

**CAN WE SUE OUR WAY TO PROSPERITY?: LITIGATION'S EFFECT ON AMERICA'S GLOBAL COMPETITIVENESS**

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**HEARING**  
BEFORE THE  
SUBCOMMITTEE ON THE CONSTITUTION  
OF THE  
COMMITTEE ON THE JUDICIARY  
HOUSE OF REPRESENTATIVES  
ONE HUNDRED TWELFTH CONGRESS  
FIRST SESSION

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MAY 24, 2011  
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**CAN WE SUE OUR WAY TO PROSPERITY?:  
LITIGATION'S EFFECT ON AMERICA'S  
GLOBAL COMPETITIVENESS**

**TUESDAY, MAY 24, 2011**

HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON THE CONSTITUTION,  
COMMITTEE ON THE JUDICIARY,  
*Washington, DC.*

The Subcommittee met, pursuant to call, at 2:08 p.m., in room 2141, Rayburn Office Building, the Honorable Trent Franks (Chairman of the Subcommittee) presiding.

Members present: Representatives Franks, Smith, Chabot, and Scott.

Staff present: (Majority) Holt Lackey, Counsel; Sarah Vance, Clerk; Grant Anderson, Legal Research Intern; (Minority) David Lachmann, Subcommittee Chief of Staff; and Veronica Eligan, Professional Staff Member.

Mr. FRANKS. This hearing will come to order. We want to welcome everyone to the Subcommittee on the Constitution, particularly the witnesses that are with us today.

We want to welcome you all here today. As you heard, the votes have just been called, and we especially appreciate our witnesses. So what we are going to do for the moment here is we are going to defer to the full Committee Chairman, Mr. Smith, for an opening statement.

Mr. SMITH. I thank the Chairman, and I also want to thank the Chairman and the Ranking Member for the special dispensation that allows me to sneak in an opening statement before I go vote. I am not necessarily going to be able to come back after votes, but I did want to make my statement. So, let me proceed, and once again, thank you.

Today the Judiciary Committee continues to pursue its job creation agenda. The unemployment rate remains close to 9 percent as it has throughout this Administration. Congress should do everything it can to reduce the cost of creating jobs in America and to put Americans back to work.

For the Judiciary Committee, this means making sure that America's lawsuit system is efficient and fair. Both the Lawsuit Abuse Reduction Act, which reigns in frivolous lawsuits, and the Health Act, which limits non-economic damages in health care, are at the top of this Committee's agenda.

Today we continue this reform agenda by investigating ways that America's bloated lawsuit system harms our global competitive-

ness. I hope that today's hearing highlights some specific areas of the law that could be improved by reasonable common sense reforms.

The Department of Commerce recently and correctly concluded that America's inflated lawsuit costs are "an important U.S. competitiveness concern." The U.S. spends twice as much on lawsuits as similar countries, which hurts American competitiveness in at least three ways.

First, excessive lawsuit costs leave less for American companies to invest. Money that America spends on its litigation system is money that is not going to research, expansion, and job creation.

Second, our lawsuit system puts American companies at a disadvantage when they are doing business abroad. American companies are increasingly being sued in domestic courts for wrongs that they allegedly committed abroad. Many of these suits have been marred by disturbing evidence of fraud, misrepresentation, and corruption by American and foreign trial lawyers.

Third, our lawsuit system discourages foreign investment in the American economy. A 2008 study by the Department of Commerce concluded that the U.S. litigation environment harmed our competitiveness by discouraging foreign investment. That study found that for international businesses, the "United States is increasingly seen as a nation where lawsuits are too commonplace."

Global surveys of business leaders have shown that the high costs of our lawsuit system discourage foreign-owned companies from expanding businesses and creating jobs. Many of these problems share a common cause. Too many trial lawyers view the law as a business to make money for themselves rather than as a profession to achieve justice for their clients. This upside down view of the purpose of the law explains many of the most questionable practices we see today.

Trial lawyers aggressively recruit clients to build massive and profitable class actions. They settle class action lawsuits on terms that pay them millions in attorneys' fees while giving relatively little to the clients whom the lawsuit was supposed to protect. They encourage hedge funds to invest in their lawsuits as if they were any other startup business.

None of this is consistent with the advice of the most revered lawyer in American history, Abraham Lincoln. Lincoln advised his fellow lawyers, "Discourage litigation. Persuade your neighbors to compromise whenever you can. Point out to them how the nominal winner is often a real loser in fees, expenses, and waste of time. As a peacemaker, the lawyer has a superior opportunity of being a good man. There will still be business enough."

I hope that today's hearing illuminates ways that this Committee can help turn America's legal system toward President Lincoln's worthy standard.

Thank you, Mr. Chairman, and I yield back.

Mr. FRANKS. And I thank the Chairman. We are going to go ahead and recess now for the votes. And so, this meeting stands recessed until after the votes.

[Recess.]

Mr. FRANKS. The meeting will come to order.

We are reconvening the hearing here. I apologize that we have been waiting here for others, but it turns out that we had already opened it with a quorum, so we are in good shape. And you know how those things go.

But I want to welcome you this afternoon again to the Subcommittee titled, "Can We Sue Our Way to Prosperity?: Litigation's Effect on America's Global Competitiveness."

America faces the highest lawsuit costs of any developed country. America's tort lawsuit costs are at least double those of Germany, Japan, and Switzerland, and triple those of France and the United Kingdom.

I believe as today's testimony will show, these lawsuit costs serve as a tax on anyone who would create jobs in America. And of all of the taxes that can be imposed, this lawsuit tax is perhaps the most regressive, job crushing, and harmful to America's global competitiveness.

The lawsuit tax is regressive because it falls much harder on small businesses than on big businesses. According to a pending study conducted by one of our witnesses today, small businesses earn just more than one-fifth of business owner revenues in America, but bear more than four-fifths of the business lawsuit costs. Small businesses are less likely to have the level of insurance that larger businesses carry. Small businesses are not as experienced in the legal system and do not have all of the same access to elite lawyers.

And precisely because they are small, small businesses are vulnerable to being wiped out entirely by just one lawsuit. This is why, though, it is relatively rare for large businesses to be driven completely out of business by a lawsuit. Probably every member of this House has met a small businessman or woman from their district whose livelihood has been threatened by a lawsuit.

This lawsuit tax is particularly harmful to job creation because it is the kind of tax that businesses cannot anticipate and the only kind of tax that can cost more than the entire revenue and assets of the business itself.

Now, while any tax can slow job creation at the margins, the lawsuit tax can stop job creating businesses in their tracks. The lawsuit system harms competition because it leads to America spending about twice as much on tort litigation as our major global competitors. The American tort system costs about 2 percent of gross domestic product as compared to about 1 percent or less of GDP in most other developed countries.

Having the highest lawsuit tax rate in the developed world makes it harder for American businesses to grow their businesses, to create jobs, and to compete in the international economy.

The trial lawyers, their political allies, and other defenders of the lawsuit status quo, often argue that these high costs are necessary to deter dangerous negligence and compensate the injured.

Everyone agrees that we should minimize the amount of injury caused by negligence, and that Americans who are harmed by the negligence of others should be compensated. But there is little evidence that America's additional tort lawsuit costs make Americans any safer. According to World Health Organization statistics, Americans die from unintentional injuries at a higher rate than

our peers in other developed countries. Among countries that the CIA designates as developed, only Finland and South Africa have higher rates of accidental death. And other modern developed countries justly compensate the injured while spending less than half of the amount on litigation that we spend here in America.

America's bloated lawsuit costs undermine American competitiveness because they only handicap those businesses that are trying to build wealth and create jobs in America. American businesses trying to grow to compete on a global scale face lawsuits and costs and risks that their international competitors do not. Americans doing business abroad must worry about being sued back home, and foreign businesses are much less likely to invest in America and create jobs that are here because they are concerned about America's high lawsuit costs.

In a competitive global economy, America cannot afford a lawsuit environment that is so much more burdensome than our competitors. To borrow a phrase, America cannot "win the future" while carrying the extra weight of the developed world's highest litigation costs.

And with that, I want to welcome the witnesses again. And we will introduce them, and we will begin.

Indeed we have a distinguished panel of witnesses today. Our first witness, Mr. Paul Hinton, is the vice president of NERA Economic Consulting and has conducted empirical economic research on the costs of American litigation. He holds a B.A. from Oxford University and a master's degree in public policy from the Kennedy School at Harvard.

Our second witness, Mr. Charles Silver, is a McDonald chair in civil procedure at the University of Texas School of Law. Mr. Silver's research and writing focuses on health care, law, and policy, civil procedure, complex litigation, and the professional responsibility of attorneys. He is currently an associate reporter on American Law Institute's project on aggregate litigation and a member of the ABA TIPS task force on the contingent fee.

Our third witness, Mr. John Beisner, is a partner and co-head of the mass torts and insurance litigation group at Skadden Arps, L.L.P. He has researched and frequently spoken and testified about alleged shortcomings in America's Federal litigation system that exposes American businesses to undue liability.

Each of the witnesses' written statements will be entered into the record in its entirety. I ask that each witness summarize his testimony in 5 minutes or less. To help you stay within that time frame, there is a timing light on your table. When the light switches from green to yellow, you will have 1 minute to conclude your testimony. When the light turns red, it signals that the witness's 5 minutes have expired.

Before I recognize the witnesses, it is the tradition of Subcommittee that they be sworn in. So, if you will please stand to be sworn.

[Witnesses sworn.]

Mr. FRANKS. Thank you. Please be seated.

I now recognize our first witness, Mr. Paul Hinton, for 5 minutes.

**TESTIMONY OF PAUL HINTON, VICE PRESIDENT,  
NERA ECONOMIC CONSULTING**

Mr. HINTON. Thank you, Chairman Franks and distinguished Committee Members, for inviting me to provide testimony today on the effects of litigation on competitiveness.

Mr. FRANKS. Pull your mic a little bit closer to you, sir. Is it on?

Mr. HINTON. How is that? Yes.

Mr. FRANKS. Okay.

Mr. HINTON. Okay, thank you.

Yes, my name is Paul Hinton. Thank you for your introduction. I am a vice president at NERA Economic Consulting, which is a global firm dedicated to applying principles of economics, finance, and quantitative analysis to complex business problems, legal, and public policy challenges.

I have co-authored and authored a number of empirical studies that estimate the direct costs of the legal system, and developed measures of the impact of the legal system on economic activity. It is the result of these studies that provide the basis of my testimony here this afternoon.

I will also reference a widely-cited study on the tort costs by Towers Watson.

U.S. litigation affects competitiveness by imposing additional costs on businesses operating in the United States. Towers Watson, the actuarial firm that reports U.S. tort costs of \$250 billion a year, estimates that the U.S. ranks number one in tort costs as a percent of GDP, as you previously mentioned. Furthermore, by this metric, U.S. tort costs are more than double those of most other countries.

A NERA study of tort costs found that higher tort costs from operating in the United States are a particular burden on small businesses. This potentially exaggerates the adverse effects on U.S. business activity because small businesses are responsible for creating 65 percent of the net new jobs in the country.

We used the approach similar to Towers Watson. Starting with the premiums paid for liability insurance, we took the analysis a step further by using more detailed data on the insurance costs for individual businesses from the insurance broker, Marsh. We found that in 2008, small businesses with less than \$10 million in revenues represented 22 percent of U.S. business revenues, but incurred 83 percent of the tort costs. These direct costs of the U.S. tort system can be described as having an effect on business similar to a tax and, like a tax, can affect the level of business activity.

We are currently conducting a study commissioned by the U.S. Chamber Institute for Legal Reform in which we quantify the potential effect on jobs of differences in tort costs across the United States. The preliminary findings of this study indicate that the legal climate within a State substantially affect tort costs. The results from studies of changes in business activity due to taxes are then used to estimate potential employment effects attributable to differences in tort costs.

Now, these direct costs of doing business are just the tip of the iceberg. Litigation also imposes indirect costs. The uncertainty created by litigation affects businesses' borrowing costs and, hence, their ability to invest, grow, and create jobs. Many foreign compa-

nies are wary of becoming embroiled in U.S. litigation, which may deter foreign direct investment.

Dealing with litigation can occupy management time, result in unproductive risk avoidance, and otherwise distort business decision making. These indirect costs imposed by the tort system reduce productivity.

So, in another NERA study, we looked at productivity. We used the liability costs associated with U.S. asbestos litigation to show how tort costs slow U.S. labor productivity growth relative to other countries.

We measured differences in productivity growth per employee in asbestos industries between the U.S. and 10 industrialized countries. We used comparisons of non-asbestos industries to control for other differences that were unrelated to the litigation, such as local market conditions and regulation.

But what we found is in the industries heavily affected by asbestos litigation, our study measured half a percentage point slower productivity growth in the United States. Now, over 14 years of the study period, that meant productivity losses in the U.S. of over \$300 billion, or \$50 billion in 2000 alone.

In conclusion, litigation imposes direct costs that are higher in the U.S. than in other countries, and these costs fall more heavily on small businesses. The direct and indirect costs of litigation together put the U.S. at a competitive disadvantage, slowing productivity growth.

Thank you again, Chairman Franks and distinguished Committee Members, for this opportunity to testify today and for holding this hearing to bring attention to this important economic issue.

[The prepared statement of Mr. Hinton follows:]

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**Written Statement of  
Paul J. Hinton, NERA Economic Consulting**

Before the Committee on the Judiciary  
Subcommittee on the Constitution  
United States House of Representatives  
May 24, 2011

**Hearing on: Can We Sue Our Way to Prosperity?  
Litigation's Effect on America's Global Competitiveness**

Thank you, Mr. Chairman and distinguished Committee members for inviting me to provide testimony today on the effects of litigation on competitiveness. My name is Paul Hinton and I am a Vice President at NERA Economic Consulting. NERA is a global firm of experts dedicated to applying economic, finance, and quantitative principles to complex business and legal challenges. For half a century, our economists have brought academic rigor, objectivity, and real world industry experience to bear on issues arising from competition, regulation, public policy, strategy, finance, and litigation.

Prior to joining NERA, I earned a BA from Oxford University and a Master's in Public Policy from the Kennedy School at Harvard University. I have authored and co-authored a number of empirical studies that estimate the direct costs of the legal system to businesses and develop measures of the impact of the legal system on economic activity. I describe these studies below.

**I. Summary**

The direct cost of the U.S. tort system is estimated to be approximately \$250 billion in 2009 or about 2 percent of GDP.<sup>1</sup> The U.S. costs are the highest as a percent of GDP amongst those reported for other industrialized countries and more than double the estimates for countries such as the U.K, France, and Japan.<sup>2</sup>

<sup>1</sup> "U.S. Tort Cost Trends, 2010 Update," Towers Watson, 2011.

<sup>2</sup> "U.S. Tort Costs and Cross-Border Perspectives: 2005 Update," Towers Perrin, Tillinghast, 2006.

One NERA study I directed on Tort Liability Costs for Small Businesses shows that tort costs are not borne evenly throughout the economy. Small businesses bear a relatively larger share of tort costs than larger businesses. For example, businesses with less than \$10 million in revenues in 2008 represented only 22 percent of U.S. business revenues but incurred 83 percent of tort costs.<sup>3</sup> This is economically important because small businesses generate the majority of net new jobs, 65 percent over the past 17 years.<sup>4</sup>

The costs of the U.S. tort system may have effects on businesses similar to an implicit tax.<sup>5</sup> The economic literature on the effects of taxes on business activity is instructive in identifying the effects of higher costs of business on economic development.<sup>6</sup> This literature as well as surveys of business attitudes describe how business decisions on where to make investments and add jobs are sensitive to local costs of doing business. Tort liability costs may also affect the growth of existing businesses within the 50 states.

In another NERA study, I worked with colleagues to examine how relatively higher tort costs in the U.S. affect international competitiveness. We compared the growth of productivity in the manufacturing industries affected by asbestos litigation in the U.S. since the late 1980s to productivity growth of the same industries in other industrialized countries. We found that productivity growth in the U.S. industries affected by asbestos litigation was 0.5 percent per year slower than their counterparts in other countries. Over the period of study from 1987 to 2000, the lower U.S. productivity growth amounted to lost GDP of over \$300bn, with \$51bn of that loss realized in 2000.

Both these studies indicate that lowering the costs of the tort system could have a substantial impact on the promotion of business activity.<sup>7</sup>

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<sup>3</sup> "Tort Liability Costs for Small Businesses," U.S. Chamber Institute for Legal Reform, May 2010.

<sup>4</sup> "Frequently Asked Questions," Small Business Administration, Updated January 2011.

<sup>5</sup> Taxes are typically paid on business profits whereas tort costs vary more closely with business revenues. However, both raise the cost of doing business.

<sup>6</sup> See e.g. Michael J. Waslenko, "Taxation and economic development: the state of the economic literature," *New England Economic Review*, March 1997.

<sup>7</sup> In addition, the U.S. Chamber Institute for Legal Reform has commissioned a NERA study, currently underway, that will quantify the effects of differences in legal climate across the states. Preliminary findings measure significant variation in tort costs between states with the best and worst legal climate.

## II. The direct cost of the tort system and its effects on business

### A. How the cost of the tort system can be estimated

The cost of the tort system is hard to quantify because information about the actual costs associated with resolving individual tort claims is not generally available. Verdict amounts are reported but only in the minority of cases that are resolved at trial. Attorney fees and settlements are generally not reported and the administrative costs of running the court system are shared between tort cases and other matters and so are hard to attribute.

An alternative approach developed by Towers Watson (formerly Tillinghast) uses data on liability insurance costs to estimate the underlying tort system expenses that this insurance covers. This approach makes sense since most tort costs are insured: rather than paying the uncertain amount of tort costs that may emerge during a policy year, insureds choose to pay a premium to provide limited insurance coverage for whatever costs actually arise. The insurance companies pay covered liabilities as they arise and charge premiums sufficient to cover their costs over the long term. The insured liability costs are computed by multiplying the premiums charged by the combined ratio, (that is the ratio of losses and insurer expenses to earned premiums).

This approach relies on being able to separate lines of particular commercial lines, personal lines and medical malpractice insurance that pay tort costs from other lines.<sup>8</sup> Uninsured costs are estimated to account for companies that self-insure (including deductibles and other retentions) or pay out-of-pocket. Some specific categories of costs are not included such as tobacco settlements and the administrative costs of the state and federal courts themselves.<sup>9</sup> The components of the Towers Watson estimate for 2008 are shown in Figure 1.

**Figure 1**  
**2008 U.S. Tort Cost Estimate (in \$ billions)<sup>10</sup>**

	Business	Personal	Total
Liability Insured Cost	86	92	179
Uninsured Cost	45	2	47
Medical Malpractice Cost	30	N/A	30
<b>Total</b>	<b>161</b>	<b>94</b>	<b>255</b>

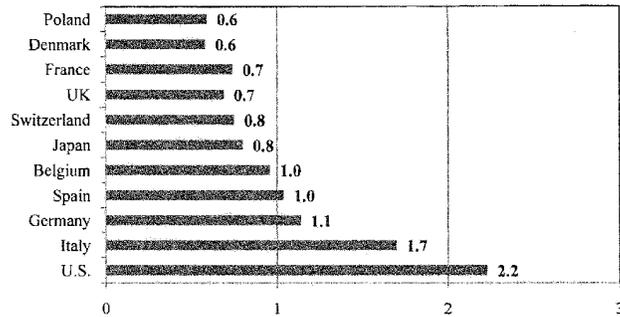
<sup>8</sup> Some lines of business cover both tort costs and property losses and for these the estimated proportion of premium related to property coverage is deducted. In particular, the non-liability portion of commercial multiple peril policies (A.M. Best line 5.1), and 91% of farmowners and homeowners multiple peril policies (A.M. Best line 3 and 4) are excluded. In addition, costs relate to non-fault auto insurance (A.M. Best lines 19.1 and 19.3) and automobile property damage (A.M. Best line 21) are also excluded.

<sup>9</sup> To the extent that punitive damage awards are excluded from insurance coverage these costs are not included. Certain types of contract and shareholder litigation costs are also excluded. See Towers Watson "U.S. Tort Cost trends, 2010 Update," p.10.

<sup>10</sup> "2009 Update on U.S. Tort Cost Trends," Towers Perrin, 2009.

Towers Watson developed similar estimates for selected industrialized countries in 2004. These estimates are expressed as a percent of GDP and are reported in Figure 2.

**Figure 2**  
**Tort Costs as a Percent of GDP, 2003**



Source: "U.S. Tort Costs and Cross-Border Perspectives: 2005 Update," Towers Perrin, 2005.

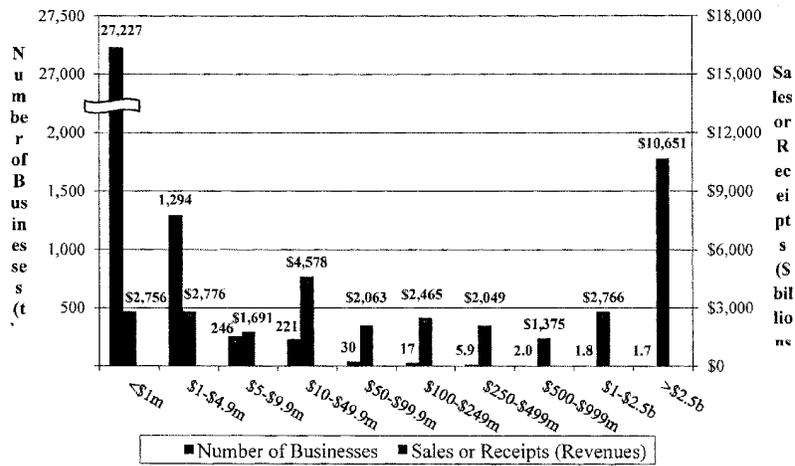
### B. The NERA small business tort cost study

NERA used a similar approach to estimate the tort costs attributed to businesses of different sizes in the U.S. economy. This study, *Liability Costs for Small Businesses*, was commissioned and published by the U.S. Chamber Institute for Legal Reform in May 2010. This analysis is based on the costs of liability insurance to individual businesses who purchased liability insurance through Marsh Inc. a major insurance broker in 2008.<sup>11</sup> In the study, we use this data to estimate how the Towers Watson \$161 billion estimate of U.S. tort costs paid by businesses in 2008, is distributed between large and small businesses.

<sup>11</sup> Marsh Inc. is a sister company of NERA Economic Consulting. They are both a part of Marsh and McLennan Companies.

For purposes of this study, small businesses are defined as those with \$10 million or less in annual revenues. According to the Economic Census in 2008 small businesses in this category numbered over 28 million and represented 99 percent of all businesses (see Figure 3) and 22 percent of business revenues.

**Figure 3**  
**Estimated Size Distribution of US Business in 2008**



Source: MarketStance 2008 data derived from the Economic Census.

The principal findings of the study are:

- The tort liability price tag for small businesses in America in 2008 was \$133 billion (see Figure 4).
- Small businesses bore 83 percent of business tort costs (including medical malpractice costs) compared to only 22 percent of revenue.
- Small businesses paid \$36 billion (27 percent) of their tort costs out of pocket as opposed to through insurance.

**Figure 4**  
**Estimated Business Tort Costs<sup>12</sup>**

Revenue Categories	2008 Estimate of Number and Size of Businesses			Estimated 2008 Business Tort Costs					% of Business Tort Costs
	Number of Businesses	Revenues	Percent of Revenues	Insured Costs	Self Insured or Uninsured	Medical Malpractice	Total		
< \$1 Million	27,226,655	\$2,756	8%	\$41	\$34	\$22	\$97	61%	
\$1 to \$4.9 Million	1,293,670	\$2,776	8%	\$23	\$1	\$4	\$28	17%	
\$5 to \$9.9 Million	246,300	\$1,691	5%	\$6	\$1	\$2	\$9	5%	
< \$10 Million	28,766,625	\$7,223	22%	\$70	\$36	\$28	\$133	83%	
\$10 to \$50.0 Million	221,195	\$4,578	14%	\$10	\$2	\$	\$13	8%	
> \$50 Million	58,390	\$21,368	64%	\$6	\$7	\$1	\$14	9%	
<b>Total</b>	<b>29,046,210</b>	<b>\$33,168</b>	<b>100%</b>	<b>\$86</b>	<b>\$45</b>	<b>\$30</b>	<b>\$161</b>	<b>100%</b>	

U.S. commercial liability tort costs are estimated separately for commercial automobile liability, medical malpractice, and other commercial liability lines. For each line of insurance, median insurance premium costs per \$1,000 in business revenues are computed for businesses of different sizes (as defined by revenues) and for businesses in different industries (as defined by one digit SIC codes).<sup>13</sup>

The insurance lines used in this analysis are commercial automobile liability, medical malpractice liability, the liability components of packaged products (including commercial multi-peril and business owners' policies), and all other primary and excess lines of liability insurance. These other primary and excess lines of liability insurance include many specialized lines of insurance, but the following lines constitute over 97% of the premiums:

- Excess/Umbrella Liability;
- Directors & Officers Liability;
- General Liability;

<sup>12</sup> Data are from "Tort Liability Costs for Small Businesses," U.S. Chamber Institute for Legal Reform, May 2010

<sup>13</sup> We use the medians within each category to reduce the influence of outliers in the sample within each category.

- Professional Indemnity/Errors & Omission;
- Employment Practices Liability;
- Fiduciary Liability;
- Pollution/Environmental Liability;
- Miscellaneous Casualty.

To control for the fact that Marsh's customers may not be representative of businesses throughout the U.S., the median insurance costs in each industry and size category is multiplied by the estimated U.S. revenues for the category (developed for 2008 by MarketStance from census data)<sup>14</sup> and the estimated proportion of businesses that purchase insurance. Estimated premium costs for non-employee businesses (over 99.9 percent of which have annual revenues less than \$1 million) are assumed equal to the median cost of packaged policies.

Liability costs are estimated from premiums earned by multiplying by the combined ratio<sup>15</sup> for the corresponding lines, reported by A.M. Best for 2008. By adjusting liability premium data by the combined ratio, we estimate the total liability losses associated with the cost of insurance.

The total liability costs consist of insured costs and costs associated with uninsured and self-insured out-of-pocket costs. The proportion of liability costs that are uninsured or self-insured by businesses themselves is estimated from business surveys conducted by MarketStance Inc. (a market research firm specializing in insurance) for businesses in different revenue size categories. As shown in Figure 4, in aggregate, businesses' uninsured tort costs represent 28 percent of business tort costs (34 percent excluding medical malpractice).

We scale the costs reported by Marsh clients to match the aggregate national tort costs reported by Towers Watson. Uninsured costs are also scaled to match the aggregate values reported by Towers Watson.

### III. The indirect costs of the tort system

The costs and uncertainty created by litigation affects defendant companies' borrowing costs and hence their ability to invest, grow and create jobs. Dealing with litigation occupies management time that could be used more productively. Also, many foreign companies are wary of becoming embroiled in U.S. litigation, which may deter foreign direct investment.

<sup>14</sup> The most recent Economic Census data is available for 2002. MarketStance uses these data along with more up to date payroll data to estimate the total revenues in the U.S. economy for 2008. The estimate is based on the historical ratio of revenue to payroll computed from the 1992, 1997, and 2002 Economic Censuses by industry group. The aggregate payroll of businesses in 2008 is computed using County Business Patterns data from the U.S. Census Bureau and employment data from the Bureau of Labor Statistics. The ratio of revenue to payroll, adjusting for historical trends for certain industries, is multiplied by the aggregate payroll data to estimate total revenues for employer businesses in 2008. Separately, MarketStance estimates the number and aggregate revenues of non-employee firms using data from the census.

<sup>15</sup> The combined ratio is a standard financial ratio used by insurers to express the cost of paying losses and administering policies as a percent of the premium revenue they earn.

Surveys of business attitudes reveal ways in which the costs of the tort system influence business decisions. For example:

- Nine of ten global companies that de-listed from U.S. stock exchanges between 2003 and 2007 mentioned the troubled U.S. litigation environment as one factor in their decisions.<sup>16</sup>
- Two-thirds of corporate counsel surveyed said that stated legal environments are a major legal consideration when their companies make important business decisions, such as whether to invest in a particular state.<sup>17</sup>
- More than one in three small business owners surveyed said they would likely have to postpone hiring of new employees, reduce benefits for existing employees, and have a harder time getting credit.<sup>18</sup>

The Department of Commerce recently released a report titled “The U.S. Litigation Environment and Foreign Direct Investment, Supporting U.S. Competitiveness by Reducing Legal Costs and Uncertainty.” This report presents the argument that a relatively costly tort system could discourage foreign direct investment in favor of less litigious countries. As it is often said, and *ceteris paribus*, “investment capital goes and stays where it is well treated.”<sup>19</sup>

Another effect of the liability system that is easier to measure is the effect on growth of existing businesses in the United States. A NERA study used the manufacturing industries affected by U.S. asbestos litigation since the 1980s as a case study on the potential effects of high liability costs on productivity growth.<sup>20</sup> The study compared the performance of affected U.S. industries over 14 years with the same industries in 10 other industrialized countries that were not affected to the same extent by asbestos litigation. This study measured a cumulative \$303 billion loss in GDP due to slower U.S. productivity growth in these industries relative to other countries.

#### A. NERA productivity growth study

First, we identified the industries that have been heavily affected by asbestos litigation. More than 6,000 companies have been hit by asbestos personal injury lawsuits, so almost all sectors have been somewhat affected.<sup>21</sup> We compiled a list of asbestos-related bankruptcies and

<sup>16</sup> “Global Capital Markets Survey,” The Financial Services Forum, Policy Research, 2007, p.8.

<sup>17</sup> “Small Businesses: How the Threat of Lawsuits Impacts Their Operations,” Harris Interactive, May 10, 2007, conducted for U.S. Chamber Institute for Legal Reform.

<sup>18</sup> Public Opinion Strategies and Douglas E Schoen LLC national survey of 1,000 small businesses, August 19-31, 2010, #10737, conducted for The U.S. Chamber Institute for Legal Reform.

<sup>19</sup> “The U.S. Litigation Environment and Foreign Direct Investment, Supporting U.S. Competitiveness by Reducing Legal Costs and Uncertainty.” U.S. Department of Commerce, October 2008, p. 2.

<sup>20</sup> [http://www.nera.com/83\\_medial.htm](http://www.nera.com/83_medial.htm).

<sup>21</sup> Stephen J. Carroll, et al., “Asbestos Litigation Costs and Compensation. An Interim Report,” Institute for Civil Justice, 2002, RAND DB-397-1CJ.

identified the primary industries in which the bankrupt companies did business and produced traded goods: we label these industries as “heavily affected.” Industries heavily affected by asbestos litigation, represent 13 percent of GDP and about half the manufacturing sector in 2000, including:

- Metal Ore Mining;
- Nonmetallic Mineral Mining and Quarrying;
- Utility System Construction;
- Building Equipment Contractors;
- Building Finishing Contractors;
- Other Specialty Trade Contractors;
- Basic Chemical Manufacturing;
- Plastics Product Manufacturing;
- Rubber Product Manufacturing;
- Clay Product and Refractory Manufacturing;
- Glass and Glass Product Manufacturing;
- Lime and Gypsum Product Manufacturing;
- Foundries;
- Electrical Equipment Manufacturing;
- Motor Vehicle Parts Manufacturing;
- Ship and Boat Building;
- Engine, Turbine, and Power Transmission Equipment Manufacturing;
- Other Heavy and Civil Engineering Construction;
- Foundation, Structure, and Building Exterior Contractors;
- Petroleum and Coal Products Manufacturing;
- Resin, Synthetic Rubber, and Artificial Synthetic Fibers and Filaments Manufacturing;
- Pesticide, Fertilizer, and Other Agricultural Chemical Manufacturing;
- Pharmaceutical and Medicine Manufacturing;
- Paint, Coating, and Adhesive Manufacturing;
- Soap, Cleaning Compound, and Toilet Preparation Manufacturing;
- Other Chemical Product and Preparation Manufacturing;
- Cement and Concrete Product Manufacturing;
- Other Nonmetallic Mineral Product Manufacturing;
- Iron and Steel Mills and Ferroalloy Manufacturing;
- Boiler, Tank, and Shipping Container Manufacturing; and
- Agriculture, Construction, and Mining Machinery Manufacturing.

We then constructed a database of industry-level labor productivity (output per employee) for the U.S. and ten other industrialized countries.<sup>22</sup> For each industry, in each country, we calculate the average rate of annual productivity growth over 1987-2000 and compare this to the U.S. rate. The industrial countries used as a comparison are the ten that had the necessary data available: Austria; Denmark; Finland; France; Germany; Italy; Japan; Korea; Luxembourg and Norway .

<sup>22</sup> The source of the data is the Organization of Economic Cooperation and Development's (OECD) “STAN” database. The OECD is the leading source of internationally comparable economic data from developed countries. The 10 countries are all of those for the OECD data from 1987-2000.

We compare the performance of industries heavily affected by asbestos litigation in the U.S. with the same industries in ten other industrialized countries. It would be incorrect to simply compare the productivity growth across different countries because growth may be slower in some countries for other reasons including local economic or regulatory conditions. To control for country specific differences in growth we use the productivity growth in the non-asbestos industries.

We compute the productivity differential in the heavily affected sectors with each of the ten countries, and then compare the differential growth to the corresponding differential growth in non-asbestos industries. We find that the heavily affected sectors in the U.S. lag behind. The average annual U.S. productivity growth was 0.5% lower relative to the other countries.

Half of one percent may seem like a small difference, but it cumulates and it compounds. By 2000, the productivity differential amounted to a value of \$51 billion per year.<sup>23</sup> The total loss from 1987-2000 was \$303 billion.

#### **IV. Effects of the legal climate on state tort costs**

Liability insurance cost data is also available at the state level and can be used to study the extent to which differences in the legal climate across the 50 states affect tort costs. The periodic Harris survey of business perceptions of the legal climate in each state provides a quantitative metric with which to assess the effects of legal climate.<sup>24</sup>

Just as the tort system imposes higher costs on businesses operating in the U.S. than in other industrialized countries (see Figure 3), variations in legal climate from one state to another means that some states impose higher tort costs than others.

A survey of economic studies on the effect of taxation on economic development by Michael J. Wasylenko provides a useful summary of the range of effects on employment and investment of interregional and interstate differences in taxation.<sup>25</sup> The median effect of taxes on total employment he reports is an elasticity of -0.58. This means that a 10 percent reduction in taxes (e.g. from 10 percent to 9 percent) would result in a 6 percent increase in employment. Similar effects could result from a reduction in business tort costs.

The U.S. Chamber Institute for Legal Reform has commissioned a NERA study, currently being conducted, that will quantify the effects of differences in legal climate across the states using this methodology. While I cannot get into the details of the study until it is finalized,

<sup>23</sup> We turned the productivity differential into a dollar figure by multiplying it by the current dollar value-added in the affected U.S. sector. While the actual effects of lagging productivity are more complex, this is a reasonable way to evaluate the loss in U.S. competitiveness.

<sup>24</sup> See e.g. 2010 U.S. Chamber Of Commerce, State Liability Systems Ranking Study, Humphrey Taylor, Chairman, March 9, 2010.

<sup>25</sup> Michael J. Waslenko, "Taxation and economic development: the state of the economic literature," New England Economic Review, March 1997.

preliminary findings measure significant variation in tort costs between states with the best and worst legal climate.

**V. Conclusion**

I would like thank the Chairman and distinguished Committee members again for this opportunity to testify on this important topic. The effect of the legal climate on the economy is a subject that deserves further attention and I hope to contribute further to the body of research of these effects in the months ahead.

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Mr. FRANKS. Thank you, Mr. Hinton.  
And, Mr. Silver, you are now recognized for 5 minutes, sir. Your microphone, sir.

Mr. SILVER. Push that. Sorry, thank you.

Mr. FRANKS. You know, you think we have been doing this for about 100 years, and whenever we invented microphones. That happens all the time, and there are ought to be a smarter way just to turn those microphones on from up here, shouldn't there?

**TESTIMONY OF CHARLES SILVER, McDONALD CHAIR IN CIVIL PROCEDURE, UNIVERSITY OF TEXAS SCHOOL OF LAW**

Mr. SILVER. All right. Thank you very much, Chairman Franks. It is an honor to be here today.

The title of this hearing is, "Can We Sue Our Way to Prosperity?" Actually, the answer is yes. Civil justice systems contribute to the prosperity of the United States. In fact, the strongest proponents of civil justice systems that protect legal rights and enforce legal obligations are not lawyers, but institutional economists, including economists who have won the Nobel Prize.

I will first demonstrate the connection between lawsuits and prosperity by talking about medical malpractice litigation, in particular about lawsuits against anesthesiologists. I will then discuss very briefly the larger literature on the connection between law and economic growth.

To start with, medical errors make America poorer. The case of anesthesiology is very interesting. Until the mid-1980's, anesthesiology was very dangerous, killed or severely injured thousands of patients every year. Malpractice lawsuits against anesthesiologists were common, and malpractice premiums for anesthesiologists were two to three times the average costs facing other physicians.

In this situation, anesthesiologists could have run to State legislatures or Congress and demanded tort reform. That is what health care providers usually do. But instead, the leaders of the American Society of Anesthesiologists initiated a patient safety campaign. They studied closed medical malpractice claims to learn the root causes of medical errors. Then they took what they knew and applied it. They redesigned their equipment. They established mandatory treatment guidelines, and they took other steps to reduce both the frequency of mistakes and the harmfulness of mistakes. The results were spectacular. In approximately a decade, mortality rates fell to one in every 200,000 anesthesia administrations, a 10- to 20-fold improvement over the immediately prior period.

Of course, as anesthesia became safer, the frequency and harmfulness of injuries declined, and lawsuits pretty much dried up. Malpractice costs fell. Premiums fell. In real dollars, anesthesiologists pay less for liability coverage today than they did in 1985.

A 2005 Wall Street Journal article summarized the developments. I will quote from it. "Today anesthesia related adverse events and emergencies are rare, and anesthesiologist malpractice insurance premiums are low. Anesthesiologists pay less for malpractice insurance today in constant dollars than they did 20 years ago." That is mainly because some anesthesiologists chose a path many doctors and other specialists did not. Rather than pushing for laws that would protect them against patient lawsuits, these anesthesiologists focused on improving patient safety. Their theory, less harm to patients, would mean fewer lawsuits.

Why did they act when they did? For a very straightforward reason—because they were beset by lawsuits and their insurance premiums were rising. To quote one of the leaders of the anesthesia patient safety movement, the campaign was set in motion because, “A malpractice crisis was markedly reducing the incomes of anesthesiologists.”

As a result of the movement, anesthesia is now the only segment of health care delivery that meets industrial standards of quality. Every other segment of the health care delivery system is beset with quality problems. There is a 2011 April peer reviewed issue of the journal *Health Affairs*, which published a series of articles finding things such as 33.2 percent of patients treated in hospitals experienced adverse events. Adverse events kill about 187,000 people in hospitals every year and cause 6.1 million injuries. The total cost of these errors run somewhere between \$393 billion and \$958 billion estimated in terms of what people pay to avoid problems like that.

We also know that health care providers can do better. In my report I cite instances recently where health care providers have reduced the number of mistakes, greatly increased the quality of their care. These improvements help make America prosperous. Patients who live contribute to America’s prosperity more than patients who die. Patients who are healthy contribute more to America’s prosperity than patients who are injured. And patients who are healthy do not need additional health care. So, we save money on health care costs when patient safety improves.

My question is, why should any group of health care providers be allowed to follow any path other than the one that anesthesiologists took, which is to devote themselves to patient safety and improve their systems? And as far as I know, no one has answered that question.

The last thing is, as I said, there is a very large literature on the connection between law and economic prosperity. That literature shows three things. Number one, that protection of human rights, including civil rights, greatly increases a society’s prosperity. Number two, countries with functioning legal systems tend to be much wealthier than countries without them. And, number three, countries with common law systems, like the United States, tend to fare better, to grow faster, than countries with civil law systems. These are findings that economists have generated, not law professors. I encourage the Committee to study this literature.

Thank you very much.

[The prepared statement of Mr. Silver follows:]

Prepared Statement of Charles Silver

Roy W. and Eugenia C. McDonald Endowed Chair in Civil Procedure  
School of Law, University of Texas at Austin

“Can We Sue Our Way to Prosperity?: Litigation’s Effect on America’s Global  
Competitiveness.”

Before the Committee on the Judiciary  
Subcommittee on the Constitution  
United States House of Representatives  
H2-362 Ford House Office Building  
Washington, DC 20515

May 24, 2011

Prepared Statement of Charles Silver

**1. INTRODUCTION:**

Chairman Franks, Ranking Member Nadler and members of the Committee: Thank you for inviting me to testify today on the connection between civil litigation and prosperity.

By way of introduction, I hold the Roy W. and Eugenia C. McDonald Endowed Chair in Civil Procedure in the School of Law at the University of Texas at Austin. Next year, I will be a Visiting Professor at the Harvard Law School. I have published many articles about civil litigation, and I am part of a research group that has produced a series of empirical studies of medical malpractice litigation in Texas. Most of our med mal studies have appeared in journals that are peer-reviewed. From 2004 to 2010, I was an Associate Reporter on the American Law Institute's project on the Principles of the Law of Aggregate Litigation. In 2009, I received the Robert B. McKay Award from the Tort Trial and Insurance Practice Section of the American Bar Association in recognition of my scholarship on tort litigation and insurance.

Owing to the short notice I received of this hearing, this prepared statement is brief. I will gladly supplement it upon request.

The title of this hearing asks, "Can We Sue Our Way to Prosperity?" The answer is plainly yes. Civil justice systems contribute greatly to the prosperity of the United States. In fact, the strongest proponents of honest and accessible civil justice systems that protect legal rights and enforce legal obligations are not lawyers but institutional economists.

I will first demonstrate the positive connection between lawsuits and prosperity by talking about medical malpractice litigation—in particular, lawsuits against anesthesiologists.<sup>1</sup> I will then discuss the more general connection between law and economic growth.

**2. MEDICAL ERRORS MAKE AMERICA POORER**

Until the mid-1980s, anesthesia was dangerous. It killed or severely injured thousands of patients every year.<sup>2</sup> Not surprisingly, malpractice lawsuits against anesthesiologists were common and "[malpractice] premiums [for these physicians] were . . . among the very highest—in many areas, [anesthesiologists paid] two to three times the average cost for all physicians. By the early 1980s, anesthesiologists recognized that something drastic had to be done if they were going to be able to continue to be insured."<sup>3</sup>

<sup>1</sup> Fuller accounts can be found in David A. Hyman and Charles Silver, Justice Has (Almost) Nothing to Do With It: Medical Malpractice and Tort Reform, in *MEDICINE AND SOCIAL JUSTICE*, (Oxford University Press: forthcoming 2011); and David A. Hyman and Charles Silver, The Poor State of Health Care Quality in the U.S.: Is Malpractice Liability Part of the Problem or Part of the Solution?, 90 *Cornell L. Rev.* 893 (2005).

<sup>2</sup> Studies put the mortality rate between 1 in 852 and 1 in 6,048 administrations in the 1950s and 1960s, and between 1 in 2,000 and 1 in 10,000 in the 1970s and 1980s. See, e.g., Alexander Goldstein, Jr. & Arthur S. Keats, The Risk of Anesthesia, 33 *Anesthesiology* 130, 133 tbl.1 (1970). About half of these anesthesia-related deaths were preventable. See Ellison C. Pierce, Jr., The Patient's Safety, *Anesthesia, Resident & Staff Physician*, 51, 51 (Feb. 1989).

<sup>3</sup> Ellison C. Pierce, Jr., The 34th Rovenstine Lecture: The Establishment of the APSF and the ASA Closed Claims Study, *The Anesthesia Patient Safety Foundation* (1995), at <http://www.apsf.org/about/rovenstine/>

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Facing the situation just described, the leaders of the American Society of Anesthesiologists (ASA) could have asked state legislatures or Congress to protect them from lawsuits. That is what health care providers usually do. When faced with lawsuits, they demand tort reform. The leaders of the ASA decided to protect patients from harm instead. Using closed malpractice claims, they identified the root causes of mistakes. Then they redesigned their equipment, established mandatory treatment guidelines, and took other steps to make accidents less likely and less harmful.<sup>4</sup> The results were spectacular. In approximately a decade, mortality rates fell to 1 in every 200,000 anesthesia administrations—a ten- to twenty-fold improvement in patients' survival odds.<sup>5</sup>

As anesthesia became safer, both the frequency of malpractice lawsuits and the cost of resolving claims sharply declined.<sup>6</sup> The fraction of total medical malpractice insurance costs attributable to anesthesia-related claims fell from 11% to 3.6% over fifteen years.<sup>7</sup> Because costs fell, malpractice insurance became more affordable. In real dollars, anesthesiologists pay less for liability coverage today than they did in 1985.<sup>8</sup>

A 2005 Wall Street Journal article summarized these developments:

Today, anesthesia-related adverse events and emergencies are rare, and anesthesiologists' malpractice insurance premiums are low. Anesthesiologists pay less for malpractice insurance today, in constant dollars, than they did 20 years ago. That's mainly because some anesthesiologists chose a path many doctors in other specialties did not. Rather than pushing for laws that would protect them against patient lawsuits, these anesthesiologists focused on improving patient safety. Their theory: Less harm to patients would mean fewer lawsuits.<sup>9</sup>

No one denies that lawsuits spurred this remarkable accomplishment. The leaders of the ASA have stated candidly and repeatedly that they acted when they did because insurance rates for

<sup>4</sup> Girish P. Joshi, 10 Things that Changed Anesthesiology (2005), available at <http://www.asahq.org/Newsletters/2005/Centennial/joshi100.html#joshi>.

<sup>5</sup> Lucian L. Leape, Error in Medicine, in *Margin of Error: The Ethics of Mistakes in the Practice of Medicine* 95, 107 (Susan B. Rubin & Laurie Zoloth eds., 2000); Ellison C. Pierce, Jr., Anesthesia: Standards of Care and Liability, 262 *Journal of the American Medical Association* 773, 773 (1989).

<sup>6</sup> On claims, see Ellison C. Pierce, Jr., ASA Monitoring Guidelines: Their Origin and Development, 66 *American Society Anesthesiologists Newsletter*, Sept. 2002, at 22, 23, available at [www.asahq.org/Newsletters/2002/9\\_02/feature7.htm](http://www.asahq.org/Newsletters/2002/9_02/feature7.htm).

<sup>7</sup> Ellison C. Pierce, Jr., Anesthesia: Standards of Care and Liability, 262 *Journal of the American Medical Association* 773, 773 (1989).

<sup>8</sup> K.B. Domino, Malpractice Insurance Premiums: Greater Stability for Most Anesthesiologists, 70 *ASA Newsletter* 6 (2006); Karen B. Domino, Increasing Costs of Professional Liability Insurance, 67 *American Society Anesthesiologists Newsletter*, June 2003, at 6; Paul R. McGinn, Practice Standards Leading to Premium Reductions, *American Medical News*, Dec. 2, 1988, at 1, 28; Medical Malpractice Rates Drop for Anesthesiologists, *Las Vegas Sun*, May 14, 2003, at B2.

<sup>9</sup> Joseph T. Hallinan, One group of doctors changes its ways, *Wall Street Journal*, June 21, 2005.

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anesthesiologists had spiked. The anesthesia patient safety campaign was set in motion because “a malpractice crisis [] was markedly reducing the incomes of anesthesiologists.”<sup>10</sup>

One connection between the improvement in anesthesia safety and the prosperity of the United States is obvious. People who are alive contribute more to our prosperity than people who are dead, and healthy people contribute more than injured people. Because anesthesia safety improved, hundreds of thousands of Americans who would otherwise have died or suffered incapacitating brain damage emerged from surgery alive and well. These people returned to their families and their jobs and continued to contribute to America’s prosperity.

A second connection is less obvious. Because anesthesia safety improved, anesthesiologists can now treat frail patients they would previously have turned away. These patients, who once would have died or remained crippled, can now have life-saving or life-improving surgeries that enable them to contribute too. Millions of Americans are better off today because decades ago, patients who were injured by anesthesia-related errors filed lawsuits.

Finally, it is worth noting that the lawsuit-inspired improvement in anesthesia safety has saved countless health care dollars. Patients who were injured by anesthesia mistakes often required expensive follow up care. Some victims needed round-the-clock care for the rest of their lives. Because anesthesia is safer, dollars that would once have been spent caring for malpractice victims now pay for other treatments.

I urge the members of this Subcommittee to ask why other health care providers should be allowed to follow any path other than the one taken by the ASA. Instead of improving their delivery systems and protecting patients from harm, interest groups representing other health care providers demand tort reforms. And they usually get them. Many states have restricted lawsuits in ways that insulate providers from responsibility for the consequences of their mistakes. Not surprisingly, anesthesia delivery is the only component of the health care system that meets industrial quality standards. All other segments have serious quality problems. In April 2011 the peer-reviewed journal *Health Affairs* published a series of articles by public health researchers that document these shortcomings:

- 33.2% of patients treated at three leading hospitals experienced adverse events, including medication errors, procedural errors, hospital-acquired infections, pulmonary venous thromboembolisms, pressure ulcers, device failures and patient falls.<sup>11</sup>
- Adverse medical events—medical interventions that cause harm or injury to a patient separate from the underlying medical condition—may cause 187,000 deaths in hospitals each year and 6.1 million injuries, both in and out of hospitals. The annual social cost of

<sup>10</sup> Jeffrey B. Cooper, *Getting into Patient Safety: A Personal Story* (2006), available at <http://www.webmm.ahrq.gov/perspective.aspx?perspectiveID=29>.

<sup>11</sup> David C. Classen et al., ‘Global Trigger Tool’ Shows That Adverse Events In Hospitals May Be Ten Times Greater Than Previously Measured, 30 *Health Affairs* 581 (2011).

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these adverse medical events, based on the amounts people pay to avoid such risks in non-health care settings, ranges from \$393 billion to \$958 billion.<sup>12</sup>

- Medical errors resulting in injuries to patients generate \$17.1 billion in additional health care costs each year. So-called “never events,” more than 400,000 of which occurred in the United States in 2008, accounted for \$3.7 billion of this amount.<sup>13</sup>

Plainly, medical errors imperil America’s prosperity.

Health care providers can do better. In fact, almost every time they try to do better, they succeed. In one recent pilot program, Michigan hospitals reduced the rate of central line infections to zero. In another, obstetricians at the New York Presbyterian Hospital-Weill Cornell Medical Center reduced the frequency of unexpected occurrences involving death or serious injury to infants from 1.04 per 1000 deliveries in 2000 to 0 in 2008 and 2009. No maternal deaths during labor and delivery occurred at the hospital for 6 years. Medical errors persist simply because providers take the steps that would prevent them less often than they should. Several reasons account for this, but an important one is that elected officials have insulated health care providers from the cost of medical errors by imposing tort reforms.

### 3. CIVIL JUSTICE SYSTEMS HELP COUNTRIES PROSPER

A large literature exists on the connection between law and economic prosperity. Economists have done most of this research, but political scientists and law professors have contributed too. I know only part of this literature, but because it strongly affirms the connection between common law adjudication and economic growth, I believe the members of this Subcommittee should be aware of it and I attempt to summarize it briefly.

#### A. It is impossible to have a developed economy without a functioning system of enforceable legal rights

Douglass North, the Nobel Prize winning economist, observed that “[t]he creation of a system of enforceable property rights is one of the most important institutional prerequisites to economic growth.”<sup>14</sup> The truth of this proposition is self-evident. Countries with weak legal regimes tend to be less developed economically than countries that with strong ones. Often, the difference is striking. Table 1 lists the ten countries with the lowest and highest “rule of law” rankings by Freedom House, along with their per capita GDPs. The tendency of countries with high rankings to be wealthier than countries with low rankings is evident.

<sup>12</sup> John C. Goodman, Pamela Villarreal and Biff Jones, The Social Cost Of Adverse Medical Events, And What We Can Do About It, 30 Health Affairs 590 (2011).

<sup>13</sup> Jill Van Den Bos, et al., The \$17.1 Billion Problem: The Annual Cost Of Measurable Medical Errors, 30 Health Affairs 596 (2011).

<sup>14</sup> Douglass Cecil North, Structure and Change in Economic History (1981).

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Table 1: Top Ten and Bottom Ten Countries by Rule of Law Rank, Personal Autonomy Rank, and GDP Per Capita, 2007				
	Country	Rule of Law	Personal Autonomy & Individual Rights	GDP Per Capita
Bottom Ten	Burma	0	4	\$1,800
	Congo (Kinshasa)	0	1	\$1,400
	Iraq	0	4	\$1,900
	Libya	0	6	\$12,300
	North Korea	0	1	\$1,800
	Somalia	0	0	\$600
	Sudan	0	0	\$2,400
	Turkmenistan	0	0	\$8,500
	Uzbekistan	0	2	\$2,000
	Chad	1	3	\$1,500
	%	%	%	%
Top Ten	Uruguay	15	15	\$10,900
	Barbados	16	15	\$18,400
	Finland	16	16	\$33,500
	Iceland	16	16	\$38,000
	Liechtenstein	16	16	\$25,000
	Luxembourg	16	16	\$71,400
	Malta	16	15	\$21,300
	Norway	16	16	\$46,300
	San Marino	16	16	\$34,100
	Sweden	16	16	\$32,200

Sources: Freedom House, Rule of Law and Personal Autonomy, Freedom in the World 2007 Subscores, <http://www.freedomhouse.org/template.cfm?page=372>; CIA World Factbook 2009, GDP - per capita (PPP) 2007 Country Ranks.

In the statement by Douglass North I quoted, the word “enforceable” should not be missed. For legal rights of any sort to do their job, rights-holders must be able to demand that rights be honored or respected. Courts are the institutions that enforce legal rights. Consequently, successful legal regimes give rights-holders access to courts.

**B. Enforceable legal rights facilitate economic growth by rendering persons and their expectations secure against external threats.**

Although North wrote of “property rights,” property is an exceptionally broad category. It includes not only land, but contractual rights to payment, inventions, trademarks, bank accounts, securities, and many other things to which people assign significant value. Moreover, when it comes to understanding the contribution the rule of law makes to economic growth, the distinction between property rights and other rights or liberties is not important. As the economist David Scully observed, “[l]ife, liberty, and property are not additively separable attributes; the diminution of one diminishes all.”<sup>15</sup> The rule of law facilitates economic growth by enhancing personal security from external threats and by enabling people to enjoy the returns on their productive activities and investments. Studying 115 countries from 1960 to 1980, Scully found that:

On average, politically open societies grew at a compound real per capita rate of 2.53 percent per annum compared to a 1.41 percent growth rate for politically closed societies. On average, societies that subscribe to the rule of law grew at a 2.75 percent rate compared to a 1.23 percent rate for societies in which state rights take precedence over individual rights. On average, societies that subscribe to private property rights and a market allocation of resources grew at a 2.76 percent rate compared to a 1.10 percent rate in nations in which private property rights are circumscribed and the state intervenes in resource allocation.<sup>16</sup>

A study published in the *Journal of Institutional Economics* in 2010 argues that civil liberties better measure the rule of law than economic liberties, for the purpose of understanding the connection between law and economic growth.<sup>17</sup>

**C. Economies tied to common law legal systems tend to develop more rapidly than economies tied to civil law systems, because common law courts decentralize power and provide superior protection against legislative and executive interference with individual rights and liberties.**

Finally, among countries committed to the rule of law with strong civil liberties, there is evidence that economic growth occurs more quickly in those with common law legal systems than in those with civil law systems. Friedrich Hayek, the Austrian economist and noted defender of liberty, suggested that this might be so when he observed that “[t]he ideal of individual liberty seems to have flourished chiefly among people where, at least for long periods, judge-made law predominated.”<sup>18</sup> Given the connection between liberty and economic growth,

<sup>15</sup> Gerald W. Scully, *The Institutional Framework and Economic Development*, 96 *Journal of Political Economy* 652 (1988).

<sup>16</sup> *Id.*, 657-658.

<sup>17</sup> Ariel Benyishay and Roger Betancourt, *Civil liberties and economic development*, 6 *Journal of Institutional Economics* 281 (2010).

<sup>18</sup> Friedrich A. Hayek, *Law, Legislation and Liberty: A New Statement of the Liberal Principles of Justice and Political Economy* 94 (1973).

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faster growth might be expected in common law countries with stronger protections for individual rights. Paul Mahoney, the Dean of the law school at the University of Virginia, published a study in 2001 finding that common law countries do indeed grow more quickly. He attributed the result to the independence of common law courts and the greater ability of common law judges to check over-reaching actions by executives and legislatures.<sup>19</sup>

Of course, the common law protects the freedom and security of individuals in many ways. It enforces property rights and contracts, and it gives everyone the right to live out his or her life free of harms inflicted unreasonably by others. The right to have others exercise reasonable care when acting in potentially dangerous ways is the fundamental principle of tort law, which is as much a part of the common law tradition as the law of property and contract. Legislation that renders tort law impotent, by watering down substantive legal standards, by imposing procedures that make lawsuits impracticable, or by undermining the independence of common law courts, threatens personal security. Such legislation may therefore be predicted to endanger prosperity too. It is difficult to test this proposition empirically, for many reasons, but the lesson of history and comparative economics appears to be that prosperity is more likely to occur when courts stand as bulwarks against executive and legislative excesses than when courts are subservient to them.

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<sup>19</sup> Paul G. Mahoney, The Common Law and Economic Growth: Hayck Might Be Right, 30 *Journal of Legal Studies* 503 (2001).

Mr. FRANKS. And thank you, Mr. Silver. You make a lot of compelling points.

Mr. Beisner, you are recognized for 5 minutes. Sir, am I saying your name correctly?

Mr. BEISNER. You said it correctly.

Mr. FRANKS. Okay, that is great?

**TESTIMONY OF JOHN H. BEISNER, SKADDEN, ARPS, L.L.P.**

Mr. BEISNER. Good afternoon, Chairman Franks, and thank you for inviting me to testify today about the effects of litigation on the global competitiveness of U.S. businesses.

Today's hearing asks an important question: Can we sue our way to prosperity? And I guess I respectfully disagree with Mr. Silver. I think the answer to that question is a resounding no. Our nation's love affair with litigation has substantially damaged our economy by hampering productivity and stifling innovation.

Why is our legal system so prone to abuse? The key problem is that we have made lawsuits an attractive investment with few disincentives for bringing meritless cases. As a result, the parties themselves are becoming less and less relevant in litigation. The litigation process is being taken over by sophisticated investors.

Today, I would like to address several examples of litigation abuse. In addition, I would like to discuss third party litigation funding and explain why, if not arrested, it will exacerbate those problems.

Let me begin by addressing fraud in mass torts. Unfortunately, fraud is something that can occur at every step of the mass tort process. One source of that fraud is the increasing use of medico-legal screenings organized by lawyers. My sense has always been that lawsuits happen when someone thinks he has been injured, goes to the doctor, finds out what is wrong, and seeks treatment. If in the course of that he thinks his injury may have been caused by another person, the individual might retain a lawyer to consider pursuing a lawsuit.

Medical screenings work exactly the opposite way. They serve to discover supposed injuries in people who never thought they were sick in the first place until they found out about the chance to be in a lawsuit. Simply put, they manufacture diagnoses to fuel litigation.

The welding fume litigation discussed in my prepared statement illustrates how such recruitment practices lead to the filing of fraudulent claims. The lawyers in that litigation collected about 10,000 plaintiffs through medico-legal screenings and claimed that all of them suffered from a rare neurological disease called manganism based largely on 5 minute diagnoses each.

As the litigation progressed, it became apparent these diagnoses were not worth very much. Most plaintiffs did not seek medical care for this alleged ailment, and several were forced to dismiss their claims after it was revealed they had lied in discovery or faked their symptoms. In one instance, a man who claimed to be bound to a wheelchair was caught on videotape carrying groceries and raking leaves. Eventually, the judge required the plaintiffs in that case to produce medical opinions substantiating their claims, and at that point, thousands of people dismissed their lawsuits.

In discussing medical screening practices, one must also mention the massive fraud uncovered in 2005 by the Texas Federal court

handling the silicosis-asbestos litigation. But the fraud and abuse so prevalent in early litigation practices has now spread to the current operations of so-called asbestos bankruptcy trusts that are effectively run by trial lawyers and appear to operate with no meaningful oversight or transparency. As such, these trusts facilitate fraudulent claiming practices and double-dipping, both of which threaten to siphon money away from more legitimate claimants.

Another problem is the increase in lawsuits by citizens of other countries that have virtually nothing to do with the United States. In some of these cases, the record suggests that lawyers have gone so far as to fabricate evidence in foreign countries in the hope of cashing in on the generous U.S. legal system.

A third area of concern is the so-called piggyback lawsuit phenomenon. In these lawsuits, private lawyers scour the news for government investigations, and then bring lawsuits echoing the government's allegations. If the target company has done something wrong, that wrong will likely be remedied by a hefty fine. Typically, no further legal action is necessary or appropriate.

The main beneficiaries of piggyback lawsuits are the lawyers who free ride on the government investigation and get big fees. The consumers or shareholders they claim to represent typically receive very little.

To me, the picture is clear. Our legal system is increasingly rife with abuse and losing its original sense of purpose. Clearly, we need to return our legal system to its roots, to create more accountability and to reduce the influences of non-parties. Remarkably, however, we seem to be doing just the opposite, embracing new practices that encourage litigation and further marginalize the actual parties.

The most troubling example is the growth of third party litigation financing in which an investor funds a lawsuit in exchange for a piece of the recovery. Traditionally, the doctrines of champerty and maintenance condemn these arrangements. Today, however, they are being touted as a way to increase access to justice.

I commend the Subcommittee for holding today's hearing and urge you to critically examine the fraud and abuse in our system, and begin a serious dialogue about what reforms are needed to restore a sense of responsibility and restraint in our American litigation system.

Thank you very much.

[The prepared statement of Mr. Beisner follows:]

**Testimony of John H. Beisner<sup>1</sup>**  
**On Behalf of the U.S. Chamber Institute for Legal Reform**  
**Before the Subcommittee on the Constitution**  
**of the Committee on the Judiciary**  
**United States House Of Representatives**

**Hearing – Can We Sue Our Way to Prosperity?:**  
**Litigation’s Effect on America’s Global Competitiveness**

**May 24, 2011**

Good afternoon Chairman Franks, Ranking Member Nadler and Members of the Subcommittee. Thank you for inviting me to testify today on behalf of the U.S. Chamber Institute For Legal Reform about the effects of litigation on the global competitiveness of U.S. companies.

The U.S. Chamber Institute for Legal Reform (ILR) is an affiliate of the U.S. Chamber of Commerce dedicated to making our nation’s legal system simpler, fairer and faster for everyone. Founded by the Chamber in 1998 to address the country’s litigation explosion, ILR is the only national legal reform advocate to approach reform comprehensively, by working to improve not only the law, but also the legal climate. The U.S. Chamber of Commerce is the world’s largest business federation, representing the interests of more than three million businesses and organizations of every size, sector and region.

Today’s hearing asks a critical question that goes to the heart of ILR’s mission: can we sue our way to prosperity? The answer to that question is a resounding no. America’s litigious nature has caused serious damage to our country’s productivity and innovation.

In recent years, we have made substantial strides in addressing certain forms of litigation abuse in the United States, both at the federal- and state-court levels. But while some problems have been corrected, new problems have emerged. And other, long-standing problems have continued unabated.

What is wrong with our judicial system? Why is it so prone to abuse? The root cause is that we have created incentives to sue – and to invest in litigation – instead of establishing disincentives for invoking judicial process unless absolutely necessary. Other countries discourage litigation; we nurture it.

When our nation was founded, Thomas Jefferson expressed the belief that the nation’s highest duty was to “do equal and impartial justice to all citizens.” But citizens and justice are

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<sup>1</sup> John Beisner is co-head of the Mass Torts and Insurance Litigation Group at Skadden, Arps, Slate, Meagher & Flom LLP. He represents defendants in a number of areas, including the pharmaceutical, tobacco, automobile and financial-services industries. He is also lead counsel for the defendants in the welding fume litigation discussed below.

now becoming largely irrelevant in the litigation process. In far too many lawsuits, citizens are simply pawns in an enterprising attorney/investor's business model, the goal of which is not to achieve justice for the citizen, but rather to secure profits for the attorney/investor. And from whom is that profit to be extracted? The American businesses that have built our economy.

Every year, this assault has grown more intense, with plaintiffs' counsel spinning increasingly marginal (if not downright frivolous) theories into threats of substantial liability. American businesses must divert both their personnel and financial resources from constructive efforts (including job creation) to defend against these efforts to loot their coffers. And the result has been a significant weakening of American competitiveness and a drain on our nation's economy.

The types of litigation abuse we continue to face in the U.S. are too numerous to catalog, but I would like to highlight four specific areas in which we are still seeing substantial litigation abuse: (1) fraud, lawyer screenings and improper client-recruitment efforts; (2) the importation of foreign claims into U.S. courts; (3) private lawsuits that piggyback on government investigations; and (4) aggregate litigation. In addition, I would like to address a growing practice – known as third-party litigation financing – that threatens to exacerbate all of these problems by making unlimited amounts of money available to litigants and attorneys who commit these abuses.

#### **I. FRAUD, LAWYER SCREENINGS AND IMPROPER CLIENT-RECRUITMENT EFFORTS**

Given the lucrative potential of private lawsuits in the U.S., it is not surprising that fraud has crept into the system. One notable example is the fraud that has occurred with respect to asbestos bankruptcy trusts. In addition, some lawyers have engaged in questionable tactics to recruit clients – tactics that have encouraged the filing of frivolous or fraudulent claims. The most notorious of these efforts have been the massive screening programs undertaken in the silica and welding-fume litigation, both of which resulted in the mass filing of meritless and even fraudulent claims – and forced defendants to spend huge sums of money defending themselves against groundless allegations. In addition, more and more lawyers are using the internet to troll for clients and sow dissatisfaction with products, in the hopes of generating large bodies of claims against targeted defendants. These efforts have contributed to the deluge of meritless lawsuits that clog the civil justice system.

##### **A. Asbestos Bankruptcy Trusts And Fraud**

One area in which we are seeing very troubling instances of fraud involves recovery for asbestos claims. More than 50 bankrupt companies have created personal-injury settlement trusts to pay present and future asbestos claimants for their alleged injuries through section 524(g) of the federal bankruptcy code. These trusts compensate asbestos victims from the assets of companies that held the greatest share of responsibility for historic asbestos exposures in the

United States.<sup>2</sup> Collectively, they manage an estimated \$30 to \$60 billion in total assets – much of which is opaquely administered with little to no oversight.<sup>3</sup> The trusts, which are effectively controlled by a handful of national asbestos law firms, routinely fail to disclose critical payment information, including who they pay, how much they pay and the reasons for making such payments. This lack of transparency has led to fraudulent, inconsistent and duplicative claims practices that threaten to siphon money away from those with legitimate claims.<sup>4</sup>

In one such instance, an alleged mesothelioma victim obtained hundreds of thousands of dollars from bankruptcy trusts by submitting claims with false details, such as describing himself as a shipyard worker when he merely passed through a shipyard on his way to Japan in World War II – while at the same time claiming in a civil lawsuit that his mesothelioma was caused exclusively by smoking cigarettes.<sup>5</sup> The ability of claimants (and their lawyers) to “double dip” – i.e., to recover multiple times for the same injury – undermines the integrity and reputation of the U.S. legal system.

#### **B. Screenings And Fraudulent Litigation**

Over the last decade, a new form of litigation abuse – phony medical “screenings” – has also harmed the integrity of our civil justice system. These mass medical screenings are generally organized by a consortium of plaintiffs’ lawyers at hotels and union halls, and have been used to generate massive numbers of plaintiffs in the context of silicosis, asbestos and fen-phen litigation.<sup>6</sup> Working off a list of supposed diagnostic criteria, well-compensated doctors often diagnose hundreds of individuals a day with diseases they never knew they had, often in a matter of minutes. In the silicosis litigation, for example, ninety-nine percent of the more than 9,000 plaintiffs involved in the litigation were diagnosed by the same nine doctors,<sup>7</sup> and one of those doctors performed 1,239 diagnostic evaluations in 72 hours – an average of less than 4

<sup>2</sup> See, e.g., <http://www.kaiserasbestostrust.com/> (“The Kaiser Asbestos Personal Injury Trust was created in 2006 as a result of the confirmation of The Kaiser Aluminum & Chemical Corporation Chapter 11 Joint Plan of Reorganization. The Trust was created to process, liquidate and pay valid asbestos personal injury claims in accordance with the Kaiser Aluminum & Chemical Corporation Asbestos Personal Injury Trust’s Amended Trust Distribution Procedures.”).

<sup>3</sup> See, e.g., *40 billion reasons why asbestos litigation will grow*, Southeast Texas Record (Jan. 12, 2009), <http://www.setexasrecord.com/news/216807-40-billion-reasons-why-asbestos-litigation-will-grow>.

<sup>4</sup> See, e.g., Texas Civil Justice League, *H.B. 2034 Halts Abuses in Asbestos Lawsuits* (Mar. 3, 2011), <http://www.tcjl.com/blog/abuses-in-asbestos-lawsuits>; Daniel Fisher, *No Double Dipping*, Forbes (Oct. 17, 2006), [http://www.forbes.com/2006/10/17/asbestos-double-dipping-biz-cz\\_df\\_1017asbestos.html](http://www.forbes.com/2006/10/17/asbestos-double-dipping-biz-cz_df_1017asbestos.html); The West Virginia Record, *Reform Attacks Trust-Fund Abuse* (Mar. 5, 2010), <http://www.wvrecord.com/arguments/225196-reform-attacks-asbestos-trust-fund-abuse>

<sup>5</sup> See Fisher, *No Double Dipping*, *supra*.

<sup>6</sup> *In re Silica Prods. Liab. Litig.*, 398 F. Supp. 2d 563 (S.D. Tex. 2005); Lester Brickman, *Ethical Issues in Asbestos Litigation*, 33 Hofstra L. Rev. 833, 836 (2005) (stating that in the asbestos context “nonmalignant asbestos litigation today mostly consists of . . . a massive client recruitment effort accounting for 90% of all claims currently being generated and resulting in the screening of over 750,000 and perhaps as many as 1,000,000 ‘litigants’ in the past fifteen years”).

<sup>7</sup> *In re Silica*, 398 F. Supp. 2d at 580.

minutes per evaluation.<sup>8</sup> The logic behind this practice is simple economics: when lawyers amass hundreds or thousands of claims, the potential exposure from those suits is often enough to force the defendant(s) to settle – even when the claims are entirely lacking in merit.

Medical screenings turn our legal system on its head. If someone thinks he has been injured by a product, the normal course of action would be to visit his doctor, determine what's wrong, and then – if he thinks he has a claim – retain a lawyer. Medical screenings, by contrast, “discover” injuries in people who never saw any reason to visit a doctor until they were encouraged to do so by a billboard or advertisement. The would-be plaintiffs who participate in these screenings have strong incentives to invent or imagine the symptoms that the doctors are looking for. And the physicians hired by the lawyers obviously have strong incentives to find that many people have been injured.

The welding fume litigation illustrates how such recruitment practices have led to the filing of fraudulent mass tort litigation. In that litigation, a group of plaintiffs' lawyers got together in the early 2000s to sponsor medico-legal screenings of welders around the country. These attorneys ran ads on billboards, the internet, and on late-night TV, telling welders they could be eligible for money if they had ever experienced any of a list of generic symptoms, including headaches, insomnia, erectile dysfunction and tremors.<sup>9</sup> The attorneys teamed up with a few neurologists whom they paid up to \$10,000 a day to set up shop in motels and union halls around the country to “diagnose” welders with an extraordinarily rare disease called “manganism.” By the time this “screening” process had wound its way through the country (primarily the South), the attorneys had managed to drum up around 10,000 welders to file lawsuits in courts around the country.<sup>10</sup> According to “fact sheet” responses that all federal-court plaintiffs were required to complete, approximately 90% of all the plaintiffs claiming a diagnosis of manganism were diagnosed by a single neurologist after exams that took as little as five minutes.<sup>11</sup> And the overwhelming majority of those diagnosed with manganism never sought follow-up medical attention for their supposed illnesses.

As the litigation progressed, plaintiffs selected several cases that came out of the screening process for trial in which the individuals turned out to have lied in discovery or faked their symptoms.<sup>12</sup> In one instance, surveillance revealed that a man who claimed to be completely disabled could in fact carry groceries, walk unassisted and rake leaves.<sup>13</sup>

<sup>8</sup> *The Silicosis Sheriff*, Wall St. J. (July 14, 2005), at A10.

<sup>9</sup> See, e.g., Mary Ellen Egan, *Twitch & Shout*, Forbes (Jan. 9, 2006), <http://www.forbes.com/forbes/2006/0109/046.html>.

<sup>10</sup> See generally *Ruth v. A.O. Smith Corp.*, 2006 U.S. Dist. LEXIS 7361, at \*11-12 (N.D. Ohio Feb. 27, 2006) (noting that “the spark leading to the great number of recently-filed lawsuits is the combination of the advertising and screening processes used by plaintiffs’ counsel to identify potential claimants”).

<sup>11</sup> See *In re Welding Fume Prods. Liab. Litig.*, 2006 U.S. Dist. LEXIS 16407, at \*32 (N.D. Ohio Apr. 5, 2006).

<sup>12</sup> See *id.*; see also Egan, *Twitch & Shout*, *supra* (“In December [2005] the first two welding cases in a mass tort with 5,300 claimants imploded amid charges of faked injuries.”).

<sup>13</sup> See *In re Welding Fume*, 2006 U.S. Dist. Lexis 16407, at \*18.

In August 2006, after several such cases were dismissed, the federal court overseeing the multidistrict litigation proceeding issued a case management order establishing a “trial certification” process to be used in identifying MDL trial candidates going forward.<sup>14</sup> The order required plaintiffs’ counsel to conduct a thorough review of their clients’ medical records in certain select cases. Following that review, plaintiffs’ counsel in each selected case were obligated to “(again) interview [their] clients carefully to obtain information bearing on whether pursuit of the case to trial might be unwarranted; this interview must include an explanation to the client that making false statements under oath can carry substantial personal penalties, both monetary and immuring.”<sup>15</sup> Once that review and interview process was complete, plaintiffs had to either “certify” that they intended to proceed to trial in each case, dismiss the case or move to withdraw as counsel.<sup>16</sup> The August 2006 Order made clear that this trial-certification process was intended to remedy the problem of plaintiffs dismissing cases “after all parties spent substantial amounts of time and money preparing to litigate” them.<sup>17</sup> These requirements led to the dismissal of thousands of claims, and currently, less than ten percent of the original 10,000 cases remain.

The welding fume litigation may sound like a success story for defendants, but it depends on how one defines “success.” These mass dismissals did not occur until years into the litigation. That’s a lot of money spent defending litigation that, at the outset, consisted almost entirely of frivolous claims.

### C. Web-Based Client Recruiting And Product Disparagement

Not surprisingly, the internet has proven to be a goldmine for entrepreneurial plaintiffs’ lawyers trolling for clients. Websites like [www.whocansue.com](http://www.whocansue.com) allow individuals to select from a series of potential lawsuits on a drop-down menu, enter a zip code, and obtain the name and contact information of a lawyer who may take their claim. Personal-injury lawyers seeking to advertise on [www.whocansue.com](http://www.whocansue.com) pay a membership fee to appear on the website, and then bid additional amounts to have their advertisements displayed to potential clients that have submitted responses to preliminary questions.<sup>18</sup> The results are highly successful – many attorneys report receiving nearly twice as many calls as usual as a result of the advertisement.<sup>19</sup> Whocansue.com is not the only website of its kind – other popular online lawyer referral services include SueEasy.com and LegalMatch.com.<sup>20</sup>

<sup>14</sup> See Order, *In re Welding Fume Prods. Liab. Litig.*, No. 1:03-cv-17000, MDL Dkt. No. 1888 (N.D. Ohio Aug. 28, 2006).

<sup>15</sup> *Id.* at 3.

<sup>16</sup> *Id.*

<sup>17</sup> *Id.* at 2.

<sup>18</sup> Whocansue.com, <https://members.whocansue.com/faq.aspx>.

<sup>19</sup> See Am. Tort Reform Ass’n, *Judicial Hellholes 2009-10* 5 (2010).

<sup>20</sup> Siobhan Morrissee, *Who Can You Sue? Click Here*, Time (Aug. 6, 2008), <http://www.time.com/time/nation/article/0,8599,1829725,00.html>.

Attorney advertising is not problematic in its own right, but plaintiffs' attorneys have also created misleading websites that are not obviously lawyer advertisements. These websites provide biased information about various topics ripe for litigation, including allegedly defective products, illnesses or wide-scale disasters. Because the design, content and URL addresses of these websites disguise them as a source of information rather than an advertisement, a consumer may not even realize that he or she is viewing lawyer propaganda. To make matters worse, these websites are often the top results on Internet searches of a product or controversy. For instance, some of the top Google results on the Chinese drywall<sup>21</sup> or asbestos<sup>22</sup> controversies are lawyer-sponsored websites.

Food-borne illnesses are another popular subject of these websites; [www.about-ecoli.com](http://www.about-ecoli.com) informs readers about the symptoms, risks and treatment of e-coli, and provides current information about e-coli breakouts caused by specific food products.<sup>23</sup> The website is sponsored by Marler Clark, a law firm that specializes in lawsuits related to outbreaks of food-borne illness. This same law firm sponsors similar websites discussing other food-related illnesses, such as listeria<sup>24</sup> and hemolytic uremic syndrome.<sup>25</sup> Lawyers also solicit clients in the wake of wide-scale disasters. For example, following the Gulf of Mexico oil spill, plaintiffs' lawyers relied heavily on the Internet to recruit clients. Plaintiff law firms established websites such as [www.gulfoilspllitigationgroup.com](http://www.gulfoilspllitigationgroup.com)<sup>26</sup> and [www.offshoreinjuries.com](http://www.offshoreinjuries.com)<sup>27</sup> to advertise contingency-fee services, and offer prospective clients free case reviews and interest-free cash advances. Once again, individuals searching the internet for information about these disasters were just as likely to land on a law firm's website as a legitimate news or public interest website – and it is not immediately apparent from these websites that the “articles” they contain are in fact attorney advertisements.

## **II. TRANSNATIONAL TORTS: THE IMPORTATION OF FOREIGN DISPUTES INTO U.S. COURTS**

Another troubling development in the American civil justice system has been the rise in foreign lawsuits with virtually no nexus to the United States. American courts attract foreign litigants because our legal system provides an advantageous forum for plaintiffs. The availability of contingency-fee arrangements, the general lack of a strong sanctions regime for frivolous claims, and the lack of a loser-pays rule work together to lower the bar for filing a lawsuit in the U.S. as compared to many other countries. Although these procedural features are

<sup>21</sup> [Chinesedrywallproblem.com](http://Chinesedrywallproblem.com), [www.chinesedrywallproblem.com](http://www.chinesedrywallproblem.com).

<sup>22</sup> [Mesotheliomanews.com](http://Mesotheliomanews.com), <http://www.mesotheliomanews.com/asbestos/>; <http://www.asbestosrights.com/cigarettes.htm>.

<sup>23</sup> [about-ecoli.com](http://about-ecoli.com), [www.about-ecoli.com/](http://www.about-ecoli.com/).

<sup>24</sup> [www.listeriablog.com](http://www.listeriablog.com).

<sup>25</sup> [www.about-hus.com](http://www.about-hus.com).

<sup>26</sup> [www.gulfoilspllitigationgroup.com](http://www.gulfoilspllitigationgroup.com).

<sup>27</sup> [www.offshoreinjuries.com](http://www.offshoreinjuries.com).

intended to make our court system accessible to people with legitimate claims, they also lead to abuse because there is virtually no downside to bringing a frivolous lawsuit in U.S. courts.

The following examples highlight two types of abuses involving foreign plaintiffs that have become increasingly commonplace in the U.S. judicial system: the rise in transnational tort lawsuits, and efforts to enforce foreign monetary judgments in U.S. courts.

Recent litigation involving the Dole Food Company highlights the problems posed to our legal system by transnational tort lawsuits. Claimants in these lawsuits alleged that exposure to Dibromochloropropane (“DBCP”) on banana plantations caused the sterilization of thousands of banana harvesters. U.S. and Nicaraguan plaintiffs’ attorneys joined forces to organize lawsuits against the defendant. They relied on local “captains” to identify potential plaintiffs and assist them in fabricating stories; plaintiffs’ attorneys also fabricated employment documentation and medical evidence of sterilization.<sup>28</sup> In 2004, attorney Juan Dominguez filed three separate actions on behalf of banana workers in California state court. The cases were assigned to Judge Victoria Chaney, and *Tellez*, the first of these three cases, was designated as a test case to proceed before the others. Following a jury verdict in favor of plaintiffs, Dole discovered – and notified the court of – misconduct by the plaintiffs’ attorneys in Nicaragua. Judge Chaney conducted a three-day hearing and dismissed the plaintiffs’ claims, citing widespread fraud and the existence of a conspiracy among judges, medical labs and plaintiffs’ attorneys in Nicaragua.<sup>29</sup> She further found that plaintiffs’ lawyers abused the judicial process and cited a laundry list of ethical violations, including perjury, bribery and witness intimidation.<sup>30</sup> Judge Chaney dismissed plaintiffs’ other cases with prejudice, stating from the bench that “each and every one of the plaintiffs in the *Mejia* and the *Rivera* cases have presented fraudulent documents and actively participated in a conspiracy to defraud this court, to extort money from the defendants, and to defraud the defendants.”<sup>31</sup> Plaintiffs later appealed; as of July 2010, the judgment in *Tellez* was vacated and all direct actions have been dismissed.<sup>32</sup>

The 17 years of litigation between Ecuadorian plaintiffs and Texaco (later Chevron after the company acquired Texaco in 2001) serves as another vivid illustration of the abuses related to transnational litigation. There, foreign plaintiffs filed a series of lawsuits, claiming that the defendants employed improper by-product disposal techniques in their oil exploration operations, which led to the release of carcinogenic toxins within the Oriente region of the Amazon in Ecuador. The first lawsuit was filed in the Southern District of New York,<sup>33</sup> where plaintiffs sought relief under the Alien Tort Statute. Another group of plaintiffs filed a similar action in

<sup>28</sup> U.S. Chamber Inst. For Legal Reform, *Think Globally, Sue Locally* 26 (2010).

<sup>29</sup> *Id.* at 28-29.

<sup>30</sup> *Id.* at 28.

<sup>31</sup> *Id.* at 29.

<sup>32</sup> Press Release, Dole Food Co., Dole Food Co., Inc. Announces Los Angeles Superior Court Vacates Judgment and Dismisses Fraudulent Lawsuit Brought by Nicaraguans Claiming to Have Been Banana Workers (July 15, 2010), <http://www.dole.com/CompanyInformation/PressReleases/PressReleaseDetails/tabid/1268/Default.aspx?contentid=11722>.

<sup>33</sup> See *Aguinda v. Texaco*, No. 93 Civ. 7527 (VLB) (S.D.N.Y. Apr. 11, 1994).

*Ashanga Jota v. Texaco*.<sup>34</sup> The District Court for the Southern District of New York consolidated the two lawsuits. The judge presiding over the cases dismissed the lawsuits on *forum non conveniens* grounds.<sup>35</sup> After these lawsuits were dismissed, plaintiffs filed two more lawsuits, one in federal court in San Francisco and one in Ecuador. With respect to the lawsuit filed in San Francisco, the court granted the defendant's motion for summary judgment and reprimanded the plaintiffs' attorneys for serious misconduct.<sup>36</sup> According to the court, the "case was manufactured by plaintiffs' counsel for reasons other than to seek a recovery on the[] plaintiffs' behalf."<sup>37</sup> The court explained that "[t]his litigation is likely a smaller piece of some larger scheme against defendants."<sup>38</sup> The pervasive misconduct carried out by the plaintiffs' attorneys in the litigation has led Chevron to bring its own lawsuit against the plaintiffs, charging them with seeking to "extort a multi-billion dollar payment from Chevron through fabricated evidence and a campaign to incite public outrage."<sup>39</sup>

In addition to transnational tort cases, the American civil justice system has also seen an uptick in efforts to enforce foreign judgments in U.S. courts. These enforcement proceedings are particularly egregious because they combine the worst aspects of certain permissive foreign laws with U.S. court procedures. Plaintiffs in some foreign jurisdictions are able to obtain judgments under substantive foreign laws that would not pass Constitutional muster here, and then take advantage of the United States' permissive rules encouraging lawsuit filing (e.g., no fee shifting and the availability of contingency fees) to file civil actions to enforce those judgments. U.S. courts should be reluctant to enforce these kinds of foreign judgments because they fly in the face of the public policy undergirding the American civil justice system: to provide compensation for injuries in a manner that comports with fundamental fairness and due process.

In the litigation involving Dole, a number of plaintiffs have attempted to enforce judgments issued in Nicaragua under Special Law 364 in U.S. courts.<sup>40</sup> Lobbying efforts by plaintiffs' lawyers were instrumental in the passage of Special Law 364, which specifically addresses the claims of individuals exposed to DBCP and includes numerous provisions that openly aid plaintiffs. But in 2007, a federal judge in Florida refused to enforce a \$97 million judgment issued by a Nicaraguan Judge implicated in the conspiracy described by Judge Victoria Chaney in a related proceeding in California state court. The court reasoned that enforcing the judgment would violate both international due process and Florida public policy.<sup>41</sup> It stated that

<sup>34</sup> No. 94 Civ. 9266 (JSR) (S.D.N.Y. 1994).

<sup>35</sup> See *Aguinda v. Texaco, Inc.*, 945 F. Supp. 625 (S.D.N.Y. 1996).

<sup>36</sup> See *Gonzales v. Texaco, Inc.*, No. C 06-02820 WHA, Order Granting Motions for Summary Judgment and Terminating Sanctions (N.D. Cal. Aug. 3, 2007).

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

<sup>39</sup> Ashby Jones, *Chevron Turns Tables on Ecuador Plaintiffs; Sues Them*, The Wall Street Journal Law Blog, Feb. 2, 2011, <http://blogs.wsj.com/law/2011/02/02/chevron-turns-tables-on-ecuador-plaintiffs-sues-them/>.

<sup>40</sup> See, e.g., *Sanchez Osorio v. Dole Food Co.*, 665 F. Supp. 2d 1307 (S.D. Fla. 2009); *Franco v. The Dow Chem. Co.*, 2003 WL 24288299 (C.D. Cal. 2003).

<sup>41</sup> *Sanchez Osorio*, 665 F. Supp. 2d at 1352.

“the legal regime set up by Special Law 364 . . . does not comport with the basic fairness that the international concept of due process requires. It does not even come close. ‘Civilized nations’ do not typically require defendants to pay out millions of dollars without proof that they are responsible for the alleged injuries . . . [and] do not subject foreign defendants to the type of discriminatory laws and procedures mandated by Special Law 364.”<sup>42</sup>

The dubious practice of enforcing invalid foreign judgments in U.S. courts is also well illustrated by the Chevron case. Plaintiffs filed suit against Chevron in Lago Agrio, Ecuador, alleging violations of Article 43 of the Environmental Management Act. The attorney representing the plaintiffs in this lawsuit had previously lobbied for the creation of the new law, which allows plaintiffs to sue in Ecuador for “environmental remediation of public land.” Plaintiffs filed this lawsuit despite the fact that the Ecuador Constitution prohibits retroactive application of new laws, and the Environmental Management Act was enacted years after the conduct allegedly giving rise to plaintiffs’ claims took place.

This past February, a judge in Ecuador ordered Chevron to pay \$8.6 billion to clean up oil pollution and to pay twice that amount if the company did not publicly apologize in 15 days.<sup>43</sup> Chevron has not issued any such apology. Instead, it moved to enjoin the multi-billion-dollar judgment in the Southern District of New York. On March 7, 2011, U.S. District Judge Lewis Kaplan granted a preliminary injunction enjoining enforcement of the Ecuadorian judgment.<sup>44</sup> In so doing, Judge Kaplan recognized that the Chevron litigation was an “extraordinary case.”<sup>45</sup> Judge Kaplan also recognized that the enforcement strategy chosen by the plaintiffs’ attorney was devised with an eye towards coercing Chevron to settle the case so as to avoid any injury to its business reputation.<sup>46</sup> The court granted the preliminary injunction to protect Chevron from the “coercive effect of multiple proceedings . . . [and] distractions and other burdens of defending itself in multiple fora . . . .”<sup>47</sup> Judge Kaplan has also ordered the release of film outtakes from a documentary film about the controversy, which capture plaintiffs’ attorneys and representatives organizing a conspiracy to pressure and intimidate judges in Ecuador, even going so far as to discuss the possibility of killing a judge if he ruled in favor of the defendant.<sup>48</sup>

<sup>42</sup> *Id.* at 1345.

<sup>43</sup> See Chad Bray, *Chevron Lawyers Press for Injunction*, Feb. 18, 2011, *The Wall Street Journal*, <http://blogs.wsj.com/law/2011/02/18/chevron-lawyers-press-for-us-injunction/>.

<sup>44</sup> See *Chevron Corp. v. Donziger*, 2011 U.S. Dist. LEXIS 22729 (S.D.N.Y. Mar. 7, 2011).

<sup>45</sup> *Id.* at \*4.

<sup>46</sup> *Id.* at \*92.

<sup>47</sup> *Id.* at \*93.

<sup>48</sup> Mark Hamblott, *Circuit Finds ‘Crude’ Filmmaker Lacked Independence*, N.Y.L.J. (May 13, 2011) [http://www.law.com/jsp/nylj/PubArticleNY.jsp?id=1202477931482&Circuit\\_Finds\\_Crude\\_Filmmaker\\_Lacked\\_Independence](http://www.law.com/jsp/nylj/PubArticleNY.jsp?id=1202477931482&Circuit_Finds_Crude_Filmmaker_Lacked_Independence); *The Amazon Post: Chevron’s Views and Opinions on the Ecuador Lawsuit, Caught on Tape*, Jan. 31, 2011, <http://theamazonpost.com/category/caught-on-tape>.

On May 12, 2011, a three-judge panel on the Second Circuit granted a partial stay to Judge Kaplan's preliminary injunction order.<sup>49</sup> The court left intact the portion of the order blocking the enforcement actions, but granted a stay as to the injunction preventing litigants from raising funds and discussing legal strategy.<sup>50</sup> The merits appeal on this matter is scheduled to be heard in late July or early August 2011.<sup>51</sup>

### III. PRIVATE LAWSUITS THAT PIGGYBACK ON GOVERNMENT INVESTIGATIONS

Another troubling trend that is undermining the administration of justice is the filing of private civil lawsuits that follow on the heels of government enforcement proceedings, either while the government proceedings are still pending or after they have concluded. These "piggyback" lawsuits have no salutary effect on corporate conduct because the companies at issue have already been subject to an enforcement proceeding – and in many cases, have paid fines, penalties or disgorgement to the government, some of which has been disbursed to consumers or shareholders. Thus, these piggyback lawsuits often serve primarily to provide a way for plaintiffs' lawyers to feed off of government investigation efforts.

For many years, the most common form of "piggyback" litigation involved lawsuits in the wake of Federal Trade Commission ("FTC") investigations. As these cases proliferated, the FTC voiced concerns that they served mostly to enrich plaintiffs' lawyers – at the expense of injured consumers. Prior to the enactment of CAFA, the FTC even began filing amicus briefs opposing piggyback class actions. In explaining this practice, Commissioner Thomas Leary accused private attorneys of basically free-riding on the government's investigative efforts.<sup>52</sup> As he put it: "[t]he counsel . . . negotiate a settlement in which the class members receive nominal recoveries, the defendants are protected from future private lawsuits, and the plaintiffs' lawyers recover generous fees for very little work."<sup>53</sup> In other words, these cases effectively amounted to a transfer of wealth from a company to a class-action lawyer, with no real work accomplished by the plaintiffs' lawyer and no real benefit to the consumers on whose behalf the suit was supposedly brought.<sup>54</sup>

<sup>49</sup> *Chevron v. Gerardo*, Nos. 11-1150-cv(L); 11-1264-cv(Con) (S.D.N.Y. May 12, 2011) (order granting partial stay of preliminary injunction).

<sup>50</sup> Mark Hamblett, *Circuit Stays Portion of Chevron Ruling*, N.Y.L.J. (May 13, 2011) [http://www.law.com/jsp/nylj/PubArticleNY.jsp?id=1202493831985&Circuit\\_Stays\\_Portion\\_of\\_Chevron\\_Ruling&lreturn=1&hblogin=1](http://www.law.com/jsp/nylj/PubArticleNY.jsp?id=1202493831985&Circuit_Stays_Portion_of_Chevron_Ruling&lreturn=1&hblogin=1).

<sup>51</sup> *Id.*

<sup>52</sup> Thomas B. Leary, *The FTC and Class Actions, Remarks at the Class Action Litigation Summit* (June 26, 2003), <http://www.ftc.gov/speeches/leary/classactionsummitt.htm>.

<sup>53</sup> *Id.*

<sup>54</sup> While some have sought to blame defense counsel (and to some extent, their clients) for agreeing to such settlements, that criticism cannot be justified. Defense counsel are under ethical obligations to zealously represent their clients (and, in turn, their shareholders). The responsibility for protecting the class interests lies exclusively with the purported class counsel, under the supervision of the court handling the matter.

More recently, the piggyback-litigation phenomenon has been most noticeable with respect to Foreign Corrupt Practices Act (“FCPA”)<sup>55</sup> enforcement proceedings brought by the Department of Justice (the “DOJ”) and the Securities and Exchange Commission (the “SEC”). These piggyback cases tend to fall into two categories: (1) shareholder class actions alleging that a company did not adequately disclose its FCPA exposure; and (2) derivative actions against officers and directors alleging that they failed to prevent a company from bribing foreign officials.<sup>56</sup>

Follow-on FCPA cases target companies at a difficult time. Companies going through DOJ or SEC FCPA enforcement proceedings often spend tens of millions of dollars, if not more, on attorneys and forensic accountants – on top of potentially multimillion-dollar criminal and civil fines and disgorgement – in order to determine whether their employees (often at a relatively low level) acted improperly. Enforcement proceedings also interrupt normal business operations, as companies make employees and documents available to lawyers, and take action against truly culpable employees. The investigations themselves are disclosable events and are almost always “bad news,”<sup>57</sup> resulting in negative publicity. Shareholder suits against companies involved in enforcement proceedings threaten to further delay the companies’ ability to return to normal operations and to further damage shareholder value. These suits serve no purpose but to take money from current shareholders and transfer it to former (or other) shareholders – with a hefty slice cut out for the plaintiffs’ lawyers.

Derivative shareholder suits are equally problematic in this arena. These suits tend to target senior officers and directors, not the employees who actually paid any bribes or condoned others paying them. The reason is simple enough: directors and officers are backed by the deep pockets of the company’s D&O insurer; culpable employees have little money to pay in private civil damages, especially if they themselves have been the target of an individual enforcement proceeding.

Often, lawyers filing shareholder class actions against companies under investigation or derivative actions against directors and officers of a company under investigation do not even wait until the government investigation is complete.<sup>58</sup> Such tactics are particularly egregious, because they necessarily involve the company and senior management in defending against a

<sup>55</sup> 15 U.S.C. §§ 78dd-1 *et seq.*

<sup>56</sup> See Brian Grow, *Bribery Investigations Spark Shareholder Suits*, Reuters (Nov. 1 2010), <http://www.reuters.com/assets/print?aid=USTRE6A04CO20101101>; Priya Cherian Huskins, *FCPA Prosecutions: Liability Trend To Watch*, 60 Stan. L. Rev. 1447 (Mar. 2008). As an example of the first type of suit, see *Glazer Capital Mgmt, LP v. Magistri*, 549 F.3d 736 (9th Cir. 2008); Complaint, *In re Syncor Int’l Corp. Sec. Litig.*, 2004 WL 5784765 (C.D. Cal. 2004), *dismissed by In re Syncor Int’l Corp. Sec. Litig.*, No. CV-03-00052ABC (C.D. Cal. Dec. 3, 2008). As an example of the second type of case, see *Midwestern Teamsters Pension Trust Fund v. Baker Hughes Inc.*, 2009 WL 6799492 (S.D. Tex. 2009); *Hawaii Structural Ironworkers Pension Trust Fund ex rel. Alcoa, Inc.*, 2008 WL 2705548 (W.D. Pa. 2008).

<sup>57</sup> Grow, *Bribery Investigations*.

<sup>58</sup> See, e.g., SciClone Pharmaceuticals, Inc., *Quarterly Report for the Period Ending March 31, 2011*, filed on Form 10-Q, at 10-11; Pride Int’l Inc., *Quarterly Report for the Period Ending March 31, 2011*, filed on Form 10-Q, at 12-13.

private civil suit – and in making strategic judgments regarding such defense – when their focus should be on resolving the government’s investigation. Both the DOJ and the SEC have developed leniency policies for companies that actively assist in government investigations.<sup>59</sup> These policies acknowledge that U.S. government resources are limited, and that cooperating companies can materially assist the government in enforcing the law and protecting shareholders. As part of cooperating with the government, companies in FCPA investigations frequently investigate their own potential wrongdoing and self-report misconduct to the government. When companies and their senior officers and directors face personal civil liability in addition to any exposure to the DOJ and SEC, their judgments regarding what issues to investigate and what results to report to the DOJ and SEC necessarily will be affected, possibly to the detriment of the integrity of the government’s investigation.

#### **IV. AGGREGATE-LITIGATION ABUSE**

Finally, although the enactment of the Class Action Fairness Act of 2005 (“CAFA”) has dramatically reduced class-action abuse, several serious problems remain in the aggregate-litigation arena. Today, I will discuss three: (1) state attorney general actions; (2) the routine deprivation of due process in class actions that remain in state courts; and (3) mass joinder actions.

##### **A. State Attorney General/Private Counsel Partnerships**

A key driving force behind abusive aggregate litigation is the proliferation of arrangements under which state attorneys general (“AGs”) hire outside counsel on a contingency basis to represent the state in civil litigation. This problem has been exacerbated by the fact that more and more federal laws give state attorneys general enforcement authority.<sup>60</sup> Attorney general-private counsel partnerships are promoted by AGs as a win-win situation, because such suits are prosecuted without using tax dollars. But AG contingency-fee litigation raises serious conflict-of-interest and other ethical questions – and it imposes other costs as well.

For one thing, these “[c]ontingency deals raise the question of whether state attorneys general are pursuing the public interest or merely rewarding campaign donors with lucrative business.”<sup>61</sup> In addition, these cases pose a danger that is often far out of proportion to their merit, for several reasons.

First, juries understand that the AG is a public official, acting on behalf of the state, posing a significant risk that the jury will find the state’s case credible regardless of the merits of the actual allegation. That might not be a problem if state AGs were fairly restrained about

<sup>59</sup> See United States Attorneys’ Manual § 9-28; SEC Enforcement Manual § 6.2.

<sup>60</sup> For example, state attorneys general can enforce the Truth in Lending Act’s mortgage mandates, 15 U.S.C. § 1640(e), and the Health Insurance Portability and Accountability Act’s privacy provisions, 42 U.S.C. § 1320d-5(d).

<sup>61</sup> Richard O. Faulk & John S. Gray, *Alchemy in the Courtroom? The Transmutation of Public Nuisance Litigation*, 2007 Mich. St. L. Rev. 941, 969 n.141 (2007).

bringing enforcement actions, but unfortunately that is less and less the case. In recent years, multiple state AGs have pushed the legal envelope, pursuing untested legal theories against American businesses that thought they were operating within the law. For example, a state might sue a drug company over its advertising – advertising the FDA had approved – arguing that each of tens of thousands of sales of the drug violated state law. Obviously, one novel aspect of such claims is that they would hold drug manufacturers liable despite compliance with highly detailed and very stringent federal standards. Another novel aspect of these claims is their size. Many of these suits seek to aggregate what are really thousands of individual transactions – that occurred under different circumstances – in a single action. In that respect, these cases are prone to all the same abuses as class actions, without the protections afforded by class-certification requirements. But the most troubling aspect of these suits is that the state attorneys general involved essentially delegate their law-enforcement responsibilities to private profit-motivated attorneys. As one article aptly noted, “[t]he specific financial interest that the [outside lawyer] has taken in the litigation presents an inherent conflict between the goals of the state and the personal goals of the appointed attorney.”<sup>62</sup>

Second, and relatedly, AG actions pose significant risks because they typically threaten substantial, even debilitating, costs to companies if they are successful. Most states authorize significant per-transaction penalties, and some state laws go even further, allowing AGs to seek full refunds for consumers, as well as attorneys’ fees. In fact, some of these cases have produced verdicts of several hundred million dollars.<sup>63</sup>

A recent example of a private counsel partnership involved the hiring of a Houston-based law firm to prosecute a lawsuit against Janssen Pharmaceuticals with respect to the drug Risperdal in Pennsylvania. In that case, Pennsylvania alleged that the company had improperly marketed the drug for off-label uses not approved by the FDA. Such a suit ordinarily would have been brought by the state AG’s office, but the Governor’s Office persuaded the AG to grant it authority to bring the suit.<sup>64</sup> The Governor’s Office then began contingency-fee negotiations with the Houston-based firm. During the same period, the firm’s founding partner, F. Kenneth Bailey, made a number of substantial contributions to the then-governor’s re-election campaign.<sup>65</sup> Janssen moved to invalidate the contingency-fee arrangement on several grounds, one of which was that the arrangement violated the company’s due-process rights under both the state and federal constitutions. The Pennsylvania Supreme Court rejected Janssen’s challenges,

<sup>62</sup> David Edward Dahlquist, *Inherent Conflict: A Case Against the Use of Contingency Fees by Special Assistants in Quasi-Governmental Prosecutorial Roles*, 50 DePaul L. Rev. 743, 781 (2000).

<sup>63</sup> See, e.g., Hillary Russ, *La. Jury Hits J&J With \$258M Verdict In Risperdal Suit*, Law 360 (Oct. 15, 2010), <http://www.law360.com/topnews/articles/201824/la-jury-hits-j-j-with-258m-verdict-in-risperdal-suit> (noting that jury returned a verdict of \$257.7 million in suit brought by Louisiana Attorney General over alleged misrepresentations concerning the drug Risperdal); Becca Aaronson, *Medicaid Fraud Up? Or Is State Getting More Vigilant?*, Texas Tribune (Feb. 15, 2011), <http://www.texastribune.org/texas-state-agencies/health-and-human-services-commission/medicaid-fraud-up-or-state-getting-more-vigilant/> (referencing Texas lawsuit against Actavis, which resulted in verdict of \$170 million).

<sup>64</sup> See *The State Lawsuit Racket, A Case Study in the Politician-Trial Lawyer Partnership*, Wall Street Journal Online (Apr. 18, 2009), <http://online.wsj.com/article/SB123914567420098841.html>.

<sup>65</sup> *Id.*

finding that the company lacked standing to contest the state's hiring of the outside law firm.<sup>66</sup> Chief Justice Ronald D. Castille, writing for the majority, declared that "[p]ursuant to the plain language of Section 103 [of the Attorneys Act], Janssen, as a party to the action other than the Commonwealth party, cannot be heard to challenge [the outside law firm's] authority to represent the Commonwealth party."<sup>67</sup> Justice Saylor dissented, explaining that "Janssen forward[ed] a colorable argument that, to avoid actual impropriety or the appearance of partiality, due process requires the government's attorneys to be financially disinterested in the outcome of the litigation inasmuch as they are – ostensibly, at least – serving the public interest, and not their own personal financial interests."<sup>68</sup> Justice Saylor's dissent echoes widespread criticism of the contingency-fee agreement at issue in the *Janssen* case from many corners, including the Wall Street Journal.<sup>69</sup>

A lawsuit filed by the South Carolina Attorney General against AstraZeneca in 2009 similarly illustrates some of the problems posed by contingency-fee arrangements with outside counsel. In that case, South Carolina filed suit against AstraZeneca for its alleged off-label marketing of the drug Seroquel.<sup>70</sup> Under the terms of the contingency-fee agreement, the outside law firms would be entitled to 23 percent of any penalties awarded to the state under the South Carolina Unfair Trade Practices Act, while the attorney general's office would retain ten percent of the contingency fee under the agreement.<sup>71</sup> Because the AG and the state's outside counsel are apparently claiming that AstraZeneca must be penalized \$5,000 for every Seroquel prescription ever written in South Carolina, the penalties could well "translate into 'at least millions' for the plaintiffs' firms."<sup>72</sup>

AstraZeneca has challenged this agreement in state court on two grounds. First, the company is claiming that the contingency-fee arrangement violates its due-process rights by allowing the attorney general to delegate his law-enforcement function to private plaintiffs' attorneys.<sup>73</sup> Second, the company also alleges that the attorney general has agreed to divide a "staggering" contingency fee among the outside counsel and the state. The lawsuit is currently pending.

<sup>66</sup> See *Commonwealth v. Janssen Pharm., Inc.*, 8 A.3d 267 (Pa. 2010).

<sup>67</sup> *Id.* at 276.

<sup>68</sup> *Id.* at 279 (Saylor, J., dissenting).

<sup>69</sup> See, e.g., Editorial, *The Pay-to-Sue Business: Write a Check, Get a No-Bid Contract To Litigate for the State*, Wall St. J. (Apr. 16, 2009), at A14, <http://online.wsj.com/article/SB123984994639523745.html>.

<sup>70</sup> David Bario, *AstraZeneca Sues South Carolina to Block Use of Private Lawyers in State's Seroquel Case*, The National Law Journal, Mar. 17, 2011, [http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1202486359257&Sure\\_You\\_Can\\_Bring\\_Counsel\\_Of\\_Your\\_Choice\\_IF\\_We\\_Want\\_Them\\_Too](http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1202486359257&Sure_You_Can_Bring_Counsel_Of_Your_Choice_IF_We_Want_Them_Too).

<sup>71</sup> *Id.*

<sup>72</sup> *Id.* (citation omitted).

<sup>73</sup> *Id.* AstraZeneca specifically characterizes the state's lawsuit as a "'law enforcement action akin to a criminal proceeding' under the guise of a civil suit." *Id.* (citation omitted).

Yet another example of private attorney-AG partnerships involves Oklahoma's "Big Chicken" lawsuit, filed in 2005, in which then-Attorney General Drew Edmondson hired the Tulsa-based firm Riggs, Abney, Neal, Turpen, Orginson & Lewis, to prosecute claims against chicken farms run by 14 major producers over alleged pollution of Oklahoma's waterways.<sup>74</sup> Recognizing the concerns raised by the arrangement, recently elected Governor Mary Fallin has announced plans to review it.<sup>75</sup>

Governor Fallin is not alone in her concerns. Several attorneys general have expressed the firm belief that this enforcement approach is ill-advised.<sup>76</sup> For example, the Attorney General of Colorado, John Suthers, has stated that his "office policy is not to hire outside lawyers on a contingency-fee basis when the state's police power is being asserted (such as when the state brings an action based on a claim of public nuisance or when bringing a consumer-protection action)."<sup>77</sup> In addition, several amendments have been introduced in the Senate that would bar state attorneys general from retaining private counsel to enforce federal laws on behalf of state AGs – or at the very least require disclosure of these arrangements.

More needs to be done, however, or AG-private counsel partnerships will continue to threaten the integrity of state enforcement actions.

#### **B. State-Court Due-Process Violations**

Although CAFA moved most class actions filed after 2005 to federal court, there are two groups of class actions that remain in state court. The first are pre-CAFA class actions (many filed on the eve of the legislation's enactment), which remain in state court because they are subject to pre-CAFA jurisdictional rules.<sup>78</sup> These cases represent the last hurrah of state-court class-action abuse, but continue to create problems six years after CAFA's enactment. The second are cases that fit within CAFA's "home state" and "local controversy" exceptions, which allow certain class actions to remain in state court as long as they satisfy specific criteria set forth in the Act.<sup>79</sup>

Unfortunately, many state courts continue to apply class-action standards in a manner that makes it impossible for defendants to get a fair day in court. Some state courts do this by

<sup>74</sup> See *Links to Okla. AG Land Lawyers Contingency Prize: Big Chicken*, Legal Newsline (Feb. 12, 2008), <http://www.legalnewsline.com/news/207875-links-to-okla.-ag-land-lawyers-contingency-prize-big-chicken>.

<sup>75</sup> See *New Oklahoma Gov. AG To Review Arkansas Poultry Lawsuit*, <http://www.hpj.com/archives/2010/nov/10/nov15/1108NewOKappoultrylawsuitrc.cfm>.

<sup>76</sup> See Adam Liptak, *A Deal for the Public: If You Win, You Lose*, The New York Times (July 9, 2007) (noting that "[n]ot all state attorneys general have embraced contingent fees").

<sup>77</sup> John Suthers, *Avoiding Contingency-Fee Land Mines: New Attorneys General Should Use Outside Counsel Only as a Last Resort*, The Washington Times, Dec. 2, 2010, <http://www.washingtontimes.com/news/2010/dcc/2/avoiding-contingency-fee-land-mines/>.

<sup>78</sup> Before CAFA, it was virtually impossible for defendants to remove most class actions to federal court (unless the named plaintiffs sought more than \$75,000 in relief for themselves).

<sup>79</sup> 28 U.S.C. § 1332(d)(4)(A)-(B).

saying that the “predominance” requirement for class certification only requires that there be “some” common issues among the class.<sup>80</sup> This watering down of class-certification requirements essentially means that these courts certify classes even if the different class members’ claims involve different facts. Such a result is grossly unfair to defendants because it means that a large group of plaintiffs can join together in one lawsuit even if some of their claims are much stronger than others – and that a defendant might end up liable to thousands of people who could never have proven their claims in individual trials.

Other courts have adopted various “presumptions” to support their conclusion that cases can be decided based on common evidence. For example, these courts might presume that everyone in the class heard an alleged misstatement or would have been affected by a statement in the same way, even if the facts show that the court’s presumption is false.<sup>81</sup> Such “presumptions” give plaintiffs enormous leverage in state-court class actions by essentially relieving them of their burdens of proof. As a result, they often lead to the types of “blackmail lawsuits” that first spurred Congress to enact CAFA.

To make matters worse, once a class is certified, many state courts are making it virtually impossible for the defendants to defend themselves at trial. That’s because these courts are effectively saying to defendants: “Sorry, this is a class action and you are therefore barred from introducing any individualized evidence at trial.” So a defendant might be barred from showing that some consumers were not deceived by a supposed misrepresentation, or that some people’s property value actually increased during the class period or that the named plaintiffs did not rely on a certain statement because those are “individualized” defenses rather than theoretical classwide defenses.

This problem has grown so vexing that Justice Scalia has raised the question whether some state-court class-action procedures are unconstitutional because they violate due-process principles. In *Philip Morris USA Inc. v. Scott*, the case that recently garnered Justice Scalia’s attention, a Louisiana state appellate court upheld a \$241 million class-action verdict in a case involving more than 500,000 Louisiana smokers who claimed to be deceived by the defendants’ allegedly fraudulent marketing practices.<sup>82</sup> The state court of appeals found that the verdict was proper even though the trial court: (1) refused to allow defendants to exercise their due-process right to cross-examine the class representatives regarding the issue of causation; and (2) did not require plaintiffs to prove reliance – a well-recognized requirement of Louisiana state-law fraud claims – on behalf of all proposed class members. In essence, the Louisiana court used the class-

<sup>80</sup> See, e.g., *Plubell v. Merck & Co.*, 289 S.W.3d 707 (Mo. Ct. App. 2009) (class certification of consumer-fraud claims is appropriate under Missouri’s class certification standard as long as there is “[a] single common issue” that applies to all proposed class members’ claims); see also *Ark. Media, LLC v. Bobitt*, 2010 Ark. 76, 12 (Ark. 2010) (“[c]hallenges based on the statutes of limitations, fraudulent concealment, releases, causation, or reliance have usually been rejected and will not bar predominance satisfaction because those issues go to the right of a class member to recover, in contrast to underlying common issues of the defendant’s liability”).

<sup>81</sup> See *Curtis v. Altria Grp., Inc.*, 792 N.W.2d 836, 859 (Minn. Ct. App. 2010) (finding that causation can be “inferred” on a classwide basis in a consumer-fraud action where the defendant engaged in “extensive marketing” because there is a “commonsense inference that [defendant’s] massive advertising campaign was successful”).

<sup>82</sup> *Philip Morris USA Inc. v. Scott*, 131 S. Ct. 1 (U.S. 2010) (Scalia, J., in chambers).

action device – a product of a rule of procedure – to fundamentally transform the substantive law governing fraud claims. Recognizing the grave implications of *Scott*, Justice Scalia took the extraordinary step of staying the verdict until the Supreme Court rules on the defendant’s petition for certiorari, noting that the order raised a “[n]ational concern” about abusive procedures in class actions in state court. Justice Scalia explained that the “apparent consequence of the Court of Appeal’s holding is that individual plaintiffs who could not recover had they sued separately can recover only because their claims were aggregated with others’ through the procedural device of the class action.”<sup>83</sup> The Supreme Court is expected to indicate shortly whether it will hear this case.

Unfortunately, the *Scott* case is not unique. Last year, the West Virginia Supreme Court issued a similar ruling in *Perrine v. E.I. Du Pont de Numours & Co.*<sup>84</sup> In *Perrine*, the plaintiffs brought a purported environmental class-action lawsuit against DuPont and other businesses seeking damages and medical-monitoring costs associated with alleged exposure to hazardous substances from one of the largest zinc smelter facilities in the United States. In certifying the action, the trial court held that whether “the defendants’ operation and management of the smelter site caused the contamination of the proposed class area” was a predominating common issue, and plaintiffs’ claims could therefore be resolved on a classwide basis. On appeal, defendants argued that the trial court improperly ignored defendants’ constitutional right to present individualized evidence and defenses at trial. The West Virginia Supreme Court disagreed and held: “to the extent that th[e] class action was properly certified by the trial court, all of [defendant’s] individualized defenses have no merit.”<sup>85</sup> In other words, as long as a class is certified in West Virginia, the defendant *is not allowed* to defend itself based on actual facts related to the actual plaintiffs or other class members. Instead, it can only defend itself based on theoretical or aggregate evidence, even if that evidence is divorced from reality. In his dissent, West Virginia Justice Menis Ketchum warned about the consequences of embracing such dubious class-action practice: “[T]he plaintiffs’ lawyers from the DuPont case will wreak enormous economic harm on West Virginia’s economy. They will collect millions in fees and return to their out-of-state residences leaving the West Virginia economy in shambles.”<sup>86</sup>

### C. Mass Joinder Litigation

Yet another area of ongoing abuse in the aggregate-litigation arena involves mass joinder actions, in which dozens of people who allege separate injuries join together in one lawsuit. These suits are similar to class actions, except that each individual is named in the complaint. To quote the Senate Report that accompanied CAFA:

[M]ass actions are simply class actions in disguise. They involve a lot of people who want their claims adjudicated together and they often result in the same abuses as class actions. In fact, sometimes the abuses are even worse because the

<sup>83</sup> *Id.* at 3.

<sup>84</sup> 649 S.E.2d 815, 854 (W. Va. 2010).

<sup>85</sup> *Id.*

<sup>86</sup> *Id.* at 915.

lawyers seek to join claims that have little to do with each other and confuse a jury into awarding millions of dollars to individuals who have suffered no real injury.<sup>87</sup>

Because the vast majority of these lawsuits involve cases with disparate facts and injuries – where the only thing in common is a shared defendant or product – mass actions pose serious due-process issues for defendants.<sup>88</sup> As one commentator succinctly put it, “[m]ass actions involve many plaintiffs, have high settlement value, and [are subject to] abuse.”<sup>89</sup>

CAFA partially addressed the mass-action problem by creating federal jurisdiction over mass actions with 100 or more plaintiffs. The Act, however, did not address cases with fewer than 100 plaintiffs. Thus, 99 plaintiffs with dissimilar claims can often still join together in one lawsuit and insulate their claims from federal jurisdiction.<sup>90</sup> When defendants have sought to remove these cases to federal court on the ground that the plaintiffs’ claims are not properly joined – and one plaintiff should not be able to spoil diversity for other plaintiffs with whom his case has little in common – they have not met with consistent success. In one case, the U.S. Court of Appeals for the Eighth Circuit concluded that dozens of plaintiffs could avoid federal jurisdiction simply by joining their claims with those of one plaintiff who did not satisfy diversity.<sup>91</sup>

The “mass action” jurisdictional loophole is often exploited to the great prejudice of defendants. In contrast to federal courts, which have almost uniformly rejected multi-plaintiff trials, state courts are more likely to embrace “mass action” cases as “efficient.” The problem with such cases, however, is that “efficiency” comes at the expense of justice. No jury can possibly keep track of the separate facts that apply to dozens of plaintiffs’ claims. Instead, juries often assume that the defendant must have done something wrong if so many plaintiffs are suing, and they set a per-plaintiff award based on a fictional, composite plaintiff, stitched together from the most compelling attributes of each plaintiff’s separate case. When plaintiffs succeed in keeping their improperly-joined cases in state court, they are able to use the threat of such an unjust (but likely) outcome to extract large settlements that do not reflect the actual value the cases would have if they were brought individually.

<sup>87</sup> S. Rep. No. 109-14, at 47 (2005).

<sup>88</sup> See Mark A. Behrens and Cary Silverman, *Now Open for Business: The Transformation of Mississippi’s Legal Climate*, 24 Miss. C. L. Rev. 393, 398 (2005).

<sup>89</sup> Cheryl Nichols, *The Importance of Selective Federal Preemption in the U.S. Securities Regulatory Framework: A Lesson from Canada, Our Neighbor to the North*, 10 Chap. L. Rev. 391, 440 n.245 (2006); see also Jack B. Weinstein, *Compensation for Mass Private Delicts: Evolving Roles of Administrative, Criminal, and Tort Law*, 2001 U. Ill. L. Rev. 947, 969 (2001) (“Private mass actions are subject to abuse.”).

<sup>90</sup> See, e.g., Nicole Ochi, *Complex Litigation in California and Beyond: Are Consumer Class and Mass Actions Dead? Complex Litigation Strategies after CAFA and MMLTA*, 41 Loy. L.A. L. Rev. 965, 1011 (2008); Guyon Knight, *The CAFA Mass Action Numerosity Requirement: Three Problems with Counting to 100*, 78 Fordham L. Rev. 1875, 1900 (2010).

<sup>91</sup> *In re Prempro Prods. Liab. Litig.*, 591 F.3d 613 (8th Cir. 2010).

## V. THIRD PARTY LITIGATION FUNDING

As the problems I have just discussed amply demonstrate, ours is arguably the most litigious society in the developed world. Our litigiousness results in large part from three characteristics of the U.S. civil-justice system that have generally been rejected in other countries: (1) we allow contingency fees; (2) we require both parties to pay their own attorneys' fees, even if they prevail at trial; and (3) there is a relatively low opportunity cost associated with filing frivolous litigation. Given the problems with the U.S. civil-litigation system that I have discussed, our system should be considering ways to reform these aspects of U.S. civil litigation in order to make plaintiffs and lawyers more accountable for filing frivolous claims – and to rid our courts of “jackpot justice.” Instead, however, a new form of lawsuit funding is emerging – third-party litigation financing or TPLF. This form of funding will lower the bar to filing lawsuits even further, and if it is left unchecked, it will make the problems I have discussed today much, much worse.

TPLF describes the practice of providing money to a party to fund the pursuit of a potential or pending lawsuit. Most TPLF contracts resemble non-recourse loans: the borrower obtains money to pursue a lawsuit and is only required to repay the loan if he or she obtains a damages award at trial or settles on favorable terms. Three variants<sup>92</sup> of TPLF have emerged and are growing in the United States:

*Consumer lawsuit lending* generally involves loans to individual plaintiffs to finance small claims or provide living expenses. Typically, the financing arrangement is structured as a non-recourse loan, with monthly interest accruing on the principal amount of the loan at rates that generally range from three to five percent per month. Essentially, in this type of TPLF, the plaintiff sells his or her claim to the TPLF company in exchange for an up-front cash payment. If the plaintiff's claim is successful, the plaintiff repays the TPLF provider the money advanced, plus interest, as well as any additional fees specified in the funding contract.<sup>93</sup> However, if the case is resolved on terms that do not provide enough funds to cover the plaintiff's loan, the plaintiff still owes the full amount of the loan – in essence the plaintiff can end up in a worse position than if he or she had not filed the lawsuit and obtained the loan to begin with.

*Direct funding arrangements with businesses involved in commercial litigation* constitute the second type of TPLF in the United States. In this type of funding, the third-party financier's return is usually a portion of any recovery that the plaintiff-business receives from the resolution of the litigation, whether through final judgment or settlement.<sup>94</sup> The percentage of

<sup>92</sup> A fourth variant of TPLF, which exists in some foreign jurisdictions, but not yet in the United States, involves TPLF providers contracting with potential plaintiffs to file class actions – and then funding those suits through direct payments to class counsel. Class-action financing is potentially the most lucrative type of third-party funding. At least one TPLF provider that funds class actions overseas has announced plans to develop funding opportunities in the United States. See IMF: *Australia's Major Litigation Funder, Experienced, Cautious and Profitable, Moves into US, UK Markets Ten Times as Large and With Huge Opportunities*, Australian Co. News Bites (May 14, 2010).

<sup>93</sup> Steven Garber, *Alternative Litigation Financing in the United States*, 9-10, The Rand Corporation (2010), <http://americanlegalfin.com/press/RAND%20Alternative%20Litigation%20Financing.pdf>.

<sup>94</sup> *Id.* at 13-16.

recovery the TPLF provider will charge turns on several factors, including the amount of money advanced, the length of time until recovery, the potential value of the borrower's case and whether the case settles or goes to trial. In this type of TPLF, the TPLF provider essentially invests money in the outcome of the company's lawsuit, betting that the lawsuit will be successful.

*Direct loans to law firms*, the third variant, involves the lending of money by financiers directly to plaintiffs' law firms. Often, these are non-recourse loans that the firm is obliged to repay only if its litigation is successful. However, if the litigation is successful, the firm must repay the loan at interest rates significantly higher than normal commercial lending.<sup>95</sup>

Although TPLF is not yet widespread in the U.S., it is playing an increasingly visible – and potentially harmful – role in U.S. litigation. The recent growth of TPLF in the United States results from a number of factors, including rising litigation costs and professional-responsibility rules that prohibit attorneys from paying clients' living expenses while litigation is pending.<sup>96</sup> In addition, as the value of traditional investments has dropped, investors have been attracted to new investment vehicles.<sup>97</sup> Recent high-profile plaintiffs' victories in lawsuits funded by TPLF providers, particularly in Europe and Australia, have fueled some investors' perceptions that investments in TPLF companies are safe and profitable. During better economic times, these same investors put their money in public companies. Now that those companies may be struggling financially, perhaps even as a result of litigation, investors are turning away from investing in them (and potentially creating new jobs) in favor of financing litigation, which will only damage those companies further.

Third-party litigation financing has at least four negative consequences for the administration of civil justice.

*First*, TPLF increases litigation costs at the expense of truly aggrieved plaintiffs, the defendant or both, because it inserts a new party into the litigation equation whose sole interest is its return on its investment. For instance, in recent litigation regarding 9/11 Ground Zero workers, one of the plaintiffs' firms representing the Ground Zero workers used a TPLF loan of the direct-to-law-firm variant. The firm then sought to pass along \$6.1 million in interest on the borrowed funds to the plaintiffs. The plaintiffs' lawyers argued strenuously in support of their position, but the judge presiding over the settlement ultimately rejected it. "In the context of \$150 million," the judge told plaintiffs' counsel, "I believe you can absorb \$6 million." One of the lawyers complained after the hearing that the judge ruled against plaintiffs' counsel "for no other reason than it's 9/11." Assuming he was correct, it means that plaintiffs in other cases *would* be required to pay interest on their lawyers' loans *in addition* to attorneys' fees.

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<sup>95</sup> *Id.*

<sup>96</sup> Model Rules of Prof'l Conduct, R. 1.8(e) (2009) (a "lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation").

<sup>97</sup> See Jane Croft, *Litigation finance follows credit crunch*, Fin. Times (Jan. 27, 2010); *Attorneys Explore Third-Party Funding in Commercial Disputes*, N.Y.L.J. (June 3, 2010).

Similarly, the consumer-lending variant of TPLF harms consumers who do not understand the implications of a funding arrangement. In the federal *Vioxx* litigation, for example, a number of persons who were eligible for the settlement program established by Merck obtained loans from a lawsuit lender. When they received their money from the program and proceeded to “settle up” with the lender, some were surprised to receive demands for amounts that equaled – and in some cases even exceeded – their recovery. When the lender sought to enforce liens on the borrowers’ settlement distributions, the judge noted that such loan arrangements were barred by the terms of the resolution program.<sup>98</sup> In the end, the lender recovered little more than the amounts advanced, but only because the judge was very vigilant and involved in the settlement distributions.

*Second*, TPLF increases the filing of *questionable* claims. Unlike attorneys working on contingency, who are inclined only to invest “sweat equity” in cases that are likely to succeed, TPLF companies are mere investors – and they base their funding decisions on the present value of their expected return, of which the likelihood of success at trial is only one component. In addition, and also in contrast to most attorneys, TPLF providers can mitigate their downside risk by spreading the risk of any particular case over their entire portfolio of cases, and by spreading the risk among their investors.<sup>99</sup> For these reasons, TPLF providers can be expected to have even higher risk appetites than attorneys, and to be more willing to back claims of questionable merit.

*Third*, TPLF prolongs litigation by deterring plaintiffs from settling unless the defendant’s offer is sufficiently generous to provide them a recovery after paying off *both* their attorneys and their TPLF lender. A plaintiff who must pay a finance company out of the proceeds of any recovery can be expected to reject what may otherwise be a fair settlement offer, hoping for a larger sum of money.<sup>100</sup> This problem is illustrated by the ongoing litigation between a network-security company called Deep Nines and a TPLF provider that previously had backed Deep Nines’s commercial litigation against a software company. Deep Nines retained the TPLF provider to finance patent litigation with an \$8 million loan. Deep Nines had a strong case, and eventually, the case settled for \$25 million. That seems like a hefty settlement. But after interest, attorneys’ fees and other expenses, how much did Deep Nines actually get? \$800,000 – about three percent of the total recovery. And here’s the most remarkable part: the financing company wasn’t satisfied with its share and it sued Deep Nines for even more

<sup>98</sup> See *In re Vioxx Prods. Liab. Litig.*, MDL Docket No. 1657, Minute Entry (E.D. La. Jan. 7, 2010).

<sup>99</sup> Cf. Maya Steinitz, *Whose Claim is This Anyway? Third Party Litigation Funding*, 95 Minn. L. Rev. (forthcoming 2011) (manuscript at 51).

<sup>100</sup> See *Rancman v. Interim Settlement Funding Corp.*, 789 N.E.2d 217, 220-21 (Ohio 2003) (noting that the amount the plaintiff-appellant owed to litigation financiers was an “absolute disincentive” to settle at a lesser amount).

money.<sup>101</sup> That litigation is still pending, more than four years after Deep Nines first borrowed the money to finance its suit.<sup>102</sup>

*Fourth*, TPLF undercuts a plaintiff's control over litigation because the TPLF provider, as an investor in the plaintiff's lawsuit, inherently seeks to protect its investment, and will therefore try to exert control over the plaintiff's strategic decisions. Even when the TPLF provider's efforts to control a plaintiff's case are not overt, the existence of TPLF funding, especially of the consumer-lending and commercial-litigation variants, inherently subordinates the plaintiff's own interests in the resolution of the litigation to the interests of the TPLF provider. In some sense, the plaintiff becomes a bystander in his or her own case. CNN reported recently about a North Carolina woman who sued the owner of a basketball team for sexual assault. She rejected all of the defendant's settlement offers, even though her own attorney recommended she take them, and insisted on going to trial – which she lost. Why did she do it? Because, unbeknownst to her attorney, she had borrowed money from a TPLF provider and needed at least \$600,000 if she won or settled to repay the TPLF provider, which was more than the defendant offered in settlement.<sup>103</sup> In sum, TPLF threatens to transform a system of justice that was designed to adjudicate claims by aggrieved parties into an investment market controlled by third parties.

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Our judicial system was established almost 250 years ago to secure justice for all Americans. But America's open-armed approach to litigation does not promote justice. Instead, we have swung open our courthouse doors to plaintiffs who peddle far-fetched and even fraudulent theories of recovery.

I commend the Subcommittee for holding today's hearing and urge you to begin a serious dialogue about how to address the problems I have discussed today – and what reforms are needed to restore a sense of responsibility and restraint in American litigation. To help inform the dialogue, the Subcommittee should first conduct rigorous oversight of problematic fraud and abuse in our civil-justice system, especially in the areas of asbestos bankruptcy trusts, transnational torts, and partnerships between state attorneys general and contingency-fee counsel to enforce federal statutes.

Congress has begun this effort with its consideration of the Lawsuit Abuse Reduction Act of 2011, or LARA, which would: (1) make Rule 11 sanctions mandatory where a party is found to have acted “for any improper purpose, such as to harass, cause unnecessary delay, or needlessly increase the cost of litigation”;<sup>104</sup> and (2) abolish the 21-day waiting period, which

<sup>101</sup> See Alison Frankel, *Patent Litigation Weekly: Secret Details of Litigation Financing*, *The American Lawyer* (Nov. 9, 2009).

<sup>102</sup> See *Altitude Nines, LLC, v. Deep Nines, Inc.*, No. 603268-2008E (N.Y. Sup. Ct.); see also Joe Mullin, *Patent Litigation Weekly: How to win \$25 million in a patent suit – and end up with a whole lot less*, Nov. 2 2009, [http://thepriorart.typepad.com/the\\_prior\\_art/2009/11/altitude-capital-partners-altitude-nines-v-deep-nines.html](http://thepriorart.typepad.com/the_prior_art/2009/11/altitude-capital-partners-altitude-nines-v-deep-nines.html).

<sup>103</sup> See <http://transcripts.cnn.com/TRANSCRIPTS/100218/cc.01.html>.

<sup>104</sup> Fed. R. Civ. P. 11(b)(1).

currently enables plaintiffs to avoid accountability for Rule 11 violations by withdrawing their claims within 21 days. Other reforms might include:

- Regulating medico-legal screenings to ensure that they comport with commonly-accepted medical practice;
- Allowing discretionary appeals of orders denying dispositive motions and *Daubert* evidentiary rulings;
- Increasing lawyer accountability by fining or disciplining lawyers who fail to perform due diligence before filing lawsuits, continue prosecuting a lawsuit after learning that the claim or claims being asserted are invalid, or otherwise engage in frivolous litigation;
- Requiring transparency in 524(g) asbestos bankruptcy trusts;
- Barring or strictly regulating third-party litigation funding; and/or
- Barring or strictly regulating state attorneys general from retaining outside, contingency-fee counsel to enforce any federal laws.

Thank you again for inviting me to speak, and I will be happy to answer any questions.

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Mr. FRANKS. Thank you, Mr. Beisner.

I will now recognize myself for 5 minutes for questions. And I will begin the questions with you, Mr. Hinton.

Mr. Hinton, you mentioned that there are studies that quantify the effect on business of taxes in general. How sensitive is the level

of business activity to changes in the cost of doing business like litigation?

Mr. HINTON. There are a lot of economists who have studied the question of the effect of taxes on business activity. And just as with taxes, tort costs raise the cost of doing business. So, looking at some of those studies can be instructive.

A survey of studies of the effect on employment of taxes found that the median effect across the studies that had been surveyed measured any elasticity of minus .6. But turning that into English, that means that if you raise taxes by 10 percent, say, from 30 percent to 33 percent, it could result in a 6 percent reduction in employment. So, that is the sort of order of magnitude that you might expect to see if you adjust tort costs.

Mr. FRANKS. Thank you, sir.

Mr. Silver, I guess my next question would be to you, sir. Do not other countries with common law systems, such as the United Kingdom, create enforceable legal rights at less cost than the U.S.?

Mr. SILVER. I am sorry. I could not hear.

Mr. FRANKS. Okay. Do not other countries with common law systems, such as the United Kingdom, create enforceable legal rights at less cost than the United States?

Mr. SILVER. I do not know what the answer to that question is, Mr. Chairman, because it really depends on how costs are counted. The costs of injuries are what they are, but the legal system only captures a fraction of those costs. So, in England, for example, the legal system will capture a very small amount in the damage award, but an additional amount will be transferred to the public health system, what they call, I guess, the National Health Service, which will care for the victim by providing medical services. So, in order to find out how much the total costs are, one has to look way beyond the legal system in other countries, and here as well because here the legal system also only captures a fraction of accident-related costs.

Mr. FRANKS. Mr. Beisner, let me go ahead and give you a shot at the same question. Do other countries with common law systems, like the United Kingdom or others, do you think they create an enforceable legal rights system at any difference in cost to the consumers and to the society as a whole?

Mr. BEISNER. I do not have a lot data to offer the Committee on that point, but from everything that I have seen, I think that the answer is yes. And I think it is reflected in the fact that when you talk with persons responsible for the administration of businesses, they certainly make a huge distinction in the environment that they find in European countries versus the United States in terms of the amount of resources that they need to divert to litigation. I think as a practitioner, one need only encounter a European business person for the first time who is engaged in having litigation in the United States to say, I have never experienced anything like this before in terms of the amount of resources and money I have to expend to deal with this matter.

Mr. FRANKS. Well, I want to thank all of you for attending the Committee here this morning. I appreciate your testimony. It sounds like the question—sure.

Mr. SCOTT. Thank you. I did not have an opening statement. I would to ask—

Mr. FRANKS. No, we asked about questions because—you do not have an opening statement anyway. I mean—

Mr. SCOTT. Well—

Mr. FRANKS. But you are welcome—please. Please proceed?

Mr. SCOTT. Thank you. I just wanted to ask Mr. Beisner, because he had recommended Rule 11 sanctions. Would you propose Rule 11 sanctions for defense counsel who drag out litigation with frivolous defenses, denials of liability when liability is clear, and that kind of thing?

Mr. BEISNER. Well, I think Rule 11 right now works both directions on that. I think the greater problem we have, though, is with lawsuits that should not be filed in the first place, and there is no consequence for that when they are filed.

Mr. SCOTT. Well, there is a sanction that the lawyer who brings a meritless case does not get paid. But when I was practicing, when you would file a suit, you would get a response that would have a total denial of liability, even when liability was clear. Should a Rule 11 sanction be applied to that kind of response?

Mr. BEISNER. Rule 11 applies, but I think often, you know, whether liability is clear is in the eye of the beholder. I think most plaintiffs' counsel I have talked to say when they file the case, the liability is clear, and it often does not turn out that way. And I think up front, denial before the facts are fully developed is often fully appropriate.

But again, to answer your question specifically, Rule 11 works both ways. If you do not have a sound basis—

Mr. SCOTT. Mr. Silver, have you ever heard of a defense who files a denial of liability, when liability is clear, ever sanctioned under Rule 11, because it is a boiler plate defense. They just deny everything. And have you ever heard anybody sanctioned under Rule 11?

Mr. SILVER. No, I have not, and it is very common to file an answer that includes a very large number of defenses, most of which will drop out of the lawsuit at some point as the case proceeds.

Mr. SCOTT. In terms of economic activity, is there any value to the tort system we have in the United States, which, because we have our tort system, people internationally know that products made in the United States are safe, and a feeling that they might not get from other countries that do not have as vigorous liability responsibility?

Mr. SILVER. Well, I cannot say whether products that are made in America sell better abroad than products that are made elsewhere. Perhaps Mr. Hinton has some insight into that. However, it certainly is the case that what we are talking about is cost internalization.

The discussion of tort costs is very interesting because it does not ever attempt to quantify the fraction of those costs that are wrongfully imposed costs. In other words, when we measure insurance costs, what we could be measuring are in fact costs that people wrongfully impose on other people. What that says is if you were to eliminate those costs, eliminate the tort tax, then what you would foster would be false growth. It would look like people were doing better economically, but in fact, they would be saddling a lot

of other people with very large billions or trillions of dollars worth of costs for which they were not accountable. And so, you would get a lot of false economic growth.

Mr. SCOTT. Thank you, Mr. Chairman.

Mr. FRANKS. Thank you, Mr. Scott.

And thank all of you again. Everyone made some pretty salient points. I appreciate that.

Without objection, all Members will have 5 legislative days to submit to the Chair additional written questions for the witnesses, which we will forward and ask the witnesses to respond as promptly as they can so that their answers may be made part of the record.

Without objection, all Members will also have 5 legislative days with which to submit any additional materials for inclusion in the record.

With that, again, I thank the witnesses, and I thank the Members and the observers.

And the hearing is now adjourned.

[Whereupon, at 3:29 p.m., the Subcommittee was adjourned.]

