Golden Lawsuits in the Golden State

Steven Hayward

Nearly a decade has passed since voters ousted Chief Justice Rose Bird and two of her colleagues from the California Supreme Court, in large part over their controversial decisions on the death penalty and other social issues. But some of the most radical decisions of the Bird Court broadened the state's liability rules. Even though the Bird Court was repl aced with Republican-appointed justices, only a few small changes have been made in liability law.

Land of the Lawsuit

Laws in a free country should protect the life, liberty, and property of citizens. Laws should be clear and understandable, so that citizens will know what is permissible and what is not. This is especially necessary for entrepreneurs who risk money and time on businesses with no guarantee of success. Risks from physical disasters can be covered by insurance. Other physical risks can be reduced by prudent preventive measures. But in California, the tort law system, rather than protecting life, liberty, and property, has itself become a threat to these. The uncertain and arbitrary nature of the system makes it difficult for businesses to take precautions against risk. The system itself arms those who would prey on businesses as surely as would the criminal justice system if it handed out guns and burglary tools rather than prison sentences to convicts.

Any serious attempt to revive the economy of California must entail fundamental reform of tort and liability law. California, with 12 percent of the nation's population, has 17 percent of the nation's lawyers. There are more lawyers in West Los Angeles than in the entire country of Japan. A handful of plaintiff lawyers, probably less than 2 percent of all California lawyers, spend more than $100 million a year advertising for clients on television, radio, and in print media. More than 850,000 lawsuits were filed in California courts in 1992—one for every 31 Californians.

Nearly every day brings news of another preposterous lawsuit or a multi-million dollar judgment in California. In some cases citizens lodge frivolous suits against governments. Example:

- A lawyer who had received three speeding tickets in his Porsche in the same speed trap

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sued the city of Huntington Beach for $60 million, claiming the speed trap amounted to "racketeering" under the Racketeer Influenced and Corrupt Organizations Act.

But in other cases such suits hit businesses, adding to costs and, perhaps worse, making it difficult or impossible for businessmen to take reasonable precautions to avoid such suits. Examples:

- A bank robber who stuffed the stolen money in his pants was injured when the red dye cartridge that banks typically slip into stolen cash blew up. He sued the bank and the city of Oakland for $2 million. It was 2 years before the case was finally dismissed during which time the bank and Oakland taxpayers had to pay thousands of dollars in legal fees.
- An even more notorious case concerned a San Francisco taxi driver who chased a mugger with his cab, eventually pinning the mugger against a wall with his bumper. The mugger successfully sued the cabdriver because his leg had been fractured, and was awarded $24,595. The award was later overturned, but the cab company spent $68,000 defending the case.
- In Redding, a man who had fallen through a skylight while burglarizing a building was awarded $250,000.
- A jury in Riverside ordered Health Net, the state's second largest health maintenance organization, to pay $89 million in damages to the family of a woman who was denied a costly, experimental bone marrow transplant for her advanced breast cancer. The woman subsequently received the experimental treatment elsewhere, but died within four months anyway.

These egregious examples are only the tip of a large iceberg. The cost of litigation in California—often dubbed the "tort tax"—is estimated by David Faustman, an attorney at the law firm of Latham & Watkins in Los Angeles, conservatively to be at least $10 billion a year, and is likely much higher. According to Faustman, for example, 30 percent of the final price of a ladder, and over half the price of some vaccines, are attributable to tort costs. Because over 90 percent of civil lawsuits in California are settled without a trial and usually for confidential amounts, it is impossible to tally the total direct costs accurately, let alone the indirect costs of lost or diverted investment capital, abandoned product development, defensive business practices, and so forth.

The political economy of the frivolous lawsuit, the kind of tendentious suit filed with the intent of turning a small settlement because its settlement value is less than the cost of defending the suit, is well developed in California. Not surprisingly, the cost of liability insurance in California is above the national average. A 1992 study by the Association for California Tort Reform, for example, surveyed states perceived as major competitors of California: Arizona, Colorado, Florida, Georgia, Illinois, Massachusetts, Nevada, New Jersey, New York, North Carolina, Oregon, Texas and Washington. It found that liability insurance consumed 6.8 percent of a firm's revenue in California, compared to a range of 3.7 percent to 6.3 percent for the other states.

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Costs to the Economy

The opportunity costs to the economy of frivolous litigation an significant. According to a study by the Rand Corporation's Institute for Civil Justice, just a single area of tort law, wrongful employment termination suits, reduces California employment levels by as much as 4 to 5 percent, or by as many as 650,000 jobs. This amount of additional employment could be expected to generate at least $500 million in income tax revenue to the state, not to mention other revenues. Lawsuits and the fear of lawsuits stifle innovation and new business start-ups. A statewide survey of businesses by Southern California Edison and annual surveys by the California Business Roundtable have found that fear of lawsuits ranks high among the reasons businesses are relocating or expanding outside of California.

The shadow of tort liability falls on some seemingly unlikely places. Architects, for example, are experiencing difficulty obtaining insurance coverage because of the increasing number of lawsuits filed over design and construction defects. The California Council of the American

"THANKS TO US, EVERY DAY IS JUDGMENT DAY."

Institute of Architects estimates that 50 percent of California architects are going without insurance. Those who do have insurance pay an average of $34,000; in most other states insurance premiums for architects run from $18,000 to $29,000. Other professions and trades face similarly high premiums for liability insurance.

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Science magazine reports that two California biotech firms, Genentech and Immune Research, have halted or delayed research on AIDS vaccines because of liability fears. The Lawrence Livermore Laboratory abandoned plans to adapt its particle accelerator technology for an insect control device because of liability concerns. Even with the current mania for moving away from chemical pesticides, California farmers can only buy high-tech bug zappers from foreign manufacturers.

Predatory Litigation

There are several kinds of predatory litigation practiced in California in addition to the standard product liability and injury-related negligence actions that have become more typical throughout the United States California's environmental laws provide ample opportunities for private parties to bring lawsuits. The California Environmental Quality Act (CEQA) allows private parties to file suits that can force endless revisions to environmental impact statements, leading to delays in construction projects that can last years if not preventing a project outright. Because of this process it is not unusual for environmental impact statements to be more than 1000 pages long.

While CEQA is not a lucrative avenue for lawsuits—e.g., it has no damage or attorney fee provisions—other environmental laws indeed can be profitable for lawyers and plaintiffs. Consider California's toxic labeling law, approved in 1986 as Proposition 65. Under this Proposition even ordinary beach sand must be labeled as a carcinogenic substance if it is bagged for garden use. Literally, the harmless substance poured into a child's sandbox, according to the state of California could cause cancer.

Worse, Proposition 65 has a "bounty hunter" provision, allowing private parties to bring suits against any product they suspect is harmful, and collect for themselves whatever punitive damages may be awarded. For example, a consumer group calling itself "As You Sow" has sued 14 major cosmetic firms over a minor ingredient in nail polish, toluene, that is "listed" as a carcinogenic substance under Proposition 65; California's Attorney General had investigated this ingredient and declined to bring a state action. Toxicological studies have found toluene produces no ill effects in animals at levels more than 1000 times higher than the Proposition 65 warning standard. The suit seeks $2,500 a day in penalties from manufacturers.

California has also seen huge class action suits brought supposedly on behalf of consumers. A favorite target of class action is financial institutions, especially banks and insurance companies. California banks have been hit with huge judgments because of their $5 late fee on credit card accounts. The big winners, of course, are the lawyers who collect millions in legal fees, and consumer groups who receive part of the punitive damages designated to them. For example, Wells Fargo Bank in San Francisco and First Interstate Bank in Los Angeles were forced to pay two consumer groups, Consumers Union and Consumer Action, a total of $1.4 million in a credit card fee overcharge case. Credit card holders received only a $3 credit each, but picked up the tab elsewhere to cover Wells Fargo's and First Interstate's $25 million in legal defense costs as well as the $7.5 million in attorney's fees awarded to the plaintiff lawyers. Similar cases are pending against other major California banks, all of whom are thinking of moving their credit card operations outside of California.

Sharing the Loot

Another favorite area of litigation is shareholder suits against publicly traded companies, especially high tech firms founded with venture capital and taken public in the hopes of rapid growth. Plaintiff lawyers look for companies whose earnings have not measured up to forecasts, or whose stock prices decline unexpectedly by 10 percent or more, and bring class action suits against the company alleging misrepresentation or even fraud. A survey of 212 publicly traded, venture capital-backed firms in California, conducted by the American Electronics Association, found that 36, or 17 percent of all such firms, had been hit by at least one class action suit. The sued companies reported that they spent an average of $692,000 in legal fees to defend themselves, and devoted more than 1,000 hours of top management time dealing with the suits. The average settlement of the suits was $4.5 million, with nearly 40 percent going to the plaintiff lawyers.

Consumers or shareholders who were supposedly ripped off usually receive little from class action suits. In most cases of this sort, shareholders typically receive a few cents a share. Examples:

- In a recent settlement of an antitrust case involving infant formula that dragged out over thirteen years in California, the plaintiff attorney received $3.75 million in legal fees, with another $8.75 million going to a San Francisco food bank. Consumers received nothing at all.
- An especially perverse case of predatory litigation involved a Northern California water district sued for discriminatory pricing on water hook-ups. The case was settled with each lot owner receiving about $500 in damages, but the uninsured district was owned by the lot owners, who suddenly found themselves on the hook for millions in legal fees. "I didn't realize I was suing myself," said the class action plaintiff in the case.

Terminal Cases

The leading area of exposure for all California employers is wrongful termination suits, which proceed under the terms of California's Fair Employment and Housing Act. These suits make up as much as one-fifth of the 850,000 lawsuits filed in California each year. Even though more than 90 percent of these cases are settled out of court, the settlement amounts, most of which are confidential, are probably high. This is suggested by the fact that the average jury verdict in cases taken to trial since 1988 is $426,000. Several major companies have been hit with large judgments in wrongful termination cases, including Texaco for $20 million, Shell Oil for $7 million, and Hughes Aircraft for $3.9 million.

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The terms of the statute that generates these suits are very broad, and allow an aggrieved employee to collect even if the employee quits a job voluntarily. In one widely publicized case, *Hunio v. Tishman*, a disgruntled management employee for a construction company, who voluntarily quit, was awarded $7.1 million on grounds that his working conditions were intolerable. A state appeals court that reviewed the trial court decision upheld the verdict and the damage award, but noted:

> Although, under the present state of the law, we can find no error with the jury's verdict in this case or the trial

> court's affirmance of the amounts in issue, it is quite clear to this court that there is a desperate need for legislative action.
>
> This area of the law is quickly running out of control and the citizens of California will be the ultimate victims and losers. . . it is clear that commerce in California cannot flourish with such multimillion dollar verdicts readily attainable. . . If the Legislature fails to act in the area, we see that, in due course, business enterprises must flee the state.

A separate concurring opinion by another judge in the case echoed this view, noting that wrongful termination suits are "one of the reasons some of the companies are moving away. . . accumulation of this type of litigation promises nothing but ill for employees of companies which can no longer absorb this kind of business cost."

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The Rand study of the costs of wrongful termination suits concluded that the direct cost of liability is only about $12 per employee, but that the *indirect* costs are much more substantial. In addition to depressing the level of employment in California by 4 to 5 percent, the Rand study noted that "the business community has reacted to increased employment liability by adopting preventive measures that carry notable hidden or indirect costs. . . Firms may provide large severance payments, retain poor performers, and respond to business expansion by using contractors, part time employees or increased overtime."

Legacy of Judicial Negligence

As has been noted by previous authors, such as Peter Huber and Walter Olson, California has long been the vanguard for the expansive interpretation of tort liability. William Prosser, the late professor at Hastings School of Law in San Francisco and author of the most widely used textbook on tort law, noted years ago that "more than any other branch of the law, the law of torts is the battleground of social theory." Long before the Bird Court explicitly radicalized what Peter Huber aptly described as a "legal revolution," the California Supreme Court was substantially transforming tort law into a means of wealth redistribution.

The first breach appeared in Justice Roger Traynor's famous concurring opinion in the 1944 case of *Escola v. Coca Cola Bottling Co.* In *Escola*, the California Supreme Court held Coca Cola Bottling Co. to be negligent for a bottle that had exploded in plaintiff Gladys Escola's hand. Impatient with the court's opinion that based the award on negligence, Traynor introduced the idea of broad social fault. "I believe," Traynor wrote, "the manufacturer's negligence should no longer be singled out as the basis of a plaintiff's right to recover in cases like the present one." Updating the old progressive argument about the impersonal nature of modern industrial economies, Traynor advanced the idea of social fault and the responsibility of "society" to compensate individual victims of misfortune regardless of the individual responsibility for whatever misfortune someone experienced.

"Even if there is no negligence," Traynor wrote further, "public policy demands that responsibility be fixed wherever it will most effectively reduce the hazards to life and health inherent in defective products that reach the market." Note the appeal to the demands of *public policy*, rather than law. Even if it can be shown that a manufacturer has not produced a defective product or acted negligently, Traynor argued that they should be held strictly liable anyway, because "the risk of injury can be insured by the manufacturer and distributed among the public as a cost of doing business." While this line of reasoning might be the basis for a legislative debate over which public policies should be adopted to allocate and compensate for risk, Justice Traynor's opinion represents a clear case of legislation by judicial fiat.

By the 1960s Justice Traynor, still sitting on the high court, was extending his ideas as the majority opinion of the court in several path-breaking tort liability cases. For more than a generation before the arrival of Rose Bird in the late 1970s, the California Supreme Court broadened liability rulings consistently in favor of plaintiffs based on the twin presumptions that big business should shoulder the cost of injury regardless of negligence, and that individuals are largely helpless "victims" of modern society who cannot be assigned any responsibility for accidents and injuries they experience. Hence, in cases such as *Li v. Yellow Cab Company* (1975), *Daly v. General Motors* (1978), and *American Motorcycle Association v. Superior Court* (1978), the California Supreme Court imposed huge judgments on the corporate defendants even though it was acknowledged that the plaintiffs in the cases were in large part responsible for the accidents that caused their injuries.

With such rulings, the California Supreme Court abandoned traditional tort liability rules such as contributory negligence, under which a plaintiff who was partially responsible for the injury through his own negligence was limited in what he could recover from the defendant. The court's new rules rendered corporate defendants virtually defenseless against damage suits. Coupled with the expansive "deep pockets" doctrine of joint and several liability, under which a single defendant could be held liable for the entire amount of a damage award even if they were only found partially at fault for the injury, California's tort liability regime had arrived at Justice Traynor's promised land of socialized fault. An out-and-out scheme of wealth redistribution is closer to the heart of the matter.

Reversing the Trend

In 1984 California voters passed Proposition 51, which limited "deep pockets" joint and several liability for non-economic pain and suffering damages to the proportion of fault of the defendant. In other words, if a defendant was deemed to be 10 percent responsible for the injury, his liability would be limited to paying just 10 percent of any pain and suffering or punitive damage award. A defendant could, however, still be liable for 100 percent of economic damage awards. Oddly enough, the California Teachers Association, normally a close political ally of the California Trial Lawyers Association, was a strong backer of Proposition 51. This was because among the chief victims of the "deep pockets" doctrine were school districts that were getting hit with suits for injuries occurring on school grounds. By 1984, many school districts in California were having difficulty obtaining liability insurance.

While Proposition 51 was a step in the right direction, it left untouched most of the broader principles of the flawed tort liability regime that had been promulgated by the courts. Even though 6 of the 7 justices on the present California Supreme Court were appointed by Republican governors, the court has not rolled back this regime with anything like the same kind of ardor with which its predecessors installed it. It did make minor changes in a few select areas. First, it has renewed use of the doctrine of assumption of risk on the part of product users. Second, it has revived an insurance contract exclusion that applies to cases in which a person intentionally uses a product in a harmful or improper manner. Third, the court has restricted "forum shopping." This is a practice in which foreign plaintiffs seek to sue in California courts for injuries incurred overseas. These and other changes have restored some balance between plaintiffs and defendants.

More than 70 percent of voters in a recent poll agree with the statement that excessive litigation is harming California's economy and driving up taxes and insurance costs.

But it is difficult to curb excessive litigation simply through changes in liability rules, even if the courts are inclined to go further in this direction, because plaintiff lawyers are successful in generating small settlements simply through the *threat* of a suit. This situation is unlikely to change until the incentive structure of the plaintiff bar is changed. Under Federal Rule of Civil Procedure Rule 11, for example, lawyers who file suits deemed to be frivolous or without merit by the court can be hit with sanctions or penalties. No such rule exists in California law.

But even Federal Rule 11 has problems. First, it is largely unenforced by the Federal judiciary, because judges are reluctant to impose sanctions or penalties. And second, the "loser pays"-idea itself might not work as effectively as its boosters suppose. California already has a limited form of the "loser pays"-rule in certain circumstances. Under California Rule 998, if a party to a suit rejects a settlement offer in favor of taking a case to trial, and the subsequent verdict comes in for *less* than the settlement offer, the party that rejected the offer is liable for the legal fees of the other party.

The rule is obviously intended to help promote pre-trial settlements. But this rule is seldom enforced, because the losing party often threatens to appeal the verdict unless the other party agrees not to seek their legal fees under this rule. Judges who like to see cases cleared from their dockets usually facilitate these unwholesome deals, putting pressure on the contending parties to make a final settlement and go away. It is because judges resist disciplining the plaintiff bar and incentives favoring small out-of-court settlement exist that most legislative changes have not been effective in curbing the growth of liability.

Further, in California, as opposed to other states such as Texas, the trial lawyers are heavily represented in the legislature, and prevent most meaningful reforms from seeing the light of day. Trial lawyers make up one of the leading sources of campaign cash for state legislators; they donated about $3 million in campaign contributions during the last three election cycles to state legislators. San Diego attorney William Lerach, who specializes in shareholder class action suits, is one of the leading donors to the Democratic National Committee as well as state politicians, with contributions of more than $1 million.

The one exception in California that tort reformers can point to as a clear success is in the area of medical malpractice. Following the medical malpractice insurance crisis in the mid-1970s, the state legislature enacted (MICRA), the Medical Injury Compensation Reform Act, which placed a $250,000 cap on "pain and suffering" awards in malpractice cases. MICRA also requires that juries be informed if a plaintiff has received any compensation for his injury from other sources, such as disability insurance. Since MICRA, medical malpractice insurance rates have risen more slowly in California than in the rest of the nation, and the number of frivolous cases going to trial has declined. The limit on "pain and suffering" awards has limited a lawyer's leverage to demand a huge lump sum settlement, and the cap has also made settlement awards more predictable. While California ranks very high nationally in the number of million dollar liability verdicts overall, it experienced million dollar verdicts in medical malpractice cases at about half the national average, measured in terms of verdicts per 1,000 doctors, and less than one third the rate of Florida or New York.

Conclusion

Recent opinion polls show that voters in California are coming to understand the high cost of excessive litigation. More than 70 percent of voters in a recent poll agree with the statement that excessive litigation is harming California's economy and driving up taxes and insurance costs. Large majorities favor tort reform. The excessively broad understanding of tort liability was largely invented in California, and spread like a plague across the nation. But like the tax revolt that began in California with Proposition 13, a wave of tort reform may begin here too.

Selected Readings

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