintiffs' constitutional rights is made even more clear by sections 102(5) and 103 of S. 640. In those sections, the authors of the bill have excepted from its provisions all commercial cases. Thus, in cases in which businesses will sue other businesses, they will not face these barriers to exercise their Seventh Amendment rights. However, they would require injured consumers to accept burdens that they themselves do not want to bear in their own litigation. Not only is this provision counter to the Constitution, but it creates a double standard—one for consumers as plaintiffs and one for businesses as plaintiffs—and, needless to say, the consumer suffers.

As the South Carolina Jury Trial Foundation testified before the Committee, "[i]t has been an elemental concept of constitutional law . . . that any infringement of the Bill of Rights, however slight, is a violation of the clearly written constitutional rights of every American citizen."¹⁰⁹ As Winston Churchill said in 1956, "[t]he jury system has come to stand for all we mean by English justice. The scrutiny of 12 honest jurors provides defendant and plaintiff alike a safeguard from arbitrary perversion of the law."¹¹⁰

The proponents of this bill attempt to justify it as a "national necessity," claiming that manufacturers cannot compete in a world economy without these infringements on the Constitution. As testimony before the Committee pointed out, that was also the primary excuse for the exercise of arbitrary power in the Star Chamber, and was the reason why Germany scrapped its jury system in 1924. As Hudson's Treatise on the Star Chamber put it, "if those of the poorer sort" bring suits, there is a presumption that they are "clamorous", and then the poor must pay the rich man's costs "if they prove not the bill."¹¹¹ That attitude is found in S. 640 as well. Surely this type of infringement upon the Seventh Amendment is not necessary in order to allow our industry to compete in

¹⁰⁶ *Id.* at 5-6.

¹⁰⁷ *Id.* at 1.

¹⁰⁸ Testimony of J. Kendall Few, Consumer Subcommittee Hearing on S. 640, September 19, 1991, transcript at 98-99.

¹⁰⁹ Few testimony, *supra*, statement at 10.

¹¹⁰ *Id.* at 19.

¹¹¹ *Id.* at 33, citing Hudson, "A Treatise on the Court of Star Chamber," (1792) reprinted by Legal Classics Library 1986, at 130.

world markets. Such a sacrifice on the altar of competitiveness must not be made.

CONCLUSION

A Committee of the United States Senate should not report legislation to federalize product liability tort law without any comprehensive data to demonstrate (1) that such legislation is necessary, and (2) that such legislation will work.

Do we know what we are getting into? Based on the scant evidence provided by the proponents of this legislation, the answer to that question is: "obviously not." We do know that enactment of this legislation would not affect insurance premiums of this legislation would not affect insurance premiums or businesses' product liability costs, S. 640 will not make American businesses more competitive, and may actually undermine current levels of product safety. We are not going to solve the problems of U.S. business with legislation of this type, and in fact, we run the risk of harming the consumer. The bill should be rejected.

Richard Porter (F)
legal
reform

THE WHITE HOUSE

WASHINGTON

September 3, 1992

MEMORANDUM FOR ANDREW CARPENDALE

FROM: ROBERT B. CHARLES ^{RBC}

SUBJECT: Legal Statistics

In response to your request yesterday, I have looked around for recent and hard-hitting statistical and anecdotal material on legal reform. Good anecdotes remain elusive (although I expect I will find them), while the two "soon to be released" studies strike me as important.

I discussed the data with Steve Provost this morning, and have passed a copy of the attached to Richard Porter. Let me know if I can be of further help.

cc. Roger B. Porter

Statistics: Legal/ Civil Justice Reform

New Data on US

- A soon to be published study [by NAM] estimates that "businesses and consumers will spend between \$163 and \$201 billion on legal services in 1992."

This figure does not include damage awards or in-house legal fees paid by many businesses. It does include payments to law firms for travel and other disbursements. [Source: NAM/ study author]

- A soon to be published study [by the Tillinghast, A Towers Parrin Company, Hartford consulting firm] estimates that "the total direct costs associated with the US tort system in 1991 are \$132 billion." [Source: Tillinghast, Co./ study author]

This figure does include settlements and benefits paid to third-parties and plaintiffs, as well as administrative costs.

It does not include the costs to business and to states of workers' compensation benefits, which "totalled another \$64 billion in 1991." It also does not include indirect costs of our tort system.

- The soon to be published Tillinghast study shows that "US costs of tort litigation have more than quadrupled since 1950, as a percent of GDP."

-- Today, the US costs of tort litigation account for 2.3 % of total US GDP.

-- By comparison, tort litigation costs in Japan account for only 0.7 percent [i.e. less than one percent] of that nation's GDP, a figure that has remained steady since 1970, while our litigation costs have risen.

-- Similarly, tort litigation costs in France account for only 0.9 percent [i.e. less than one percent] of that nation's GDP, and since 1970, tort costs in France have been falling.

Data on Wisconsin

- In 1980 [most recent data], Wisconsin:
 - Had 9,117 lawyers
 - Had a State population/lawyer ratio of 516/1
 - Had more lawyers than 33 other US States
 - Had 1.7 percent of all lawyers in US