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On Harmonizing Laws and Evaluating Claims Processes

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I.

I am pleased that Professor Priest addressed the role of tort law in international competitiveness because this is an area of mutual concern to the participants in this conference. But what is the real story? One version is that American enterprise, losing out in world competition, is desperately looking for something to blame that loss on, and the tort system looks like a good excuse. Chief executive officers thus go around giving speeches railing against tort liability to cover up deeper failings. Another version is that tort liability really does importantly contribute to the decline in world competitiveness of American companies. Which is right?

My view is that the question is too narrowly phrased. Enterprises in all countries are concerned, not just about tort law overhead, but also about the full range of accident and illness costs suffered by their employees, their customers, and others who might be affected by their activities. These are costs they may be required to bear through tort liability, through compensation systems like workers' compensation, through employment-based social insurance and health insurance schemes, and so on. And all those costs can potentially have some effect upon an enterprise's international competitiveness.

That is why I think it is too narrow to focus only on tort liability costs when addressing the issue of international competitiveness. For example, under my reform proposals, American tort liability for enterprises would be largely eliminated,²⁴ and that might help make

²⁴ STEPHEN D. SUGARMAN, *DOING AWAY WITH PERSONAL INJURY LAW* (1989) [hereinafter SUGARMAN].

American companies more competitive. But, of course, I admit that my plan would impose on them new costs through expansion of the social insurance and employee benefit system. And, while the net effect is meant to lead to a cost reduction, the additions certainly should not be ignored.

Professor Priest spoke about the movement towards uniformity in tort liability among industrialized nations. I want to explore a distinction I see between uniformity brought about through competition and uniformity attained through harmonization.

Suppose, for example, we think about trying to harmonize the provision and funding of unemployment compensation and workers' compensation among industrially developed nations. If harmonization implies a movement towards the norm, then the financing of these schemes would not rely upon experience rating at the individual firm level. Firms would pay differing rates for workers' compensation based upon their industry-wide experience. Unemployment compensation would be funded through a uniform national payroll tax, or its equivalent.

Notice that the harmonization solution would not be the current American solution, which, to a substantial extent, bases an individual firm's costs on the unemployment and workers' compensation benefits paid out to its employees.

Several economists in the U.S. have argued, however, that experience rating is "efficient" because it causes employers to take socially desirable preventative actions to reduce work accidents and to reduce uneven employment levels. Suppose for the moment that this is the correct analysis (a matter of some dispute).

Now we see a potential conflict between competitive advantage and the harmonization of national legal regimes around common solutions.

This, in turn, suggests that if international competition is its goal, a country may not be interested in harmonization of legal regimes. Indeed, it suggests that an "efficient" legal system, even if adopted in but a few places, has the potential to undermine an otherwise common regime and force a kind of "invisible hand" harmonization around it. Put differently, each country faces pressures to adopt a least cost, lowest-common-denominator, solution, even if it means most countries changing their rules.

Yet, there are also pressures the other way. Legal regimes that help a country's firms internationally can have very undesirable result on that nation's domestic population. To put it simply, one good way to

be internationally competitive is to drive down your wages. But that is obviously undesirable in other respects.

A better strategy, then, is to see if you can get something for nothing. That is, try to find some feature you can take out of your legal system which is both causing trouble for your enterprises and not really much benefiting your people. The issue, of course, is whether there really are features in your legal systems that people can agree both do damage and little good and hence should be changed.

For me, two features of the American tort system that have this quality are first the very high transactions costs that accompany the operation of U.S. tort law, and second, the enormous sums paid out for intangible losses. To be sure, it's a fair question as to whether we would sacrifice something important by sharply reducing these costs. Unlike me, others feel we would; they value both the individualized administrative process (where claimants are represented by high priced lawyers) and the award of large, individualized sums for pain and suffering. The upshot is that until more people with political power think as I do, American tort law is not likely to be substantially changed even if it has negative effects on our firms' ability to compete abroad.

Just how great a burden is American tort law anyway? My understanding is that, for the overwhelming proportion of American enterprises, the direct cost of tort liability is well under one percent of sales. This seems rather small. Indeed, for most firms surely it must be true that differences in tax costs, social insurance costs, labor costs and the like are far greater from one country to another than whatever differences there are in tort liability burdens (no matter how slight the tort law burden elsewhere). And besides, firms from abroad that compete in the U.S. face U.S. tort law burdens too.

On the other hand, this does not mean that the tort burden is simply unimportant. For one thing, in some sectors of the economy the direct cost is substantially greater than one percent of revenues. I understand that in the hospital sector, for example, it may amount to three percent.

Furthermore, a few individual firms and firms providing a few products have been subjected to enormously burdensome liability. Maybe these burdens are deserved, and maybe they are not. For executives looking from the outside at these few high visibility defendants, their concern is that they too might be drawn into that turmoil despite their best efforts to avoid that fate.

If the response to this fear were simply to redouble safety efforts, this would probably be a good thing, even though putting too much

money into safety can at some point be wasteful. But the bigger concern is that this fear discourages innovation. In short, how much does the possibility of embroiling the enterprise in potentially ruinous litigation make firms excessively cautious and unwilling to bring out what would be socially desirable new products?

The very interesting new book sponsored by the Brookings Institution called *The Liability Maze*²⁵ contains several very interesting and quite insightful, although, ultimately, I think, not dispositive, chapters on innovation effects in various industries. That clearly is an area that needs more research.

This is very difficult work to carry out, like identifying the dog that did not bark, because you have to focus on desirable products that are not introduced but would have been but for the fear of liability. But it is possible that the most important negative consequence of American tort law on U.S. international competition is its chilling of innovation.

II.

Berkeley Professor Tom Tyler, a social psychologist, has been looking at how satisfied people are with different types of dispute resolution mechanisms. He finds that people decidedly care about the process as well as the outcome. Furthermore, he finds that people are more satisfied with trial-type processes than they are with arbitration, and they are more satisfied with arbitration than they are with litigation that leads to settlement.

Some people who have seen this work claim that it demonstrates the importance of maintaining the traditional personal injury law system. But I read the evidence in the opposite way. I say that because I believe it is wholly implausible to think that we could ever operate a system in which all accident disputes are resolved through trials. Therefore, we are necessarily stuck, under tort law as we now know it, with an overwhelming proportion of claims being resolved through litigated settlements which Professor Tyler shows are not so satisfying to people.

If we are going to be concerned with how claimants feel about the process they encounter, the key comparison, I think, is between tort settlements and claims filed under compensation schemes or first party

²⁵ THE LIABILITY MAZE: THE IMPACT OF LIABILITY LAW ON SAFETY AND INNOVATION (Peter Huber and Robert Litan, eds. 1991).

insurance arrangements. Perhaps Professor Tyler will next examine this comparison.

Another interesting researcher whose work is relevant to us is Andrew Tobias, a freelance writer who lives in Florida. He wrote a book called *The Invisible Bankers* about the insurance industry. Tobias has made a very creative proposal that would both provide us with good information about people's satisfaction with their insurance carriers and, he hopes, prompt better customer service.

Under the Tobias plan every time you have a transaction concerning an insurance claim, you would be given a performance evaluation form to complete and send to the appropriate public agency, such as the state insurance commissioner. Tobias then links the ratings insurers obtain from claimants with new business they are able to write. There are many ways to link the two that I will not take the time to explore here.

What I want to emphasize instead is that this technique could be employed in other settings as well. For example, how about patient evaluations of hospitals that might be linked to the hospital's reimbursement rate under from health insurers?

Professor Jerry Mashaw has written about management evaluation techniques that can be used to improve the service delivery by a bureaucracy, with a focus on welfare and social security benefits. One such strategy is quality control in which, for example, a sample of cases is retrospectively audited and the agency is fined or receives a bonus based upon the results of the performance evaluation.

Yet another technique for controlling bureaucracies is through whistle-blowing awards. The American Law Institute's recent Reporters' Study of personal injury law has recommended that, if companies disclose dangers they know about, this will help them make out a "regulatory compliance defense" in a tort suit.²⁶ That is an interesting idea, but it should not be the only way to prompt firms to disclose product dangers. I propose that if a company does not disclose a danger before a citizen comes forward and points that danger out, the enterprise would be subject to a fine. And out of the fine, a substantial share (perhaps half) would be paid to the whistle-blower who brought the danger to the public's attention. The hope, of course, is that the threat of the fine and public disclosure would prompt the firm to come forward earlier on its own.

²⁶ 2 ALI REPORTERS' STUDY, *supra* note 2 at 83-110.

The more general point here is that those of us interested in public policy toward accidents should direct our imaginations towards evaluation techniques of two sorts: (1) those which promise to induce claims handling bureaucracies to provide service that claimants find satisfying, and (2) those which will prod risk creators to take socially desired safety precautions. The development of effective evaluation systems can make alternatives to tort law all the more appealing.