

Cato Handbook *for* Policymakers

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28. Tort and Class Action Reform

State legislatures should

- enact punitive damages reforms;
- eliminate joint and several liability;
- strengthen judicial review of dubious expert testimony; and
- prohibit government litigants from engaging private attorneys on contingency fee.

Congress should

- restore meaningful sanctions for meritless litigation in federal court;
- constrain courts' long-arm jurisdiction over out-of-state defendants;
- enact a federal choice-of-law rule for multistate litigants in product liability cases; and
- implement further reforms for class actions that cross state lines.

Both state legislatures and Congress should

- strengthen the role of contract and consent-based alternatives to tort litigation, including predispute arbitration, venue selection, disclaimers of liability, and assumption of risk.

Although America has long been considered a litigious nation, its lawsuit sector really took off after the 1960s, following changes in the law aimed at making it easier to sue. As a share of the U.S. economy, tort costs are two-and-a-half times as high as in Western Europe and four times as high as they were after World War II. The direct cost of American tort litigation is upward of \$250 billion a year, a figure that does not include important categories such as securities litigation and the multistate tobacco settlement.

In a global marketplace, that means costs are not competitive, business investment is discouraged, there are fewer jobs, and wealth is reduced.

Widely shared discontent over the many ill effects of litigation has made lawsuit reform a popular issue at both state and federal levels. At the state level, advocates have enjoyed considerable success. For example, with California's Medical Injury Compensation Reform Act in the lead, most states have enacted curbs on medical malpractice litigation. The result has been a turnaround in what was once a soaring rate of claims and insurance rate increases associated with that sector.

At the federal level, reform has faced tougher resistance. It is true that Congress has enacted two broad-based reform laws, applying to securities litigation and to multistate class actions, as well as a number of more specialized bills pertaining to specific areas, such as gun liability and small aircraft liability. One reason the federal government has not taken the lead in more areas is that the predominant share of injury litigation goes on in state courts, rather than federal. Under our constitutional structure, though the federal government does play some role in supervising state courts (for example, when they infringe on constitutional rights, or when one state rules on matters affecting the rights of residents of other states), that role does not extend to broadly displacing state authority over conventional, usually smaller, in-state disputes.

State-Level Tort Reform

Because of the strong ongoing interest in state-level reform, lawmakers can choose from a large menu of ideas that have proved themselves in other states. Here are four.

First, states should limit or abolish the availability of punitive damages in civil cases. One good beginning would be to limit them to cases involving actual malice, intentional wrongdoing, or gross—as distinct from ordinary—negligence. Punitive damages share some of the functions of criminal law, and thus call for—yet commonly lack—procedural protections that parallel those afforded criminal defendants. Among those protections is a higher burden of proof than the usual civil standard, which is preponderance of the evidence. Another is double jeopardy protection. Current rules allow punitive damage claims over the same conduct to be made again and again in multiple lawsuits. Another is protection against coerced self-incrimination by way of compulsory discovery. Many modern jurisdictions do not allow civil claims for punitive damages at all.

Second, states should dispense with joint and several liability. That's the "deep pockets" rule that permits plaintiffs to collect all of a damage award from any one of multiple defendants, even if the paying defendant was responsible for only a small fraction of the harm. The better rule is to apportion damages in accord with defendants' degree of culpability.

Third, holdout states should join the predominant trend toward stronger judicial review of expert testimony (so-called Daubert review, after the leading Supreme Court case) to cut down on speculative litigation based on flimsy scientific premises.

Fourth, contingency fee contracts between private lawyers and government entities should be prohibited. Private lawyers acting on behalf of government should bear the same ethical responsibility as in-house government lawyers—as public servants beholden to all citizens, including the defendant, and obliged to seek justice. Imagine a state attorney receiving a contingency fee for each indictment, or a state trooper receiving a bonus for each speeding ticket. Contingency fees are equally corrupting.

Tort Reform That Respects Federalism

The Constitution foresees a number of roles for Congress in supervising civil litigation. The least controversial is Congress's power to prescribe rules for the handling of lawsuits brought in federal courts and those based on the federal government's own laws. One example is sanctions against meritless litigation in federal courts under so-called Rule 11. Congress should enact a measure restoring strong sanctions, which were unwisely cut in 1993 after a decade-long experiment in vigorous sanctions. Sanctions should be based on the monetary cost of responding to meritless claims and motions, as specified in the bill known as the Lawsuit Abuse Reduction Act.

Congress also has considerable power to supervise the doings of state courts—for example, when those courts violate litigants' due process, impair the obligation of contract, or abridge the privileges and immunities of citizens of other states. But its power is not "plenary," or unlimited; it may act only when it can cite constitutional authority. Some proposals for federal-level malpractice reform, for example, are unwisely premised on broad New Deal readings of the power to regulate interstate commerce.

On a practical level, not every national problem requires a federal solution. Most states have capped damages in health care suits, with favorable results for their climate of medical practice, and virtually all have at least considered reforms. In the long run, excessive lawsuit recoveries by in-state plaintiffs against in-state doctors over in-state therapy are likely

to generate in-state political pressure for reform. The substantive rules of tort law are not commerce, and proposals to override them with federal law because they have some indirect effects on interstate commerce have no obvious stopping point. Congress is better off focusing its energy on lawsuits in which a state is tempted to assert its sovereignty beyond its borders through its courts. Federal procedural reforms do have an important role to play in curbing that behavior.

Federal Procedural Tort Reform

A guiding principle in supervising interstate litigation is that federal lawmakers and courts are authorized to act when there is a high risk that states will appropriate wealth from the citizens of other states. One federal reform consistent with that principle is to amend the currently lax and ambiguous rules that control state exercise of so-called long-arm jurisdiction over out-of-state businesses. Congress might, for example, preclude a local court from hearing a case unless the defendant engages directly in business activities within the state. A company's mere awareness that the stream of commerce could sweep its product into a particular state should not suffice to confer jurisdiction. A sensible rule would give firms an exit option—that is, they could withdraw from a state and thus avoid the risk of a runaway jury, even if a product somehow ends up in the state.

A second federal reform compatible with federalist principles is a federal choice-of-law rule to prescribe which law governs in cases where plaintiff and defendant in product liability cases are from different states. It might provide that the applicable law is that of the state where the manufacturer was located, or where the product was first sold to a consumer. Consumers would be on notice of the system and could evaluate the rules, if of a state other than theirs, when deciding whether to buy a particular manufacturer's product. States would be more likely to balance the voting interest of in-state consumers against the in-state benefit of a healthy retail or manufacturing sector. In effect, competition among the states would enlist federalism as part of the solution to bad incentives.

The Class Action Fairness Act and Beyond

Multistate class actions were once a rarely used procedural device designed to litigate an assemblage of largely identical claims. In the last half century, they have morphed into a commonly used device for bundling

cases that are often quite dissimilar but which together may command a higher settlement value and steering them into a favorable court.

The 108th Congress attempted to address the latter problem in the Class Action Fairness Act of 2005 (CAFA) by giving defendants the power to remove some class suits from state to federal courts. Although helpful, CAFA left unresolved many issues that courts have had to address through prolonged litigation. Congress should clarify CAFA's gaps and advance the fairness of the process in ways that go beyond the 2005 law. Following are three suggestions to address gaps and four suggestions to go further.

First, under CAFA, a class action can be removed to federal court so long as at least one-third of the class members reside outside the state where the suit was filed and the amount at stake overall exceeds \$5 million. The amount-in-controversy threshold, in particular, occasions needless litigation since plaintiffs' damage theories at the outset of a case may lack specifics. Congress can and should clarify what types of evidence and level of certainty are needed to establish a basis for removal. In general, because most national class actions do seek more than the \$5 million threshold, Congress should set a rebuttable presumption in favor of removal for national classes.

Second, the key make-or-break stage in a case is typically the motion for class certification. CAFA did not explicitly provide that one federal court's denial of certification bars attempts to relitigate the question before other federal courts. Congress should spell out that federal courts have power to enjoin multiple bites at the certification apple when one has been adequately argued.

Third, CAFA does not provide a means for removal of cases in which plaintiffs' lawyers and defendants, in effect, collude against the interests of the class. At present, if they have in mind what is known as a "sweetheart settlement"—one in which the lawyers get a big payoff, defendants get a slap on the wrist, and absent class members recover little or nothing—they can file in a friendly state court and simply not file removal. Congress should provide that absent class members, and not just defendants, can file for removal.

Beyond plugging gaps in CAFA, Congress should seize the opportunity to rethink the class device itself in its current form. The present rules create a presumption that individuals out of court, who have not affirmed their connection to the class, favor being represented on nothing more than the say-so of the trial lawyer who steps forward to file the action. Modern class-action lawyers often claim to represent the interests of thou-

sands or even millions of people who have no idea that they are litigants at all.

Lawmakers should take four steps to confine class actions to the kinds of cases in which they can best advance justice:

1. Class action rules should require would-be litigants to affirmatively *opt in* to a class action (for example, by mailing a consent form to the court) before being counted as part of the class.
2. Class action rules should assure defendants of their due process right to assert defenses that may apply to some but not other individual plaintiffs. Presently, classes are certified even when a governing statute or common-law rule requires that key elements of proof—such as reliance, causation, or damages—be shown on an individual basis. That means trial lawyers can use the class device to combine tens of thousands of factually dissimilar claims into one proceeding, making it impossible for defendants to adequately smoke out and identify weak or meritless individual claims. Congress should enact a rule stating that, unless a statute clearly provides otherwise, certification and liability in class actions arising under federal law require proof as to all class members of all the elements of each claim.
3. Lawmakers should act to head off the problem of certification of classes in low-merit cases. Class certification decisions are made very early—before plaintiffs have demonstrated that they have evidence to support their allegations. That allows trial lawyers to game the system by filing cases that are extremely unlikely to succeed at trial, but for which the sheer monetary risk generated by a million-member class generates settlement value: Why take even a 1-in-20 risk of a fluke jury outcome if the stakes are of bet-the-company magnitude? Congress should nip meritless class actions in the bud by providing that classes may be certified only after the class “representative”—the main plaintiff—is able to make a preliminary factual showing that he or she has a reasonable likelihood of success.
4. Congress must clarify when, if at all, class actions may go forward on the basis of statistics. Class actions generally must be proved using evidence “common” to all class members, but some federal statutes allow statistical sampling to prove injuries to a large group. Where this is so, plaintiffs sometimes have gotten away with shoddy statistics purporting to show that all class members suffered the same injury. Congress should provide that, before a class action

can go forward, plaintiffs' statistical evidence must meet the same demanding reliability standards imposed on expert evidence sent to a jury.

Defending Arbitration

Allowing parties to set the terms of their own deals reduces the uncertainty that gives rise to litigation and advances the values of individual choice. Yet too often courts and legislators have been hostile to waivers and disclaimers of liability and to contractual provisions that seek to prescribe methods of handling disputes before they arise (such as agreements to arbitrate or mediate, venue selection clauses, and clauses excluding class action treatment of a claim). Arbitration in particular is under attack from organized trial lawyers who would prefer all-out, open-ended litigation as an alternative. Both state and federal lawmakers should defend consumer arbitration.

Courts and lawmakers have also neglected the vital doctrine of assumption of risk, which gives legal force to the choice consumers make to engage in risky activities, such as recreation. Legislators should act to bolster assumption of risk, where appropriate, by codifying doctrines like the "baseball rule" (spectators at a ball game assume the risk of balls hit into the stands) and suitable doctrines limiting liability for ordinary risks experienced by skiers, hikers, and others in search of recreation.

Conclusion

For the most part, the states have reformed and are continuing to reform their civil justice systems. Under those circumstances, time-honored principles of federalism dictate that each state exercises dominion over its substantive tort law. Still, Congress does have appropriate roles to play, both in setting a good example with federal-court litigation and in restraining states from exercising inappropriate jurisdiction beyond their borders or discriminating against out-of-state businesses.

Suggested Readings

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—Prepared by Robert A. Levy, Mark Moller, and Walter Olson