CHAPTER 11

The Tort System

Tort is the civil law through which injured individuals seek compensation from another party alleged to have caused or contributed to their injury. The tort system in the United States is intended to compensate accident victims and to deter potential defendants from putting others at risk. Expenditures in the U.S. tort system were $233.4 billion in 2002, equal to 2.2 percent of gross domestic product (GDP), more than twice the amount spent on new automobiles in 2002. The expansive tort system has a considerable impact on the U.S. economy. Tort liability leads to lower spending on research and development, higher health care costs, and job losses. This chapter examines the growth of the tort system, the benefits the United States receives from it, and how alternative injury-compensation systems compare with the present tort system in terms of costs.

The key points of the chapter are:

- The evidence is mixed on whether the tort system serves to deter negligent behavior.
- The tort system is a costly method of providing insurance against injuries, and has a number of adverse effects on the economy.
- Possible ways of reducing the burden of the tort system include limiting noneconomic damages, reforming class action procedures, setting up trust funds for payments to victims, and allowing parties to avoid the tort system contractually.

The Changing Role of Tort Law

Until the 1960s, tort law covered injuries involving strangers, such as those caused by automobile accidents. Injuries resulting from the interaction between individuals with a prior relationship, such as physicians and patients, were covered by contract law instead of torts, which enabled individuals to define the terms the court would use to resolve any injury disputes in advance. This division between the tort system and contracts limited the courts' role to hearing cases involving injuries in which one person had harmed another with no predetermined specification of damages by the parties—either because no contract existed or because the existing contract did not cover a particular set of circumstances. In essence, the courts' job was to decide if the defendant was

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liable (at fault) and to determine compensation for the plaintiff (the victim). An important feature of the legal environment was that courts assigned liability for an injury by applying the *negligence standard*, under which the court assessed whether the injury had occurred because the defendant had failed to exercise the caution of a reasonable person under the circumstances of the accident. Changes to tort law since the 1960s have altered the standard of care courts apply in considering claims for compensation. Although some tort cases, such as those alleging medical liability, still use the negligence standard, others, such as product liability, are now generally decided using *strict liability*. Under this standard, defendants are held responsible for any product-related injuries even if they were not negligent. More injuries have become eligible for compensation as a result of this change, thus increasing the number of injuries litigated in the tort system.

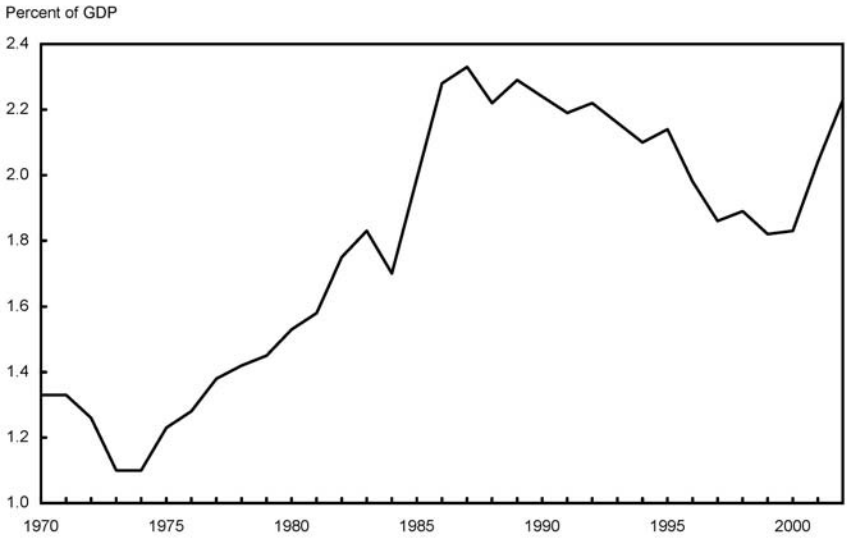
Another change since the 1960s is that the tort system now serves to provide insurance against harms relating to any goods or services consumers or businesses purchase. This function is in addition to the original purpose of punishing negligence in order to deter future injuries. The right to sue for damages means that the tort system today effectively obligates suppliers of goods and services to provide this insurance along with their products. As recently as the late 1950s, ladder manufacturers would not have been liable for falls from ladders, doctors would not have been liable for birth defects, and diving-board manufacturers would not have been liable for injuries resulting from diving; in today's tort system, they are. Courts used to presume that falls from ladders were caused by deviations from normal use and not, as is currently the case, that ladder manufacturers were potentially liable for not warning consumers about the dangers of their product.

The Expansion of Tort Costs

Expenditures associated with the tort system have risen along with its increased role in society. One estimate based on insurance industry data finds that aggregate expenditures in the tort system were $233.4 billion in 2002. This estimate includes the legal costs of defending policyholders, benefits paid to parties injured by policyholders, insurance companies' administrative costs, and estimates of medical liability and self-insurance costs. Tort costs as a percentage of GDP increased after 1974 and peaked in 1987 (Chart 11-1).

The number of injuries handled in the tort system has increased along with expenditures. The number of filings per capita started to rise in the early 1980s and peaked in the mid-1980s, at least in the 16 states for which data on lawsuit filings are available between 1975 and 2000 (Chart 11-2).

Chart 11-1 **Tort Costs as a Percent of GDP**
Tort costs as a percent of GDP have been rising since 1974 but, until recently, have fallen from their peak in 1987.

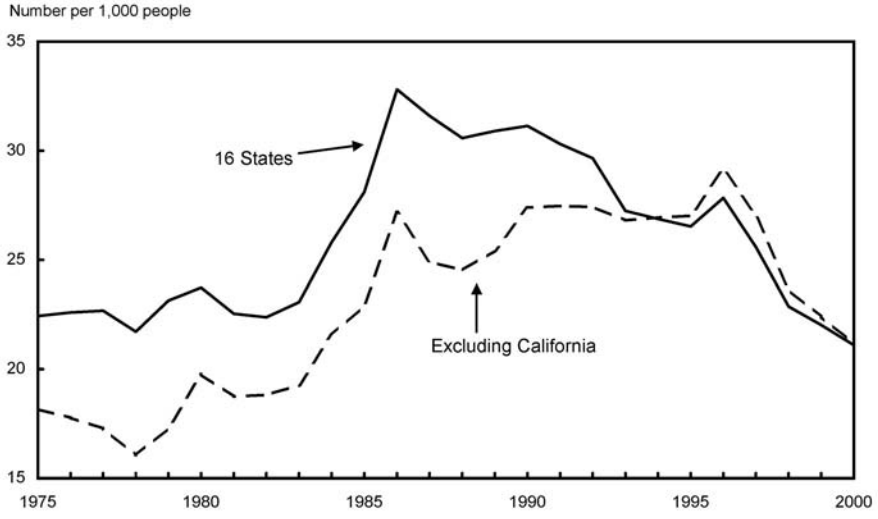


Source: Tillinghast-Towers Perrin, "U.S. Tort Costs: 2003 Update, Trends and Findings on the Costs of the U.S. Tort System," 2003.

Much of the decline in filings since 1985 appears to have occurred in California, where medical liability reforms included a $250,000 limit for noneconomic damages that was found constitutional in 1985. Although there has been a decline in cases per capita since the 1980s, some types of tort awards have increased. For example, between 1990 and 2001, the median award in medical liability cases increased from about $100,000 to more than $300,000.

Expenditures in the tort system vary by the type of dispute (Table 11-1). In auto cases plaintiffs received a median award of $18,000 (in 57.5 percent of the cases). The most expensive cases tended to be those in which plaintiffs and defendants had preexisting relationships, such as product liability and medical liability. Plaintiffs won 23.4 percent of the time in medical liability cases and received a median award of $286,000. The median award in asbestos cases tried in state courts was $309,000, with 56 percent of plaintiffs receiving compensation. Large awards are relatively rare. In the 75 largest counties in the United States in 1992, 73 percent of the 377,421 tort cases disposed in state courts concerned auto accidents, which tend to result in relatively small awards at trial.

Chart 11-2 **Tort Filings in 16 States**
Tort filings rose through the 1980s but have returned to 1975 levels.



Note: The 16 States comprise: Alaska, California, Colorado, Florida, Hawaii, Idaho, Kansas, Maine, Maryland, Michigan, North Dakota, Ohio, Tennessee, Texas, Utah, and Washington.
Source: National Center for the Study of State Courts.

TABLE 11-1.— *Characteristics of State and Federal Tort Cases Decided by Trial, 1996*

Tort cases by type	Cases won by plaintiff (percent)	Median award	Percent of awards $250,000 or more	
			Total	$1 million or more
All tort cases				
State	48.2	$31,000	16.9	5.8
Federal	45.8	139,000	38.1	14.6
Automobile cases				
State	57.5	18,000	8.7	3.4
Federal	59.7	100,000	37.4	11.6
Medical liability				
State	23.4	286,000	51.0	20.2
Federal	39.8	252,000	54.3	22.9
Asbestos				
State	55.6	309,000	50.6	12.1
Federal	40.0	465,000	50.0	0.0
Product liability other than asbestos				
State	37.1	177,000	41.2	16.3
Federal	26.6	368,500	62.0	24.0

Source: Congressional Budget Office.

The Economic Effects of the Tort System

The economic effects of the tort system go beyond their direct impact in terms of expenditures. Resources that could be directed toward productive uses are diverted instead to the tort system or dissipated as firms and individuals take actions not needed for actual safety concerns but rather to avoid exposure to tort liability. Studies suggest that the gains to society from tort compensation and deterrence do not make up for these losses. A study of the impact of tort reform on productivity finds that limitations on the size of tort claims (for example, caps on punitive damages) enacted by states from 1972 to 1990 increased productivity by 1 to 2 percent a year, an amount equal to $955 per worker per year in 2002 dollars. Limitations on tort awards moved some injury payments out of the tort system so that the $955 figure represents an estimate of the cost of the tort system over alternative systems.

The gains from limits on the tort system come about because torts cause firms and individuals such as medical professionals to change the way they do business. Firms choose not to sell certain products so that they can avoid potential liability or they take costly extra precautions in the delivery of their products and services—precautions beyond the level that would reasonably balance costs and benefits to society. For example, torts cause doctors to practice defensive medicine, such as ordering extra tests that are a waste of time and resources. Some expenditures in the tort system, such as compensation for damages, are transfers of money from defendants to plaintiffs and do not consume resources. Other expenditures involve true economic costs in that the resources involved are not available for more productive uses; attorney's fees are an example. Additional costs include the profits and consumer benefits forgone by society when a potential defendant removes a product or service from the market or does not produce it in the first place in order to avoid frivolous lawsuits.

Torts as Injury Compensation

The tort system is not the only way in which society can deter injuries and compensate victims. There is an extensive system of regulations to improve the safety of products, medicines, and many other goods and services. Consumers have access to numerous publications and Internet Web sites that offer reviews and facilitate discussions of products. The availability of this information on product safety provides producers with a powerful financial incentive to make their products safer.

The question then becomes whether another system could provide the same benefits in terms of compensation and deterrence as the tort system but at lower cost. There is not enough evidence to determine the answer to

this broad question. Nevertheless, some evidence indicates that in certain areas, such as product liability and medical liability, the tort system does not deliver enough deterrence benefits to justify the associated administrative costs (such as legal fees, overhead to process insurance claims, and the cost of running the tort system itself).

The Principal Injury-Compensation Methods

Injury-compensation systems can be broadly classified by the type of act that leads to the compensation being provided. A *fault-based* system compensates the injured party on the basis of negligent action, intentional harm, or strict liability. In contrast, a *cause-based* system is one in which the specific cause of the injury entitles an individual to compensation. The most widespread cause-based program in the United States is workers' compensation, which pays for many workplace injuries regardless of whether the employer was negligent with regard to the worker's injury. Finally, *loss-based* systems pay compensation based only on injury or illness. Loss-based systems include private systems like health insurance and public systems like Medicare.

The tort system is not the principal means by which injuries are compensated. Private health insurance, Medicaid, and Medicare are all substantially larger providers of compensation than the tort system (Table 11-2). The portion of tort expenditures that covers only economic damages such as current and future lost wages (that is, not including noneconomic damages such as for pain and suffering) is comparable in size to either the workers' compensation system or payments for life insurance.

Administrative Costs

The tort system is one of the most expensive compensation systems to run, with administrative costs equal to 54 percent of benefits. Sixty-one percent of these administrative costs (about a third of every dollar spent in the tort system) are the legal fees generated by attorneys for plaintiffs and defendants. In 2001, administrative costs of the health insurance industry were around 14 percent of benefits paid. The overhead for the Social Security disability system was around 3 percent of benefits in 2003; a study from the mid-1980s found that workers' compensation had overhead costs of around 20 percent of benefits. Some of the high cost of the tort system may arise because it deals with accidents that are more difficult to evaluate than those of other injury-compensation mechanisms.

TABLE 11-2.— *Compensation for Injury, Illness, and Fatality in the United States, Selected Methods*

Type of injury or illness compensation system	Compensation (billions of 2002 dollars)
Fault-based	
Tort economic payment[1]	51.3
Tort noneconomic payment[1]	55.9
Cause-based	
Workers' compensation[2]	48.0
Veterans' benefits[2]	26.0
Loss-based	
Health insurance (private first-party)[2]	408.2
Life insurance (private first-party)[2]	46.1
Social/public insurance	
Health:	
Medicaid[3] and Medicare[2]	362.1
Medicaid prescription drug[4]	13.1
Disability:	
Social Security Disability[1] and Supplemental Security Income[2]	94.1

[1]Data are for 2002.
[2]Data are for 2000.
[3]Data are for 1999.
[4]Data are for 1998

Sources: Department of Commerce (Bureau of Economic Analysis); Social Security Administration; Centers for Medicare and Medicaid Services; American Council of Life Insurers, "Life Insurers Fact Book," annual; and Tillinghast-Towers Perrin, "U.S. Tort Costs: 2000, Trends and Findings on the Costs of the U.S. Tort System," February 2002.

Compensation of Noneconomic Losses

Another way in which the tort system differs from other compensation methods is that it forces consumers to accept not only coverage for economic losses such as current and future lost wages and medical costs, but also nonpecuniary losses such as pain and suffering. Of the 46 cents of each dollar spent in the tort system that goes to plaintiffs, on average, 22 cents compensates them for economic losses and 24 cents compensates them for noneconomic damages.

Damages paid through the tort system are costs to firms—and higher costs ultimately translate into higher prices for goods and services. Tort awards can thus be seen as a form of insurance: consumers pay "premiums" in the form of higher prices for goods and services and receive compensation if injured. Torts cover only a limited set of possible injuries, however, so a consumer seeking comprehensive insurance against all possible economic and noneconomic losses would still have to purchase additional insurance. In reality, few people buy insurance against noneconomic losses such as pain and suffering; people do buy insurance against economic losses such as lost wages, medical expenses, or costs to rebuild a damaged house. This suggests that insurance policies against noneconomic losses are not worth their cost to potential buyers.

Extent of Coverage

Despite the expansion of the tort system, torts still provide compensation for a relatively limited number of injuries compared to other systems such as health insurance. For example, injuries that are the sole fault of the victim do not give rise to a legal claim for compensation and hence do not fall under the purview of the tort system. Many injuries are too small in economic terms to justify litigation. The long delays inherent before the tort system delivers monetary compensation likely also dissuade many potential lawsuits from being filed. In tort cases resolved in the 75 largest counties in the United States in 1992, the median time from filing to disposition was just over two years, with nearly one out of six cases taking more than four years. For medical liability, the median time to resolution was nearly three years with almost three out of ten cases taking longer than four years.

There is evidence that the eventual compensation does not match the injury well. In medical liability cases, the tort system appears to overcompensate minor injuries relative to the compensation that would have been provided by private insurance, while more serious injuries are undercompensated. This discrepancy may exist because factors other than the medical specifics of the injury could affect the compensation received by the plaintiff. For example, the location of the trial and the composition of the jury pool appear to affect the verdicts of some tort lawsuits and the size of the compensation. In addition, compensation may be tied more to the ability of the defendant to pay than to the actual injury suffered by the plaintiff. This is particularly a concern for punitive damages (Box 11-1).

Moreover, the tort system does a poor job of identifying which injuries are entitled to compensation and which are not. Many injuries that would meet the legal definition of negligence are never pursued, and the majority of those that are pursued appear not to merit compensation. A 1984 study of the outcomes of hospitalizations in New York City found that 3 to 4 percent of hospitalizations gave rise to adverse events such as drug reactions, with just over one-quarter of these due to negligent actions. However, more than half of the medical liability claims actually filed in the tort system arose from circumstances in which neither negligence nor any identifiable injury was present. One-third arose from instances in which the patient was injured but the doctor was not negligent (for example, for injuries resulting from a previously unknown drug allergy). Only one-sixth of the cases identified instances of true negligence and injury. Moreover, in this study, these claims represented a small fraction of injuries that actually arose due to negligence. Consequently, the majority of the compensation went to people who were not injured or were not injured by the doctor accused of malpractice, while the majority of those actually injured by doctor error were not compensated at all. Only in a minority of cases did those legally entitled to compensation receive it through the legal system.

Box 11-1: Punitive Damages

Compensatory damages are intended to "make the plaintiff whole" by offsetting an injured victim's losses. Punitive damages, on the other hand, are intended to punish the party whose negligent action caused the injury. Defendants may be liable for punitive damages if a jury finds that their actions were malicious, oppressive, gross, willful and wanton, or fraudulent. The Department of Justice studied civil trial cases in the country's 75 largest counties and found that punitive damages were awarded in 4.5 percent of cases that plaintiffs won (or 2.3 percent of all cases), but represented 21 percent of all damages awarded to plaintiffs. The median punitive award was $40,000 in those cases in which the plaintiff received an award. The threat posed by large punitive damages is that they may encourage more frequent and larger settlements.

Some are concerned that punitive damages are awarded against companies because they have deep pockets rather than because they have behaved egregiously. Indeed, the Supreme Court has expressed unease over the fact that the size of certain punitive awards has seemed out of proportion to the wrongfulness of the defendant's actions. This capriciousness also has implications for the deterrence effect of punitive damages, because a deterrence effect can be realized only if firms are able to take specific actions to avoid liability. If firms cannot tell which actions will likely incur liability, they cannot avoid them. Anecdotal evidence suggests that punitive-damage awards can indeed be unpredictable. Two identical allegations of fraud against BMW were heard in the same Alabama court and before the same judge. One purchaser was awarded $4 million in punitive damages; the second purchaser received no punitive damages.

Torts As Deterrence

The threat of a lawsuit can create and enforce appropriate standards of behavior. If the tort system made products and services in the United States safer, fewer accidents would occur and the higher administrative cost of torts would provide benefits to society in terms of reduced injury rates and associated health care costs. For example, the move by a number of states to no-fault automobile insurance in the 1970s appears to have led to as much as a 15 percent increase in the highway fatality rate. Such no-fault auto insurance laws eliminate or restrict liability for auto accidents so that each driver's own insurer typically pays for his or her own accident costs regardless of how

the accident happened. Drivers who know that they will not be financially liable for other drivers' injuries in the event of an accident might be expected to take fewer safety precautions than if they were responsible for the financial consequences of their actions. In other areas of tort law such as medical liability and product liability, there is not consistent evidence that deterrence effects are large enough to justify the considerable administrative costs of the tort system. This suggests that alternatives to the tort system provide deterrence. For example, the possibility of losing a medical license could provide an adequate incentive for doctors to take steps to avoid negligence beyond the steps doctors take in the interests of their patients.

General Aviation and Deterrence

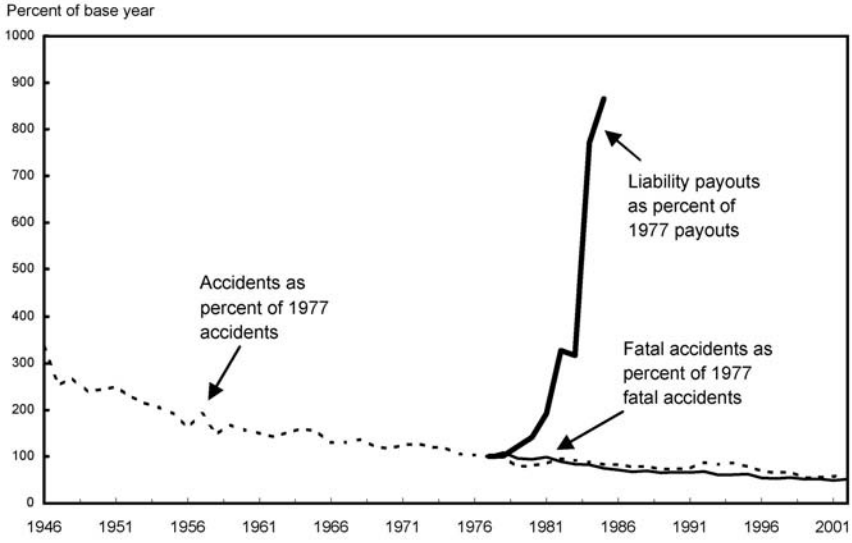
The experience of the general aviation industry over the past several decades provides an example of the role of tort liability in affecting product safety, firm profits, and the availability of goods to consumers. General aviation is the segment of the aviation industry composed of all civil aircraft not flown by commercial airlines or the military. General aviation manufacturers were the targets of a large volume of litigation in the 1970s and 1980s.

The general aviation accident rate has been declining for 50 years (Chart 11-3). In 1963, court rulings made lawsuits alleging manufacturing defects in the design of private and commercial aircraft subject to strict liability. In the most extreme cases, this meant that firms were responsible for accidents even if the accidents were caused by product defects that were not known or knowable at the time of manufacture. By the mid-1970s, this change in the law had led to a sharp rise in the number of product-liability cases and increased liability costs for the general aviation industry, with liability awards increasing nearly ninefold from 1977 to 1985.

The merits of these product-liability claims against airplane manufacturers were subject to question. A study of a sample of general aviation lawsuits filed between 1983 and 1986 showed that none of the accidents that led to lawsuits was caused by a design or manufacturing defect, as each suit had claimed. Thus, these lawsuits did not give manufacturers any additional incentives to produce safer aircraft, since the allegations of design defects appear to have been specious in the first place.

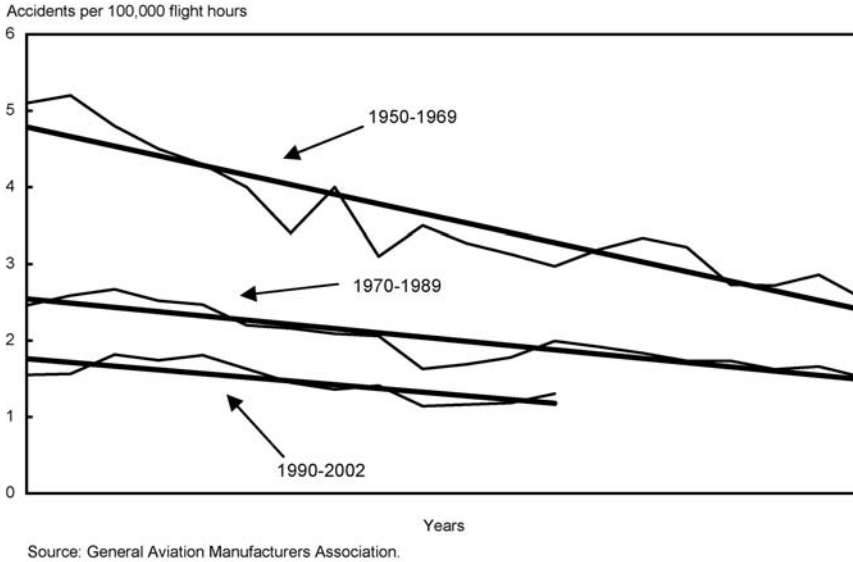
Indeed, the rise in tort claims had no discernible effect on the accident rate. An examination of the trends in the accident rate calculated over various periods shows that the steepest decline in general aviation accidents occurred between 1950 and 1969—before the dramatic rise in tort costs in the 1970s and 1980s (Chart 11-4). If liability exposure were driving the general aviation industry to build safer products, accident rates would have declined more rapidly as the increased likelihood of tort litigation pushed aircraft manufacturers to add safety features to their aircraft.

Chart 11-3 **General Aviation Liability Payouts and Accident Rates**
The increase in liability payouts between 1977 and 1985 did not cause a change in trends of the number of accidents or fatal accidents per 100,000 flight hours.



Sources: George L. Priest, "The Modern Expansion of Tort Liability: Its Sources, Its Effects, and Its Reform," *Journal of Economic Perspectives*, Summer 1991, and General Aviation Manufacturers Association.

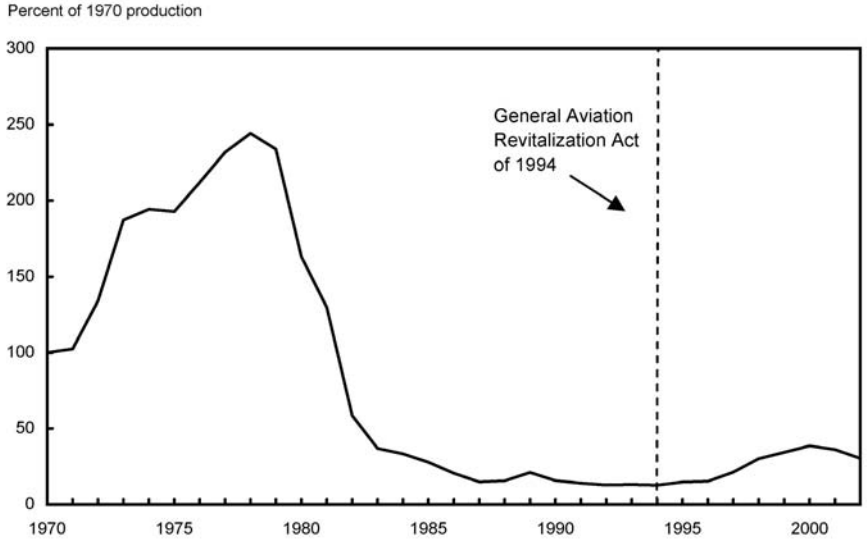
Chart 11-4 **Accident Rate for Small Aircraft**
The rise in tort claims has had no discernible effect on the declining accident rate in general aviation. The steepest decline was between 1950 and 1969, which predated the rise in tort costs during the 1970s and 1980s.



Source: General Aviation Manufacturers Association.

The rise in liability expenses did, however, cause great harm to the general aviation industry. During the period of expanding liability costs from 1977 to 1985, the financial health of the general aviation industry deteriorated markedly, with a number of firms shutting down production lines and one going bankrupt. As a result, small-aircraft production fell precipitously (Chart 11-5). By discouraging the production of new planes, tort law has created a situation in which the mix of planes in use actually presents a higher risk than would have been the case had older planes been retired and replaced by new ones. The General Aviation Revitalization Act of 1994, which exempted some general aviation aircraft older than 18 years from product-liability claims, appears to have led to a small resurgence in the industry.

Chart 11-5 **Small-Aircraft Production**
The increase in tort liability beginning in the 1970s caused a decrease in small-aircraft production. This effect was attenuated by the General Aviation Revitalization Act of 1994.



Source: General Aviation Manufacturers Association.

Other Evidence on Deterrence

It is difficult to find deterrence effects in other contexts. For example, studies examining injury rates for consumers and workers as well as death rates from workplace injuries show that such injuries did not decline more rapidly following a steep increase in litigation. Other research has examined the deterrence effect of medical liability by estimating the impact on treatment outcomes of state-imposed limits on damage awards at trial (such as California's $250,000 limit on noneconomic damages). Studies have found no appreciable impact on treatment outcomes—the lower threat of torts did not lead to more medical injuries. These findings suggest that there is at best limited deterrence from such cases.

The Limits of Tort Deterrence

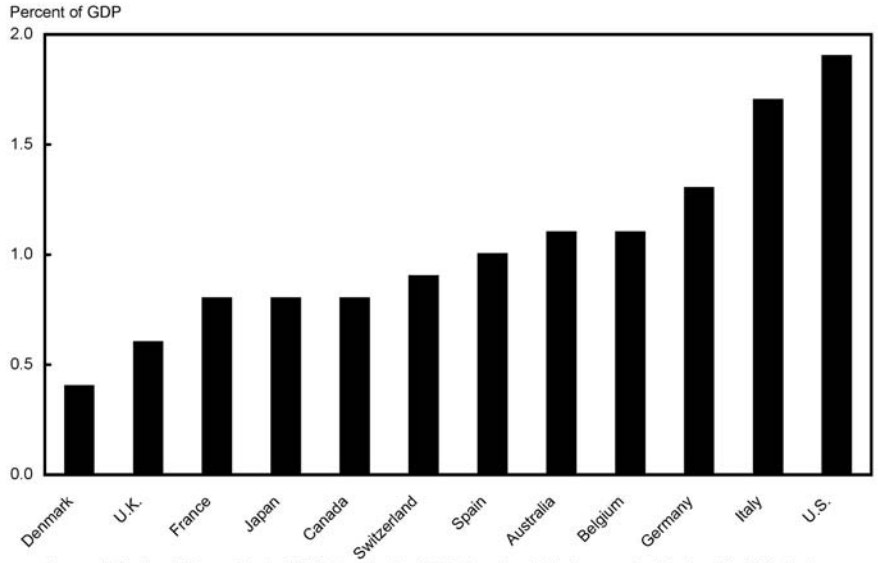
Why does the tort system appear to be ineffective in improving product safety? One major reason is that market incentives already provide an important form of deterrence against unsafe products. Firms whose products cause injuries lose customers and suffer economic losses. In addition, many products and services face government regulation. The producers of such items are required to undertake investments in safety, and the tort system may have no incremental effect on safety. Similarly, medical services also face market incentives and regulation by governmental and professional bodies.

The current tort system makes it hard to predict which actions will be deemed negligent during litigation. Thus, the system does not provide much deterrence because people do not know what steps to take to avoid a lawsuit or an adverse judgment.

Potential Tort Reforms

One way to consider the effects of changes in the U.S. tort system is to compare the U.S. system with those in other advanced economies, such as Canada, Japan and the United Kingdom. Like the United States, many of these countries use a negligence standard for medical liability and strict liability for product-related injuries, yet they expend fewer resources in their tort systems than the United States (Chart 11-6). Possible explanations for this divergence are discussed in the following sections.

Chart 11-6 **International Comparison of Tort Costs, 1998**
Tort costs as a percent of GDP were higher in the United States than in other industrialized countries.



Source: Tillinghast-Towers Perrin, "U.S. Tort Costs: 2000, Trends and Findings on the Costs of the U.S. Tort System," February 2002.

Limiting Noneconomic Damages and Other Potential Reforms

One important reason for the divergence in tort costs between the United States and other countries is that awards for noneconomic damages, such as pain and suffering, appear to be much higher in the United States. Noneconomic damages account for half of all compensation awarded in the United States, but in other countries are either capped (as in Canada) or otherwise restricted (as in Germany). Reforms aimed at reducing or eliminating pain and suffering awards, such as the President's proposed $250,000 limitation on noneconomic damages in health-related cases, have the potential to reduce the cost of the U.S. tort system.

Several other differences appear to be less important in explaining the divergence than compensation for noneconomic damages. One difference is that in other countries, judges decide the vast majority of tort claims, while juries typically decide cases in the United States. Empirical evidence suggests that U.S. judges and juries decide cases in approximately the same way, suggesting this is not a major factor in explaining the divergence. Another difference is that in the United States each side pays its own legal costs, whereas in many other nations the losing side pays both sides' legal costs. A study of Florida's temporary use of a "loser-pays" method in medical liability

cases found that when the losing side paid legal expenses, plaintiffs were more likely to receive compensation either at trial or in a settlement. Furthermore, the compensation was higher. This finding suggests that apportioning legal costs to the losers discourages plaintiffs from pursuing low-quality (nuisance) cases because they would have to pay all legal costs if the case went against them.

Procedural Reforms

Some of the costs of the tort system arise because there are incentives that encourage state judges and juries to extract financial compensation from out-of-town defendants. The vast majority of tort cases are litigated in state courts. Tort cases tried before elected state judges have been found to result in higher awards when the defendant is a corporation headquartered outside of the state than when the defendant is local. By removing national class action suits from state courts, the Federal government could reduce the ability of entrepreneurial lawyers to *forum shop*, that is, to file cases in a sympathetic state court. Some evidence on asbestos tort litigation suggests that forum shopping is indeed a problem. Research also suggests that certain small counties tend to be magnets for national class actions in the sense that they attract many more cases than would be expected on the basis of their populations.

The Class Action Fairness Act of 2003 would allow removal of some class actions to Federal court if any plaintiff is from a different state than any defendant (Box 11-2). Under current law, a plaintiff's attorney who does not like a particular judge's limitations in a class action can seek a less restrictive judge in a different jurisdiction. The proposed Act would make this more difficult by reducing the ability of plaintiffs' attorneys to file national class actions in state court.

Limiting the Scope of Tort Compensation

An alternative approach to the current system would be to resolve disputes and compensate victims outside the tort system. An example of this approach is the case of compensation for individuals exposed to asbestos. The proposed Fairness in Asbestos Injury Resolution Act of 2003 would create a trust fund to compensate those injured by asbestos exposure. Disbursements from the fund would be restricted to those who are actually suffering from asbestos-related illnesses. The use of asbestos has been all but abandoned in the United States, so the focus in resolving claims is now appropriately placed on compensating injured workers rather than deterring new instances of future liability (Box 11-3).

Box 11-2: The Role of Class Actions in the Tort System

A *class action* is a legal procedure in which individuals are joined together to litigate a single case (the class refers to the group of such individuals). Class actions are used in a variety of contexts, including cases involving securities fraud, consumer protection, employment, civil rights, and exposure to toxic chemicals or other pollutants. Class actions are intended to secure compensation in cases that involve substantial aggregate losses but relatively small individual losses. In practice, private attorneys often initiate these cases, each one in effect becoming a "Private Attorney General." In this role, lawyers identify both the legal violations and a number of individuals harmed by the violations and bring an action on these individuals' behalf. To induce attorneys to take on this role, they are compensated out of the settlement fund. In many cases, this compensation is based on a *contingent fee*, a percentage of the settlement or award.

An important concern about class action suits is that many of them are filed more for the benefit of the plaintiffs' attorneys than for the plaintiffs. In individual litigation, plaintiffs enter a contract with an attorney and have an incentive to monitor the attorney's effort to ensure a favorable outcome. In class action suits, most individual plaintiffs have only a small stake in the case's outcome and thus have little incentive to monitor the activities of their lawyers. In principle, judges are expected to monitor payments to plaintiffs' attorneys and the nature of settlements. With growing caseloads, however, many judges face pressure to clear their dockets as rapidly as possible. Accepting a settlement and associated attorneys' fees is one way to accomplish this.

Without the active scrutiny of clients or judges, plaintiffs' lawyers have an incentive to collude with defendants to set higher attorney's fees in exchange for lower overall payouts from defendants to plaintiffs. One study of a small number of class action cases found that in a substantial fraction of them, class counsel received more in fees and expenses than all of the plaintiffs combined.

Box 11-3: Asbestos and the Tort System

The tort system's treatment of asbestos cases demonstrates how the system can fall short of its purported objectives of deterring harmful behavior and funding compensation. Beginning in the 1970s, increased public awareness and concern about the health effects of asbestos led to regulations limiting exposure to asbestos. By 1989, all new uses were banned, and strict regulations have limited remaining asbestos use. Between 1973 and 2001, asbestos use in the United States fell by 98 percent. With extensive regulations in place and minimal use, the tort system's role in deterring harmful behavior has been substantially reduced simply because there is little activity to deter.

Yet even as the use of asbestos declined, the number of claims rose substantially. The total number of claimants is estimated to have grown from 21,000 in 1982 to over 600,000 by the end of 2000. To be sure, some additional claims are warranted because cancers caused by asbestos can take years to develop. An estimated 90 percent of the new claims, however, are by people who have no cancers and may never develop cancer. Claims by individuals without a diagnosed asbestos-related cancer account for almost all of the growth in asbestos case loads during the 1990s and most of the compensation received by claimants goes to those without malignant cancers. Only 43 percent of the money spent on asbestos litigation is recovered by claimants—the rest goes to lawyers and administrative costs. In short, the current system neither achieves deterrence in the use of this dangerous substance nor directs appropriate compensation to its victims.

Instead, asbestos litigation has imposed costs on workers, shareholders, and those who in the future will become ill from their previous exposure to asbestos. Estimates suggest that roughly 60 companies entangled in asbestos litigation have gone bankrupt primarily because of asbestos liabilities, with most of the bankruptcies occurring since 1990. One study estimated that between 52,000 and 60,000 workers were displaced because of these bankruptcies. Moreover, bankruptcy results in a shrinking pool of money to be divided up among future claimants. The growing number of bankruptcies raises concerns that those who become ill in the future will receive little or no compensation.

For other injuries, a possible approach to compensating accident victims would be a system akin to workers' compensation, in which compensation would be provided by an insurance system. New Zealand has replaced the personal injury and medical liability aspects of its tort system with a government-run compensation system. Such a system, however, can increase the prevalence of accidents because fully-insured individuals may not take sufficient care against a loss. This is not a concern in cases where accidents have already occurred, such as asbestos exposure. In other cases, such as product liability or medical liability, the effect of changes in the system on the behavior of potential victims is an important consideration. Moreover, like the tort system, workers' compensation systems tend to be costly to administer and may encourage frivolous claims. Replacing the tort system with a more general workers' compensation system could well mean replacing one costly and inefficient system with another.

Avoiding the Tort System

Recontractualization is an alternative approach to reform that has been the subject of considerable academic discussion. According to this idea, individuals and firms would be allowed to specify by contract the types of damages for which injurers would be liable. For example, consumers or their insurers could determine individual caps on damages in exchange for lower prices for goods and services. In principle, potential defendants would enter into such contracts if they reduced the expected costs of dealing with injuries. Such a system would be voluntary, so that individuals could refuse to participate if offered a contract by a potential defendant that was inferior to the insurance associated with the tort system.

A possible drawback to this approach is that the courts currently view contracts limiting damages or defining negligence with suspicion. Courts have held that warranties that limit liability are not enforceable because they are *contracts of adhesion*—agreements that the purchaser of a product or service has no choice but to accept. Hence, it is likely that any steps toward recontractualization would require substantial institutional and legal changes. This could explain why this approach has not received much attention from policy makers.

Conclusion

The tort system has expanded in the last 30 years. By expanding the number of accidents for which accident victims receive compensation, the current tort system in effect requires the suppliers of goods and services to provide insurance to their customers. This tort-based insurance against accidents appears to be more expensive than other methods of compensating victims. At least in the cases of product liability and medical liability, the expansion of the tort system does not appear to have had an appreciable effect in deterring negligent behavior.

The President has proposed several initiatives to reduce the burden of torts on the economy. These include placing limits on noneconomic damages, reforming class action procedures, and finding alternative methods to compensate injuries such as those that have been proposed for people suffering from asbestos-related ailments. These steps would focus the tort system on those cases it can deal with most effectively and lessen the costs to society of frivolous lawsuits and awards.