

Statement Presented to the  
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by

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Protecting Main Street from Lawsuit Abuse

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Thank you, Mr. Chairman, and members of this Conference, for your kind invitation to testify today about the magnitude of the effect on the economy of excessive litigation.

I serve as Director of the AEI Legal Center for the Public Interest, and as a Resident Fellow at the American Enterprise Institute for Public Policy Research, but I am not testifying here on their behalf and the views that I am sharing today are my own.

While the cost of the tort system has apparently declined since 2004, thanks in part to reforms passed by Congress and by individual states, it is still a tremendous drag on the economy relative to other industrialized nations. A 2007 study by the Pacific Research Institute found that “America wastes \$589 billion each year from excessive tort litigation,” or an annual price tag to a family of four of \$7,848.<sup>1</sup> I do not entirely agree with the methodology of PRI, which I believe underestimates some aspects and overestimates others. But I independently arrive at a number in the same range of magnitude to theirs.

Our nation’s tort system is substantially more expensive than that of other nations. Features unique to the United States—unbounded non-economic damages; a broader use of punitive damages; contingent fees of a percentage of recovery; the lack of loser-pays; extraordinarily broad discovery; class-action litigation; the use of speculative and non-scientific expert testimony in some state courts—raise costs tremendously. Yet, despite these increased costs, there is no evidence that the United States tort system provides marginal benefits relative to other nations. For example, New Zealand does not even offer the availability of private medical malpractice litigation, yet there is no evidence that medical care in New Zealand is of substandard quality due to the lack of fear of malpractice litigation.<sup>2</sup> If anything, it is quite likely that the arbitrary nature of the American tort system has distorting effects that make it perform worse than that of other nations.

This testimony briefly explores the marginal direct and indirect costs of the United States tort system. Everything here will necessarily be an estimate: we can only indirectly measure the “but-for”

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\* I greatly appreciate the input of Jack Calfee, and the assistance of AEI research assistants Sara Wexler and Luci Hague in preparing this report. Nevertheless, the opinions, and any errors, in this testimony are mine alone.

<sup>1</sup> Lawrence J. McQuillan, Hovannes Abramyan, and Anthony P. Archie, *Jackpot Justice: The True Cost of America’s Tort System* (Pacific Research Institute 2007) (“PRI study”).

<sup>2</sup> Michelle M. Mello & Troyen A. Brennan, *Deterrence of Medical Errors: Theory and Evidence for Malpractice Reform*, 80 TEX. L. REV. 1595 (2002); Marie Bismark, *et al.*, *Accountability sought by patients following adverse events from medical care: the New Zealand experience*, 175 (8) CMAJ 889 (Oct. 10, 2006). The Veterans’ Health Administration, which substantially limits medical malpractice liability, yet is regularly praised by liberal economists and policy analysts as providing high-quality health-care, is another example of a health-care system where malpractice costs are limited without sacrificing quality. David A. Hyman & Charles Silver, 90 Cornell L. Rev. 893, 933-34 (2005) (acknowledging liability limitations, but coming to opposite conclusion); Paul Krugman, *Health Care Confidential*, N.Y. TIMES, Jan. 27, 2006 (praising VHA); Ezra Klein, *The Health of Nations*, THE AM. PROSPECT, May 7, 2007 (same).

world that would result if excessive tort litigation were eliminated. We can never know what life-saving drugs have not been invented because of the excessive costs of pharmaceutical litigation; we can never know with certainty what jobs have not been created and what great businesses were never built because of excessive tort liability. I have used conservative estimates where possible; others have looked at the same data, and come away with far higher numbers.

I conclude:

- The direct costs to the United States economy from excessive tort litigation are at least \$128 billion/year.
- The indirect costs to the United States economy include:
  - Over \$400 billion/year of loss from the effect of tort litigation on wages;
  - Between \$30 billion and \$120 billion/year from deadweight loss from defensive medicine;
  - Between \$30 billion and \$150 billion/year from deadweight loss from the deterrence of manufacturing innovation;
  - Between \$11 billion and \$104 billion/year from lives lost due to lost innovation in the pharmaceutical industry; and
  - Thousands of lives and tens of thousands of jobs lost every year.

The total loss to the economy from excessive tort litigation above and beyond a baseline of an employment at will regime and an average industrialized tort system can be estimated at between over \$600 billion and over \$900 billion a year, 4.3% to 6.5% of GNP, or a tort tax of between \$8,000 and \$12,000/year for an average family of four. And this is very much a conservative estimate, as other economists find much stronger effects than I have estimated here, as I have not tried to estimate a number of identifiable secondary and tertiary effects of excessive tort litigation on allocation of economic resources, and as I have not tried to estimate the likely effect of recent Congressional expansions of tort liability in the last twelve months.

## I. Direct Costs

Towers Perrin, which has done twelve studies on the annual direct cost of the tort system since 1985, has estimated that the direct costs of the tort system in 2007 were \$252 billion, or 1.83% of GDP.<sup>3</sup> This reflects a tripling in the costs of the tort system relative to the size of the economy since 1950: adjusted for inflation, tort costs have increased per capita more than eight-fold, even as the per-capita GDP has increased less than three-fold in that same time.

Of course, it would be unfair to attribute the entire cost of the tort system to excesses. After all, no one is proposing abolishing the tort system and reducing tort costs to zero. But we can compare the

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<sup>3</sup> Towers Perrin, *2008 Update on U.S. Cost Trends* (2008) (“Towers Perrin study”).

direct costs of our tort system with those of other nations. The best estimates of Tillinghast-Towers Perrin found that ten other industrialized nations had tort costs of 0.6% of GDP (Poland and Denmark) to 1.1% of GDP (Germany), with an outlier in Italy (1.7% of GDP). These are numbers similar to the United States experience before (and even during the earliest years of) the litigation explosion in the 1960s and 1970s.<sup>4</sup> If we compare the United States to the average of other industrialized nations (0.9%), we find that the excessive direct costs of U.S. tort liability are \$128 billion, or \$425 each for every man, woman, and child in the United States. This is a conservative estimate: other industrialized nations, such as Korea and Taiwan, not included in the Towers Perrin study, have even lower tort costs.<sup>5</sup>

Some industries are affected more than others: one Chrysler executive has stated that product liability costs add \$1000 to every car built in the United States<sup>6</sup>—a \$16 billion/year cost to consumers. And a National Association of Manufacturers report found that tort costs have reduced American manufacturers' competitiveness by 3.2 percent, encouraging many manufacturers to move operations overseas, and speeding the decline of American manufacturing jobs.<sup>7</sup>

## II. Indirect Costs

But this is only an estimate of the direct costs. There are much larger indirect costs caused by excessive litigation. Businesses incur non-legal expenses to comply with the tort system, from document management systems, to executive time lost in depositions and pre-trial preparation, to activities foregone because of legal risk. Businesses raise prices and lower wages to compensate for the expected costs of the tort system. Individuals change their behavior in inefficient ways because of the distorting effects of the tort system.

Because litigation can threaten the solvency of even Fortune-500 companies, the demand for attorneys is tremendous: even in the middle of a recession, a 25-year-old graduate from a top-ten law school will more often than not make more than a U.S. senator: \$177,500/year just out of law school, with the expectation of substantial salary increases rising to \$300,000/year income in six years.<sup>8</sup> As a result, we have a distortion in the economy resulting in many of the best and brightest college graduates choosing to become attorneys instead of engineers or scientists or other professions where people produce things rather than work to promote or prevent wealth transfers.<sup>9</sup> The cost to the economy of this incentive is simply unmeasurable: we will never know what inventions and innovations we are losing from this brain-drain. So while I will arrive at large numbers for the indirect costs, these numbers will necessarily be underestimates.

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<sup>4</sup> PRI study, *supra*; Tillinghast-Towers Perrin, *U.S. Tort Costs and Cross-Border Perspectives: 2005 Update* (2006).

<sup>5</sup> Jeremy A. Leonard, *How Structural Costs Imposed on U.S. Manufacturers Harm Workers and Threaten Competitiveness* 16 (2003).

<sup>6</sup> Theodore H. Frank, *Did the Right Make America a Lawsuit Nation?*, 12 TEX. R. L. & POL. 477, 516 (2008).

<sup>7</sup> PRI study, *supra* note 1 at 33; Jeremy A. Leonard, *How Structural Costs Imposed on U.S. Manufacturers Harm Workers and Threaten Competitiveness* (2003).

<sup>8</sup> E.g., David Lat, *May It Please the Court? Massive Law-Firm Bonuses, Not So Much*, N.Y. OBSERVER (Nov. 20, 2007).

<sup>9</sup> Frank, *supra* note 6 at 517.

### A. Indirect Wage Losses from Employment Litigation

For most of this nation's history, employment relationships were governed by the employment-at-will doctrine. Over the last forty years, courts have carved out substantial exceptions to employment-at-will common law doctrine<sup>10</sup> and Congress and state legislatures have expanded the ability to sue over adverse employment actions.<sup>11</sup>

If Congress were to demand that every employer provide a \$50 gift-certificate to Borders, employers would simply react by reducing wages by the same \$50, and employees would be worse off, because some would have preferred the cash to the gift certificate. Similarly, making it harder to fire workers is a non-pecuniary benefit to workers that raises costs to both employers and employees. With the expansion of employment litigation, every hire (and decision not to hire) of an employee is the purchase of a potential lawsuit. Employers respond in three ways: hiring human-resources employees who do not improve productivity or output, but merely help the employer reduce the potential cost of lawsuits by navigating regulations; substituting capital for labor and hiring fewer employees; and reducing employee wages to account for the additional expected litigation cost from hiring an additional employee.

Employment-at-will permits job flexibility in hiring. This can be seen by the comparison of the American employment-at-will system to that of Europe: unemployment rates in European nations where employers find it legally difficult to close plants or dismiss employees are much higher.<sup>12</sup> If over-expansion cannot be legally remedied, it is safer not to hire in the first place. This dynamic can also be seen in the United States: for example, after the Americans with Disabilities Act was passed, the unemployment rate for the disabled increased: the increased litigation risk priced numerous disabled workers out of the market.<sup>13</sup>

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<sup>10</sup> Frank, *supra* note 6 at 490-91; Richard Epstein, *In Defense of the Contract at Will*, 51 U. CHI. L. REV. 947, 947-50 (1984) (discussing "retreat" of at-will employment principle); Deborah A. Ballam, *Employment-at-will: the impending death of a doctrine*, AMER. BUS. L. J. (Jun. 22, 2000).

<sup>11</sup> Frank, *supra* note 6 at 490-91; RICHARD A. EPSTEIN, SIMPLE RULES FOR A COMPLEX WORLD 151-93 (1995); WALTER OLSON, THE EXCUSE FACTORY (1997).

<sup>12</sup> Bureau of Labor Statistics, Unemployment Rates in Ten Countries, Civilian Labor Force Basis, Approximating U.S. Concepts, Seasonally Adjusted, 1995-2007, <ftp://ftp.bls.gov/pub/special.requests/ForeignLabor/flsjec.txt> (last visited Oct. 17, 2007).

<sup>13</sup> Daron Acemoglu and Joshua D. Angrist, *Consequences of Employment Protection? The Case of the Americans with Disabilities Act*, 109 J. POL. ECON. 5 (2001); Thomas DeLeire, *The Americans with Disabilities Act and the Employment of People with Disabilities* in THE DECLINE IN EMPLOYMENT OF PEOPLE WITH DISABILITIES: A POLICY PUZZLE (David C. Stapleton, Richard V. Burkhauser, editors) (2003); Thomas DeLeire, *The Wage and Employment Effects of the Americans with Disabilities Act*, 35 J. HUM. RES. 693 (2000); Christine Jolls, *Accommodation Mandates*, 53 STAN. L. REV. 223, 273-76 (2000); *but see also* Samuel Bagenstos, *Has The Americans With Disabilities Act Reduced Employment For People With Disabilities?*, 25 BERKELEY J. OF EMP. AND LAB. L. 527, 529 (2004) (defending ADA, but saying "I find it hard to disagree with the claim that the statute (at least initially) imposed some negative pressure on employers' decisions to hire some people with disabilities."). *Cf. also* Jonathan Klick, Bruce H. Kobayashi, and Larry E. Ribstein, "The Effect of Contract Regulation: The Case of Franchising" (December 13, 2006). George Mason Law & Economics Research Paper No. 07-03 Available at SSRN: <http://ssrn.com/abstract=951464> (employment in franchise industries is significantly reduced when states enact restrictions on franchisor termination rights and the effect is larger when states limit the ability to contract around these restrictions).

Economists have measured the effect of legal limitations on employment-at-will. A 1992 RAND study found that the decline in employment resulting from indirect costs of wrongful termination suits is roughly equivalent to the effect of a ten percent wage increase.<sup>14</sup>

In 2007, according to the Department of Commerce Bureau of Economic Analysis, wage and salary disbursements were \$6.362 trillion: if the RAND numbers are correct, then the aggregate effect of employment litigation on wages is \$636 billion a year. Only a small fraction of that finds its way back into employees' pockets through victories in employment litigation—the EEOC, with an annual budget of over \$300 million, has not even averaged \$100 million annually in recovery for employees over the last decade.<sup>15</sup> The RAND study found that the indirect costs dwarfed the direct costs of employment litigation a hundredfold.<sup>16</sup>

We as a nation may well decide that the intangible benefits from legal limitations on employment-at-will are worth the cost to wages. The need for the Civil Rights Act of 1964 when it was first passed to break the effects of Jim Crow is beyond question. In 2009, however, the benefits are far from evident. We have an African-American president in the White House; women are no longer blocked from participating in the workforce, and, when choosing to work similar hours to men, will earn the same as men with equivalent experience and education;<sup>17</sup> and consumer and employee demand has encouraged companies to engage in affirmative action and diversity programs far beyond the requirements of the law, with many going so far as to voluntarily offer benefits to domestic partners. It thus may be prudent to reevaluate the costs and benefits of our employment litigation system, especially given unemployment rates at quarter-century highs. We may even have reached the point where Title VII is counterproductive to its original goal of promoting minority employment; federal law may actually hinder diversity programs because it permits reverse-discrimination lawsuits.<sup>18</sup> Unfortunately, the policy debate of the effect on wages and jobs has consistently been absent from Congressional discussions over expansions to employment litigation.

To be conservative, I have estimated the intangible benefits from employment discrimination litigation to be \$200 billion/year. I firmly believe that this is a vast overestimate. No one has tried to quantify the benefits from the availability of employment litigation remedies. The fact that very few unions have negotiated for employment discrimination remedies in union contracts before they were implemented into federal law, combined the fact that courts have felt the need to preclude employees from being permitted to sign away their rights to employment discrimination litigation,

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<sup>14</sup> JAMES N. DERTOUZOS AND LYNN A. KAROLY, LABOR MARKET RESPONSES TO EMPLOYER LIABILITY (RAND 1992); see also Timothy M. Shaughnessy, *How state exceptions to employment-at-will affect wages*, 24 J. Labor Research 447 (2003).

<sup>15</sup> EEOC Litigation Statistics, FY 1997 through FY 2008, found at <http://www.eeoc.gov/stats/litigation.html> (last visited March 13, 2009).

<sup>16</sup> Dertouzos & Karoly, *supra* note 14 at 63.

<sup>17</sup> Judith O'Neill and Solomon Polachek, *Why the Gender Gap in Wages Narrowed in the 1980s*, 11 J. LABOR ECON. 205 (January 1993); Warren Farrell, *Why Men Earn More* (2005) (former NOW Board of Directors member concludes wage gap entirely due to lifestyle choices); Diana Furchgott-Roth, testimony before EEOC (Philadelphia, Pa.), Apr. 12, 1999, available at [http://www.aei.org/publications/pubID.17864.filter.all/pub\\_detail.asp](http://www.aei.org/publications/pubID.17864.filter.all/pub_detail.asp).

<sup>18</sup> See, e.g., *Rudebusch v. Hughes*, 436 F.Supp.2d 1058 (D.Ariz. 2006) (awarding plaintiffs \$1.6 million for Title VII violations arising from 1993 equity pay adjustments in favor of minority professors); *Dee McAree, DOJ Pays \$11.5M in Reverse Discrimination Case*, NAT. L. J. (Nov. 18, 2004).

suggests that workers, given a choice, would overwhelmingly prefer higher wages to the possibility of a right to bring a lawsuit down the line. Moreover, without government interference such as Jim Crow laws, free-market pressures would punish employers who hire, promote, and fire workers for irrational reasons. I believe the benefits of employment discrimination laws in the twenty-first century are closer to zero than to \$200 billion/year.

Finally, since the RAND study was done, Congress has substantially expanded liability in employment suits through the 1991 Civil Rights Act, the Americans with Disabilities Act Amendments Act of 2008, and again this year with the Lilly Ledbetter Act; the ten percent figure as an effect on wages may well be an underestimate. A conservative estimate of the costs of the employment tort system on wages is over \$400 billion a year, or at least \$1300 for every man, woman, and child in the United States, in exchange for intangible benefits that are far from certain in the twenty-first century.

## B. Indirect Losses from Medical Malpractice Litigation

It is conventional wisdom that there is a medical malpractice crisis,<sup>19</sup> with physicians having substantial trouble finding affordable professional liability insurance, especially in states with litigation environments that favor plaintiffs' attorneys.<sup>20</sup> Malpractice liability does a poor job of distinguishing between good doctors and bad doctors.<sup>21</sup> Outcome bias affects even experts in the field when it comes to retroactively judging physician conduct,<sup>22</sup> and must reasonably be considered to be a defect in the litigation system as well, where lay decision-makers are finding facts. The resulting random and capricious nature of malpractice liability prevents using claim histories to "experience rate" physicians,<sup>23</sup> so the increase in insurance costs ends up deterring medical practice, rather than malpractice.<sup>24</sup> The problem is exacerbated from the misuse of litigation techniques to

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<sup>19</sup> E.g., FRANK A. SLOAN & LINDSEY M. CHEPKE, *MEDICAL MALPRACTICE* 1 (2008); American Medical Association, *America's Medical Liability Crisis: A National View* (Chicago: AMA, January 2007); Michelle M. Mello, *et al.*, *The New Medical Malpractice Crisis*, 348 *NEJM* 2281 (Jun. 5, 2003); Eliot Menkowitz, *Med lawsuit abuse still a crisis*, *PHIL. BUS. J.*, Feb. 28, 2008. *Contra* TOM BAKER, *THE MEDICAL MALPRACTICE MYTH* (2005) (disputing existence of crisis); David A. Hyman and Charles Silver, *Medical Malpractice & Tort Reform: It's the Incentives, Stupid*, 59 *VAND. L. REV.* 1085 (2006) (same); Marc A. Rodwin, *et al.*, *Malpractice Premiums In Massachusetts, A High-Risk State: 1975 To 2005*, 27 *HEALTH AFFAIRS* 835 (2008) (flatly stating Massachusetts does not have medical malpractice crisis). But even Rodwin's data showed that the mean insurance rate paid by "high-risk" doctors in Massachusetts went from \$65,612 in 2000 to \$95,045 in 2005 in 2005 dollars, a 45% increase in constant dollars. *Id.*; see Theodore H. Frank, *Malpractice in Massachusetts: Another View*, 27 *HEALTH AFFAIRS* 1745 (2008).

<sup>20</sup> American Medical Association, *supra* note 19.

<sup>21</sup> SLOAN & CHEPKE, *supra* note 19 at 81 (citing Entman (1994)); Brennan *et al.*, *Relation between Negligent Adverse Events and the Outcomes of Medical-Malpractice Litigation*, 335 *NEJM* 1963 (Dec. 26, 1996) (litigation system was just as likely to award damages in a case where no medical malpractice has taken place as one where medical malpractice has taken place; sued non-negligent doctors paid more on average to injured patients than the sued negligent doctors; majority of patients receiving compensation weren't injured by negligence); David M. Studdert *et al.*, *Claims, Errors, and Compensation Payments in Medical Malpractice Litigation*, 354 *NEJM* 2024 (May 11, 2006) (73% accuracy).

<sup>22</sup> Caplan & Posner, *The expert witness: Insights from the Closed Claims Project*, *ASA NEWSLETTER* 61(6):9-10, 1997 (expert witness testimony affected by outcome bias); Caplan *et al.*, *Effect of outcome on physician judgments of appropriateness of care*, 265 *JAMA* 1957 (1991) (same).

<sup>23</sup> SLOAN & CHEPKE, *supra* note 19 at 228; *cf. also* Entman, *supra* note 21.

<sup>24</sup> David J. Becker and Daniel P. Kessler, *The Effects of the U.S. Malpractice System on the Cost and Quality of Care, in MEDICAL MALPRACTICE AND THE U.S. HEALTH CARE SYSTEM* 84, 86 (William M. Sage & Rogan Kersh, eds., 2006)

push scientifically questionable theories of liability and the expense of unfettered noneconomic damages,<sup>25</sup> which are inherently arbitrary and unpredictable, and present moral hazard risk of *ex post* exaggeration by plaintiffs.<sup>26</sup>

There are two sources of indirect losses from medical malpractice litigation, in addition to the direct costs of the litigation itself. *First*, malpractice liability disrupts doctors' incentives to provide cost-effective care and promotes defensive medicine that may be worthless or even counterproductive in the long run. *Second*, the arbitrary nature of malpractice litigation results in it deterring the *practice* of medicine, rather than malpractice, raising health-care costs and reducing health-care outcomes to the extent that additional doctors would provide additional care at the margin.<sup>27</sup>

Studies show that the vast majority of doctors engage in defensive medicine.<sup>28</sup> The leading study on the role of malpractice liability on defensive medicine found that liability concerns had increased hospital costs between five and nine percent.<sup>29</sup> Extrapolating that to the entire health-care system would imply annual costs between \$100 and \$180 billion.

Some defensive medicine is counterproductive: for example, unnecessary CAT scans for children may increase risk of cancer later in life. Other defensive medicine is simply inefficient: there is some marginal benefit, but at expense far greater than it is worth. The effect of the liability system is confounded by other perverse incentives for doctors to engage in defensive medicine, including patient demand spurred by moral hazard created by medical insurance; a culture within the American medical community to spare no expense that is only partially accounted for by liability concerns; and doctors' own economic incentives if they individually profit from the running of tests. The Kessler/McClellan study, by focusing solely on the difference in liability regime, would have controlled for some of these features, but I believe that it would be unfair to identify the entire \$100 to \$180 billion figure as a deadweight loss caused by liability concerns. My more conservative

(because patients "reap substantial surpluses from medical care for which they cannot compensate providers," doctors that weigh malpractice downside risk of treatment against only fraction of upside may inefficiently refrain from treatment of patients); Frank, *supra* note 6 at 515; Michelle M. Mello & Troyen M. Brennan, *Deterrence of Medical Errors: Theory and Evidence for Malpractice Reform*, 80 TEX. L. REV. 1595 (2002).

<sup>25</sup> E.g., *Harris v. Mt. Sinai Medical Center*, 116 Ohio St.3d 139 (Ohio 2007) (striking down \$30 million verdict won because of overzealous advocacy by trial lawyer Geoffrey Fieger); David Merenstein, *Winners and Losers*, 291 JAMA 15 (2004) (plaintiffs' lawyer successfully portrayed evidence-based medicine as sinister); Adam Liptak and Michael Moss, *In Trial Work, Edwards Left a Trademark*, N.Y. TIMES, Jan. 31, 2004 (prominent North Carolina plaintiffs' attorney made tens of millions using combination of abusive closing arguments and questionable scientific theory of causation in cerebral palsy medical malpractice cases).

<sup>26</sup> Patricia Danzon, *Liability for Medical Malpractice*, in HANDBOOK OF HEALTH ECONOMICS 1337 (A.J. Culver and J.P. Newhouse, eds., 2000).

<sup>27</sup> Mello & Brennan, *Deterrence of Medical Errors: Theory and Evidence for Malpractice Reform*, 80 TEX. L. REV. 1595 (2002); Dorothy L. Pennachio, *Why Dr. Kooyer had to move*, MEDICAL ECONOMICS (Dec. 23, 2002); Daniel Kessler, William Sage, and David Becker, *Impact of Malpractice Reforms on the Supply of Physician Services*, 293(21) JAMA 2618 (2005); William Encinosa and Fred Hellinger, *Have State Caps on Malpractice Awards Increased the Supply of Physicians?* 24 HEALTH AFFAIRS 250-59 (2004). Cf. also Atul Gawande, *A Lifesaving Checklist*, N.Y. TIMES (Dec. 30, 2007) (fear of increased liability among reasons hospitals have failed to impose ICU safety measures that would save hundreds of lives).

<sup>28</sup> E.g., Amy Lynn Sorrel, *Defensive medicine widespread among Massachusetts doctors*, AMER. MED. NEWS, Dec. 29, 2008 (study finding 83% of Massachusetts doctors admit to practicing defensive medicine).

<sup>29</sup> Daniel Kessler and Mark McClellan, *Do Doctors Practice Defensive Medicine?*, 111(2) Q. J. ECON. 354 (1996).

estimate would be between \$30 billion and \$120 billion a year. I note that the PRI study's \$124 billion/year estimate<sup>30</sup> is at the high end of my range, and the Avraham/Schanzenbach econometric study that suggested a net cost between 0.5% and 2% of total health care costs, or approximately \$10 billion to \$40 billion,<sup>31</sup> is at the low end of my range.

The effect of the loss of productive doctors and closing of emergency rooms on health-care results is unknowable. One estimate, based on Paul Rubin and Joanna Shepherd,<sup>32</sup> estimated 2700 deaths a year.<sup>33</sup> I believe that is an overestimate of the effect of tort reform on emergency-room care,<sup>34</sup> but I believe the number is in the hundreds of lives a year, and perhaps even as high as 1000 deaths and many more exacerbated injuries a year. Sometimes one can easily pinpoint the causation of a particular death or injury to the liability regime, as in the case of Tony Dyess, who is brain-damaged, or Fred Andricks, who died, because lawyers drove neurology specialists out of their area, forcing a several-hour delay in treatment while they were being airlifted to another hospital.<sup>35</sup> But far more often, preventable deaths and crippling injuries are passing unnoticed because we do not see the doctors who are not practicing, nor the lives they would have saved.

### C. Direct and Indirect Costs of Expansive Asbestos Litigation and Mass Tort Fraud

Though the Navy recognized the dangers of asbestos as early as 1939, its World War II Liberty Ship and Victory Ship shipbuilding program, in the name of wartime urgency, knowingly exposed thousands of shipyard workers to dangerous levels of asbestos.<sup>36</sup> The government then failed to compensate those workers, and stood by as trial lawyers sued into bankruptcy asbestos suppliers and other third parties<sup>37</sup> who had nothing to do with Navy working conditions, thus victimizing not only government workers but government contractors.

Asbestos litigation is rife with fraud, and state tort systems and Congress have largely failed to address this problem.<sup>38</sup> An investigation matching plaintiffs in a multidistrict litigation against silica

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<sup>30</sup> PRI study, *supra* note 1 at 19-20.

<sup>31</sup> Ronen Avraham and Max M. Schanzenbach, *Impact of Tort Reform on Private Health Insurance Coverage* (December 17, 2007). Northwestern Public Law Research Paper No. 07-16. Available at SSRN: <http://ssrn.com/abstract=995270>.

<sup>32</sup> Paul Rubin and Joanna Shepherd, *Tort Reform and Accidental Deaths*, 50 J. L. & ECON. 221 (2007).

<sup>33</sup> PRI study, *supra* note 1 at 18.

<sup>34</sup> Presentation, *Can Tort Reform Save Lives?* (AEI, Oct. 12, 2005).

<sup>35</sup> Testimony of Leanne Dyess, "Patient Access Crisis: The Role of Medical Litigation," Senate Judiciary Committee, Feb. 11, 2003; Testimony of Dr. Thomas Gleason, "Medical Liability Reform: Stopping the Skyrocketing Price of Healthcare," House Small Business Committee, Feb. 17, 2005.

<sup>36</sup> WALTER OLSON, THE RULE OF LAWYERS 189-92 (2004); Walter Olson, *Dangerous When In Power*, REASON (March 2007).

<sup>37</sup> Ted Frank, *Making the FAIR Act Fair*, 1 LIABILITY OUTLOOK No. 1 (2006); STEPHEN J. CARROLL *et al.*, ASBESTOS LITIGATION COSTS AND COMPENSATION (RAND Institute for Civil Justice 2005); Joseph E. Stiglitz *et al.*, *The Impact of Asbestos Liabilities on Workers in Bankrupt Firms* (2002).

<sup>38</sup> *In re Silica Products Liab. Litig.*, 398 F.Supp. 2d 563 (S.D. Tex. 2005); Ted Frank, *Making the FAIR Act Fair*, 1 LIABILITY OUTLOOK No. 1 (2006); Lester Brickman, *The Use of Litigation Screenings in Mass Torts: A Formula for Fraud?* (2008) (unpublished manuscript available at [bepress.com](http://bepress.com)); Lester Brickman, *Disparities between Asbestosis and Silicosis Claims Generated By Litigation Screenings and Clinical Studies*, 29 Cardozo L. Rev. 513 (2007); Lester Brickman, *On the Applicability of*

defendants against claimants from the Manville Trust found that thousands of the plaintiffs claiming silicosis injuries had previously claimed asbestosis and that the asbestosis claims made no mention of the alleged silicosis and vice versa, even though the two competing diagnoses were sometimes made by the same doctor.<sup>39</sup>

According to a study co-authored by Nobel-prize winning economist Joseph Stiglitz; Jonathan Orszag; and President Obama's OMB director, Peter Orszag, the effect of asbestos litigation has caused dozens of bankruptcies and cost American workers 60,000 jobs.<sup>40</sup>

Several law firms were responsible for massive fraud in the fen-phen litigation. These firms would set up "echo mills" with three or four echocardiogram machines and several sonographers and cardiologists; lawyers would generate the medical histories and doctors would rubber-stamp thousands of diagnoses; they paid millions of dollars to doctors to generate for litigation fraudulent diagnoses of valvular regurgitation to submit to the trust fund for fen-phen settlement, including contingent bonuses for successful recovery.<sup>41</sup> In the words of federal district court Judge Harvey Bartle about one such doctor:

The circumstances under which the Dr. Crouse echocardiograms were performed and interpreted undermine her credibility. Despite her extensive experience with echocardiography, she relied on a law firm employee to instruct her staff on how to measure regurgitant jets. On days when Hariton and Napoli clients were scheduled, her office would conduct echocardiograms for twelve hours at half hour intervals, all with the same sonographer! Dr. Crouse spent little time actually reviewing and approving the results of these echocardiograms. She never met with the claimants, never reviewed their medical records, and largely relied on the law firms to provide the medical history required by the Green Form. Nonetheless, Dr. Crouse received \$725,000 from the Hariton and Napoli firms to say nothing of the \$2,000,000 or more that she earned from other law firms for interpreting fen-phen echocardiograms. When considering the thousands of echocardiograms that Dr. Crouse interpreted during the period that she worked for the Hariton and Napoli firms, her practice resembled a mass production operation that would have been the envy of Henry Ford.<sup>42</sup>

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*the Silica MDL Proceeding to Asbestos Litigation*, 12 CONN. INS. L. J. 35 (2006); Lester Brickman, *On the Theory Class's Theories of Asbestos Litigation: The Disconnect Between Scholarship and Reality*, 31 PEPPERDINE L. REV. 33 (2004); Lester Brickman, *False Witness*, WALL. ST. J. (Dec. 2, 2006).

<sup>39</sup> *Id.*

<sup>40</sup> Stiglitz, *et al.*, *supra* note 31; *see also* PRI study, *supra* note 1, at 39-43.

<sup>41</sup> Lester Brickman, *The Use of Litigation Screenings in Mass Torts: A Formula for Fraud?* 52-55 (2008) (unpublished manuscript available at [bepress.com](http://bepress.com)); Berkeley Rice, *Do these doctors give medicine a black eye?*, 80 MEDICAL ECON. 58 (Dec. 19, 2003); *see also* In re: Diet Drug Litigation, Master Docket No. BER-L-13379-04MT, 2005 WL 1253991 (N.J. Super. L.) (May 9, 2005) ("the techniques used in performing the echocardiograms fell so far below appropriate practice so as to make the data reported in the echocardiograms virtually worthless in either diagnosis or treatment").

<sup>42</sup> In re Diet Drugs Products Liability Litig., 236 F.Supp. 2d 445, 457 (E.D. Pa. 2002); *see also id.* at 462 (Napoli has "submitted numerous claims that are medically unreasonable").

These firms have suffered no disciplinary or criminal consequences.<sup>43</sup> As a result of such frauds, a settlement expected to cost \$3.75 billion ended up costing American Home Products and its successor tens of billions dollars more.<sup>44</sup> These billions are accounted for in Section I of the report, and do much to explain why the American tort system is so much more expensive than its European counterparts.

#### D. Indirect Losses from Effects on Innovation and Product Withdrawals

Last week's *Washington Post* had a heart-rending story by Gene Weingarten on the deaths caused by parents inadvertently leaving their children in the backseats of cars (itself an unintended consequence of airbag regulations that mean children are no longer seated next to their parents).<sup>45</sup> Weingarten documents an inventor who has created a safety device that would warn parents of a child left behind. But no manufacturer is willing to develop this product, which could save dozens of lives a year. Why? Because even if the product worked 99.99% of the time, the lawsuit from one failure would erase the profits from all of the other sales. Such is the perversion of our modern product liability laws, which have done more to hinder than to promote product safety.<sup>46</sup>

Product-liability litigation over the Ford Pinto drove American manufacturers away from building smaller cars in the 1970s, perhaps contributing to their current perilous financial state.<sup>47</sup> But this was not litigation that improved vehicle safety, because the Pinto was safer than comparable foreign subcompact vehicles. In 1975-76, the Pinto averaged 310 fatalities per year per million cars in operation. In comparison, the Toyota Corolla averaged 313, the Volkswagen Beetle averaged 374, and the Datsun 1200/210 averaged 405—a fatality rate more than 30 percent higher than that of the Pinto.<sup>48</sup>

As Harvard University professor John D. Graham stated at a Brookings Institution conference in 1990,

The case studies provide little evidence that expanded product liability risk was necessary to achieve the safety improvements that have been made. In the absence of liability risk, the combined effects of consumer demand, regulation, and

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<sup>43</sup> Napoli, Kaiser & Bern LLP is also named in multiple lawsuits alleging that it violated ethical rules in how it handled settlements for its clients in the fen-phen litigation. Anthony dePalma, *9/11 Lawyer Made Name in Lawsuit on Diet Pills*, N.Y. TIMES (Mar. 30, 2008); In the Matter of New York Diet Drug Litig., 15 Misc.3d 1114(A) at \*11 (2007) (“this Court finds that a sufficient showing has been made that the Napoli Firm may have violated the Disciplinary Rules and may have made material misrepresentations”), *affirmed*, In re New York Diet Drug Litig., 47 A.D.3d 586, 850 N.Y.S.2d 408 (2008) (permitting litigation to go forward); *see also* Buckwalter v. Napoli, Kaiser & Bern LLP, Case No. 1:01cv10868 (S.D.N.Y.) (dismissed without prejudice because of arbitration clause in clients’ retainer agreements).

<sup>44</sup> Alison Frankel, *Fen-Phen Follies*, AM. LAWYER (March 2005); *see also* NAGAREDA, *supra* note 1 at 143-51.

<sup>45</sup> Gene Weingarten, *Fatal Distraction*, WASH. POST., Mar. 8, 2008.

<sup>46</sup> *See also* American Medical Association, Report of the Board of Trustees, Impact Of Product Liability On The Development Of New Medical Technologies 79 (1988) (“Certain older technologies have been removed from the market, not because of sound scientific evidence indicating lack of safety or efficacy but because product liability suits have exposed manufacturers to unacceptable financial risks”).

<sup>47</sup> Ted Frank, *Rollover Economics*, 2 LIABILITY OUTLOOK NO. 1 (Jan. 2007).

<sup>48</sup> Gary T. Schwartz, *The Myth of the Ford Pinto*, 43 RUTGERS L. REV. 1013, 1028-32 (1991).

professional responsibility would have been sufficient to achieve improved safety. ... [I]here is no evidence that expanded liability for design choices has been a significant cause of the passenger safety improvements witnessed since World War II.<sup>49</sup>

Viscusi and Moore examined the indirect effects of product-liability costs on research and development, and found that excessive liability would substantially reduce research and development expenditures.<sup>50</sup> The PRI study suggested that the ultimate effect of this R&D loss was lost sales of new products of \$367 billion/year.<sup>51</sup> I am skeptical of that final conclusion; I believe that this analysis produces a number that is too high, and would imply that some industries are acting economically irrationally by foregoing research and development that would be profitable even in the face of excessive product liability. But even if the true number were a fraction of the PRI conclusion, it would be a deadweight social loss of \$30 billion to \$150 billion a year from product sales.

The effect is especially pernicious in the pharmaceutical industry. Pharmaceutical companies have essentially abandoned research on contraceptives in the United States because of fear of liability.<sup>52</sup> Similar problems arose from liability over childhood vaccines.<sup>53</sup> Bendectin, a drug for morning sickness that has been used safely and effectively in Europe and Canada for decades, has been unavailable in America since 1983 because of the litigation expense and risk from trial lawyers improperly blaming it for unrelated birth defects.<sup>54</sup> Hospitalizations of pregnant women for dehydration have doubled since it has been withdrawn from the market.<sup>55</sup>

A 2005 study found that every percentage point of decline in pharmaceutical revenues causes a reduction of 0.58% of R&D spending.<sup>56</sup> Another study finds that \$1,345 in pharmaceutical research results in one life-year being saved.<sup>57</sup> With an estimate of excess liability costs equal to 2% to 4% of

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<sup>49</sup> John D. Graham, *THE LIABILITY MAZE* 184 (Peter Huber and Robert Litan, ed., 1990). *See also* Murray Mackey, *id.* at 220-21.

<sup>50</sup> W. Kip Viscusi and Michael J. Moore, *Product Liability, Research and Development, and Innovation*, 101 J. POL. ECON. 161 (1993).

<sup>51</sup> PRI study, *supra* note 1 at 21-28.

<sup>52</sup> Marc M. Arkin, *Products Liability and the Threat to Contraception*, 36 MANHATTAN INSTITUTE CIVIL JUSTICE MEMO, Feb. 1999, [http://www.manhattan-institute.org/html/cjm\\_36.htm](http://www.manhattan-institute.org/html/cjm_36.htm); Warren E. Leary, *Obstacles are Said to Block New Kinds of Contraceptives*, N.Y. TIMES, May 29, 1996, at A16.

<sup>53</sup> Richard L. Manning, *Changing Rules in Tort Law and the Market for Childhood Vaccines*, 37 J.L. & ECON. 247 (1994).

<sup>54</sup> W. Kip Viscusi, *Corporate Risk Analysis: A Reckless Act?*, 52 STAN. L. REV. 547, 584 (2000) (“The risk of juror error coupled with high litigation costs led manufacturers to withdraw Bendectin from the market notwithstanding the continuing assessment by the FDA and the scientific community that Bendectin provides benefits exceeding its risks.”); G. Koren *et al.*, *Drugs in pregnancy*, 338 NEJM 1128 (1998) (noting lack of evidence that Bendectin was teratogenic given that birth defects had not declined after its withdrawal despite the fact that 40% of pregnant women took the drug).

<sup>55</sup> Paolo Mazzotta, *et al.*, *Attitudes, Management and Consequences of Nausea and Vomiting of Pregnancy in the United States and Canada*, 70 INT’L J. GYNECOLOGY & OBSTETRICS 359 (2000).

<sup>56</sup> Carmelo Giaccotto, Rexford E. Santerre, and John A. Vernon, *Pharmaceutical Pricing and R&D Growth Rates*, 48 J. OF L. & ECON. 195 (2005).

<sup>57</sup> R. Lichtenberg, *Sources of U.S. Longevity Increase, 1960–1997*, NBER Working Papers, Working Paper No. 8755, NBER (2002).

\$286.5 billion of annual sales, the billions of dollars of liability the pharmaceutical industry faces reduces R&D by 1% to 2.3% a year, or \$0.3 billion to \$0.7 billion/year, costing 220,000 to 520,000 life-years. The social cost to the economy, using a conservative value of \$50,000/life-year, would be \$11 billion to \$26 billion/year. This is a conservative estimate: in making cost-benefit analysis, NHTSA ascribes a statistical life-value of \$5.8 million,<sup>58</sup> which would work out to about \$150,000 to \$200,000 a life-year, implying an indirect social cost of \$33 billion to \$104 billion/year—from pharmaceutical litigation alone.

### **E. Indirect Losses from Securities Litigation**

As I have documented elsewhere, a substantial proportion of securities litigation settlements reflect purchases of extortionate “insurance” by risk-averse executives.<sup>59</sup> The effect is to reduce returns to investors while increasing risk, increasing the cost of capital to American businesses, especially start-ups and businesses in volatile industries like technology and biotechnology. This is potentially a tremendous drag on the American economy. The ultimate effect of this cost remains to be quantified; however, bipartisan groups have noted that the long-term effect on the American financial industry alone will be substantial if there is not reform.<sup>60</sup>

### **Conclusion**

A conservative estimate of the direct and indirect costs of the tort system on the United States is between \$600 billion and \$900 billion a year, a drag on the economy of between 4.3% and 6.5% of GNP. This estimate does not include the effect of recent Congressional legislation that substantially expands the ability of trial lawyers to bring lawsuits in federal court. Moreover, there is every reason to believe that if additional yet-to-be-quantified secondary and tertiary effects on economic resource allocation were included, the total would be substantially greater.

I welcome your questions.

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<sup>58</sup> Tyler D. Duval and D. J. Gribbin, *Treatment of the Economic Value of a Statistical Life in Departmental Analyses*, Department of Transportation, Feb. 5, 2008.

<sup>59</sup> Theodore H. Frank, Testimony, “Investor Protection: A Review of Plaintiffs’ Attorney Abuses in Securities Litigation and Legislative Remedies,” Capital Markets, Insurance, and Government Sponsored Enterprises Subcommittee of the House Banking Committee, Feb. 28, 2006; Ted Frank, *Arbitrary and Unfair*, WALL ST. J., May 31, 2007.

<sup>60</sup> *E.g.*, MICHAEL R. BLOOMBERG AND CHARLES E. SCHUMER, SUSTAINING NEW YORK’S AND THE US’ GLOBAL FINANCIAL SERVICES LEADERSHIP (2007); CHAMBER OF COMMERCE CENTER FOR CAPITAL MARKETS COMPETITIVENESS, STRENGTHENING U.S. CAPITAL MARKETS: A CHALLENGE FOR ALL AMERICANS (2008).