

Regulation Through Litigation:

Assessing the Role of
Bounty Hunters and Bureaucrats
in the American Regulatory Regime



CENTER FOR LEGAL POLICY
AT THE MANHATTAN INSTITUTE

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**Assessing the Role of
Bounty Hunters and Bureaucrats
in the American Regulatory Regime**

Litigation

or Government Regulation?

A Public Choice Comparison

of Litigation and the Regulatory State

Sponsored by:

**Center for Legal Policy
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**U.S. Chamber of Commerce
Institute for Legal Reform**

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Opening Letter

In modern life, there are two obvious ways to address threats to human health and safety that may be presented by private commercial activity. One is by litigation, whereby an individual who has been harmed by private conduct sues a business for compensation under common law (or perhaps even statutory) tort liability principles, with the additional objective of creating incentives for businesses to behave differently in the future. The other possibility is through the regulatory state, whereby the government promulgates rules *ex ante* and an agency then investigates, judges, prohibits or requires certain conduct in the future, and sometimes awards compensation for harm. Both regimes can serve as regulators who set standards for reasonable conduct. But, how do we prioritize, coordinate, or integrate these two institutions to achieve the desired end? How well suited to the task of standard setting and technical evaluation is the tort system? And, under what circumstances do marketplace forces provide all the incentives necessary to alert the public to possible harms and deter businesses from undesirable activities?

To respond to these questions the Manhattan Institute, The Federalist Society and the U.S. Chamber of Commerce held a conference on the subject in February 2000.

This conference was the second in a series of conferences on the newest wave of legal reform issues. The first, *Regulation by Litigation: The New Wave of Government Sponsored Litigation* was held in June 1999. The transcript of that conference is available on request.

The conference sponsors wish to thank Kim Kosman, once again, for her superb editing services. We also wish to thank the panelists and moderators for their thoughtful, insightful dialogue.

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Panel One

Litigation or Government Regulation?

Todd Buchholz

Economist and Author

Honorable Guido Calabresi

U.S. Court of Appeals, Second Circuit

Professor Daniel Kessler

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MR. JAMES WOOTTON: Most of us are familiar with former Labor Secretary Robert Reich's comment that the era of big government is over and now the era of regulation through litigation has begun. Many assumed that he was an unqualified supporter of that development. He has recently indicated otherwise, however, in describing government litigation as a threat to democracy and warning that we should be careful about using it as a substitute for legislation. The Chamber also is concerned with this development. We recognize that, at the end of the day, there has to be litigation to challenge enforcement actions. Litigation is legitimately used, to some extent, to enforce regulations. But the new breed of government litigation that exists is something we find quite chilling.

Regulation through litigation concerns us for three reasons. First, there is an anti-democratic aspect of the new government suits. If we are not careful about which issues we take away from the democratic process, the constituencies that feel strongly about these issues are going to feel disenfranchised. Court and jury ordered remedies make people feel cut off from government. When issues of great importance are settled by undemocratic means, people feel that they have been shut out of the decision-making process.

Second, when you make available to private parties the power of the state, conflicts of interests arise. State attorneys general give contingency fee lawyers the power to sue. These attorneys are often encouraged to make political contributions to the attorney general or are given suing rights to reward past generosity. When the dollars are so large and the power is so great, there is an invitation to corruption. To give a recent example, the FBI agent in charge of the Morales Five investigation—which is ongoing in Texas—has left the FBI and joined one of the target firms.¹ This is the kind of impropriety, or appearance of impropriety, that could become more common if we accept that the right to sue is for sale.

Finally, there is a growing and dangerous view that we are no longer a country subject to the rule of law. If the government can change the rules to prosecute an unpopular industry or to assure a certain outcome, then there is really no limit to how rules are applied to anyone in the process.

MR. TODD BUCHHOLZ: We are here to assess the role of “bounty hunters” and of bureaucrats engaged in the quest for consumer protection, health, and safety. This panel is entitled “Litigation or Government Regulation,” and I wonder whether I’m the right moderator. The way Congress is run, the way agencies are run, and the way the courts are run, the moderator ought to be Regis Philbin—these processes take on more of the tone of a game show than serious government business. The prizes, however, are

not contributed by corporate sponsors; they are swiped from corporate shareholders.

We've all heard stories about out of control litigation. The McDonald's cup of coffee and the two and a half million dollar verdict resulting from a spill. The nearly four million dollar settlement from Hooters, the restaurant chain, because two men who applied for the job of waitress couldn't fill the required outfit. The Supreme Court recently considered whether a high school football coach could pat his players on the backside without constituting sexual harassment. The list goes on and on.

Conservatives applaud various types of deregulation: airlines, trucking, communication, and trade. Many of us are convinced that deregulation has been a major factor behind the new wealth in America, making our economy richer and more flexible. But we are now seeing re-regulation in society, regulation coming from the courtroom.

JUDGE GUIDO CALABRESI: I speak to this topic today not as a judge, but as a legal scholar. As a judge, I am perfectly happy to apply regulations, and I'm perfectly happy to apply the laws that allow litigation. In diversity cases, I will apply the laws of various states, no matter how absurd they are. Obstructing rules that I disagree with, isn't my job as a judge. Expressing my strong opinions on the subject is, however, my job as a teacher.

In a way, today's topic is misstated. Instead of choosing between regulation or litigation, we should be more precise and describe the debate as one between regulation and incentives. Should safety be pursued by the imposition of bureaucratic rules? Or should safety be pursued by giving incentives to those who are capable of administering risks?

Courts aren't capable of administering risks. Agencies aren't capable of administering risks in any reliable way. The only people, in

a free enterprise society, who can administer risk and choose the amount of safety that is worthwhile are entrepreneurs. What encourages entrepreneurs to administer risks correctly? Is it best done by a system of incentives—do it right and make money; do it wrong, and lose money? Or is it better done by setting up a bureaucratic system of regulation that tells entrepreneurs what is and what is not acceptable? I would suggest that the presumption should be in favor of incentives.

Of course, a system of incentives has its problems. Just look at the system of incentives we have at the moment, which is litigation. But for every horrible that exists in litigation, you can have the identical horrible in a system of regulation. The disadvantage of regulation, however, is that its problems are more entrenched. One example is agency capture, which I don't think is all that important. Much more important is stultification or obsolescence.

Regulation is always out of date and usually hinders the true entrepreneur. Building codes, enacted for safety reasons, regularly get in the way of innovation in the construction industry. Similarly, consider Ralph Nader's so-called reforms with respect to automobiles. They determine what kinds of automobiles will be accepted, and, in the process, exclude innovators who might find improved safety another way.

But there is something else even more important to think about. To the extent that we are willing to let risk be regulated—to let somebody else decide what is okay and what is not—we are abolishing the entrepreneur's very reason for being. We like entrepreneurs and enterprise *because* we do not trust the government to decide what is worthwhile. We do not trust it to decide who will get into the shoe industry or any other type of activity. This is why we create incentives.

To the extent that we regulate, or decide what is worth having, we get rid of any reason for having profit. Long ago, the Chicago

economist Frank Knight defined profit as being the return one gets for taking an uninsurable risk, one that can not be quantified ahead of time. Profit is not monopoly rents. It is not return on capital. It is not payment for one's labor. Those things are available to many people. The person who makes a profit is a person who handles more competently something that other people can not handle as well: risk.

With respect to accidents, we need the same kind of system if we're going to justify profits. Does that mean having the current litigation system? No. There is much in that system that is wasteful, silly, and ripe for reform. But if the choice is between litigation incentives or regulatory mandates, the preference for anyone who is devoted to a libertarian enterprise system must be for litigation. We have to change our current litigation system, but with caution. Accident costs are real costs; they are costs that are part of the production, sale, and use of goods and services. We want to reduce these costs, but any such reform has real dangers. Under the guise of reducing these costs, we may actually remove them from the only people who can make appropriate decisions. Regulation follows and—at first—most people will be happy because they can live with the regulatory rules. In the end, however, if we do this we will take a long step towards destroying the free enterprise system.

Who can administer accident costs best? Who can decide what is worthwhile and what is not? Sometimes it's the victim; sometimes it's the injurer. More often than not, though, it is the entrepreneur who can best make safety decisions. To the extent that victims don't adequately watch out for themselves, the best way to make them do so often is through regulation. People can be punished if they don't behave well, or if they are unduly careless. But the entrepreneur usually should not be similarly punished. The better way to encourage the entrepreneur is to say, "if you produce a safer product, you will pay less in compensation for injuries." Now that can be done by a structured system of costs rather than through our litigation system. If, however, the choice

is offered between a system that creates incentives through litigation or a system that imposes regulation, anyone who's devoted to enterprise and the entrepreneurial system should opt for litigation, despite its many problems.

PROFESSOR DAN KESSLER: I'd like to talk about a current issue in the litigation versus regulation debate: the patients' bill of rights. What are the merits of using the tort system instead of regulation to promote quality care in HMO's? Since the patients' bill of rights means different things to different people, I will consider one aspect of the several proposals for reform, which is a change to federal law that lifts the current federal preemption against suing HMO's and other health plans for medical malpractice.

The findings here are not definitive. On the whole, however, the evidence indicates that expanding the reach of the tort system to HMO's—which is what most of these proposals would do—is not likely to be an effective or efficient way to address real and valid concerns about the quality of health care. More generally, my research shows that expanding the liability system actually does just the opposite.

Some suggest that the experiences of states that have adopted state patients' bills of rights—Texas, Michigan, Missouri, California—demonstrate what the likely effects of federal reform would be. Whatever you think of these state experiments—and there is some feedback from what has happened in Texas—these state bills of rights are largely preempted by existing federal law. The effects of these state law reforms, both good and bad, are going to be much less than the effects of any federal reform. Because of existing federal law, there is really no direct evidence of how effective lifting the preemption on suing HMO's would be at insuring the cost or quality of care.

There is, however, evidence on the consequences of expanding malpractice liability for the cost and quality of care. My research

with a colleague at Stanford, Mark McClellan, shows that incremental increases in malpractice liability lead to more defensive medical practices—precautionary treatments with minimal medical benefit administered out of fear of legal liability.² We found that an increase in liability adds to what we call the “malpractice pressure” that doctors face: the time, effort, expense, and hassle of defending against malpractice claims and lawsuits. In turn, increasing malpractice pressure leads to more defensive medicine.

If expanding liability to HMO’s decreases the malpractice pressure on doctors, then it might be a way to improve cost effectiveness and quality of care. Alternatively, if expanding liability to HMO’s increases malpractice pressure on doctors—say by leading to more frequent and more complex suits in which doctors are inevitably involved, even if they’re not the defendant of record—then it will lead to more defensive practices and more treatment intensity that is very costly but provides few benefits to patients.

The problem with using litigation to get appropriate health care is that nobody pays for care at the point of decision. Doctors don’t pay for care. Patients don’t pay for care because of health insurance. This is what economists call “moral hazard.” It is very hard to get the right level of care with a system of tort-based incentives when there is moral hazard.

So what do we do? I will suggest two alternatives, although I have no evidence on whether they will be effective or useful. First, we want to get HMO’s to make appropriate benefits decisions on average. Second, we want to provide patients with a kind of insurance against bad HMO behavior, a guarantee against arbitrary and capricious denials of benefits at a time when people are worst suited to handle them.

As for appropriate benefits decisions, we might enact mandatory, potentially publicly financed, HMO quality measures, which would facilitate competition among HMO’s on the basis of the care they

offered. These measures could be based on patient surveys, or on outcomes-based studies of the quality of care. In fact, many HMO's, through private trade associations, are already reporting quality measures in response to consumers' demands. To protect patients against capricious decisions, mandatory second opinions on benefits decisions could be made available, at a patient's request, by an outside panel not financed by the HMO's. In California, at least, managed care plans have already implemented this sort of thing in response to patients' requests.

To summarize, evidence suggests that more litigation is not a good vehicle for quality control. A patients' bill of rights that expands the reach of the liability system is likely to lead to more malpractice pressure on doctors, which in turn is likely to lead to more defensive medicine that offers very little in the way of patient benefits. More research into regulatory alternatives that directly address patients' concerns, like the two I suggested, would be a better solution.

PROFESSOR W. KIP VISCUSI: I'm going to restrict myself to three points. First, regulation works pretty well in terms of creating safety incentives. In fact, when regulation does exist, the safety incentives are generally *too* great—regulation is too stringent. EPA and OSHA, for example, have restrictive legislative mandates that prohibit benefit costs tests, at least in the interpretation of the agencies. As a result these regulations, as well as other regulations, are too stringent. In terms of FDA reviews, year after year, people complain that there is too much weight on errors of commission, as opposed to errors of omission. Drugs don't reach the market as fast as they should. The main exception to this trend would be the Department of Transportation, which tends toward under-regulation.

If you look at studies of regulatory impacts, you can actually find significant effects, particularly for the EPA. The air is cleaner. The water is cleaner. To the extent that a problem exists, it is excessive

stringency. For this reason, in situations where regulation exists, I've advocated a regulatory compliance defense against regulation. The objective is to get firms to provide an efficient level of safety. Once you've complied with the regulation that should be sufficient. These regulations create incentives beyond what you would want from the standpoint of economic efficiency.

My second point concerns the relationship between litigation and safety incentives. My colleagues and I have examined data regarding product safety levels and product liability costs by industry, as well as changes in products in response to product liability costs. We find the following patterns. First, incentives work. Economists, such as Judge Calabresi, who are great believers in incentives, have not misplaced their beliefs. Low and moderate penalties on firms increase innovation; in fact, as you increase the level of product liability costs over sales at the low and moderate level, it increases every measure of innovation. You have more patents. You have new products, new product introductions, and more changes in product design. We don't know that all these changes are good, but at least they are in line with the usual story about how economic incentives operate.

If you have extremely high penalties for industries relative to industry sales, however, that tends to shut down in regard to innovation. This is not an anecdotal hypothesis—it is based on real data across firms and statistical estimations. The companies in this scenario essentially shut down in regards to innovation. We found this, for example, in the pharmaceutical industry in the 1980's.³ Companies withdrew from innovation with respect to anything to do with contraception or the birth process.

I've been doing work recently on the effects of punitive damages. Do punitive damages, which tend to be random and capricious, provide a deterrent effect to careless or irresponsible behavior? The answer is a clear no. I have a paper in the *Georgetown Law Journal* in 1998 that tried to find a link between punitive damages and

any beneficial safety incentive.⁴ Wherever I looked—toxic chemical accidents, the number of facilities reporting reduced toxic discharges, surface water discharges, accidental deaths, medical malpractice misadventure deaths—I could find no beneficial response to punitive damages.

In terms of what role the courts play, then, low and moderate levels of incentives seem to play a constructive role. Very high penalties and/or random and capricious punitive damages do not. The incentives that work tend to be those present in the more routine types of court cases, not in the heavy hitters that we often read about in the paper.

My third point: jurors do a lousy job of risk-cost balancing. I have a paper coming out this month in the *Stanford Law Review* that describes an experiment I conducted.⁵ I gave a series of cases to approximately 500 mock jurors. I asked them to decide whether punitive damages were warranted in these cases, and if so, how high they should be. The cases they considered concerned automobile accidents generally modeled after the GM and Ford Pinto-type cases where the companies did risk analysis. The imaginary companies assessed the benefits and costs of particular safety innovations, and then decided on that basis that costs exceeded benefits.

The results are as follows: if a company does not do any analysis at all, jurors are a little unhappy. If a company does regulatory analysis, assessing benefits and costs, jurors are very unhappy. If a company uses a compensatory damage amount of, say, \$800,000 to value life, the juries hit the companies harder than if they had done no analysis at all. Regulatory analysis is, apparently, more offensive than just putting a product out on the market.

The story gets worse. You might think that if a company does an analysis the way the government does its analysis—if it, for example, follows the procedures and value of life used by the National

Highway Traffic Safety Administration—that the jurors would be pleased. In fact, they actually hit the companies harder. Jurors hit companies with a higher punitive damage amount when life is valued at three million dollars than when life is valued at \$800,000. Jurors, it seems, are trying to send companies a message. They focus on the value that the companies themselves use. If a company values life at three million dollars, jurors assume a higher award is necessary to get their attention.

Companies, if they think systematically about risk and assign a high value to life, get hammered if this information is given to a jury. Economically, at least, they are far better off doing no analysis at all and simply dumping risky products on the market. This is not a good message.

We found other systematic errors as well with respect to hindsight bias. We gave our juries a case involving a railroad accident and a choice whether to fix the railroad track now or later. Most people opted to fix it later. Then the same case was presented with a tragic consequence. The track was broken and not fixed. A train fell off the track. Not surprisingly, everybody wanted to levy punitive damages. Before the fact, jurors would not fix the track. After the fact, they levied punitive damages. I should add that I've run the same scenario on a sample of state judges, including one who's in this room. I'm pleased to report that they did much better. Whereas two-thirds of the jurors wanted to award punitive damages, two-thirds of the judges did not. This result suggests that more authority over the setting of punitive damages should be taken away from jurors and given to judges if we're to have punitive damages at all.

There are other studies that suggest that jurors do a lousy job of mapping their punishment intent into a dollar value in terms of damage numbers. In short, jurors are not well equipped to do the kind of risk/cost balancing that we would like them to do. They should not be in charge of setting safety levels for society.

Why is my view different than Judge Calabresi's? The judge is one of the inventors of law and economics, and I claim to be a law and economics person. I think the main reason behind our differences, perhaps, is that we are focusing on different issues. For some areas, such as automobile accidents, the courts do a great job; juries can determine whether or not a driver was being careful. For other things, like trying to set an overall product safety level on a marketwide basis, I'd rather take my chances with government regulation.

MR. EDWARD WARREN: I'm speaking as a practicing lawyer this morning. Over the course of the last three decades, I have been trying regulatory issues. In the last ten years or so, I have practiced tort law, that alternative regulatory system. I have firm opinions about which of these two systems makes the most sense and in which cases. Kip's remark about distinguishing between problems is important—circumstances dictate which regulatory mechanism is best.

Government-sponsored tort litigation—cigarettes, guns, lead paint—represent the culmination of more than three decades of shift away from the administrative/regulatory approach. Our courts have moved away from traditional tort law concepts and expanded their role considerably. This is true in the context of awarding both equitable relief and damages. Before we even look at the economic questions involved, this trend raises fundamental questions about the respective roles of the three branches of government. Is it wise, let alone democratic, to turn away from legislation and executive branch regulation as the preferred means of addressing health, safety, and consumer protection? How much does this trend call upon the courts to depart from their traditional role of allocating responsibility retrospectively on a case-by-case basis? Finally, what limits on the courts' equitable jurisdiction remain if they are willing to oversee consent decrees which serve the purpose of statutes or regulations?

There is no time today to compare the recent evolutions of the tort and administrative systems. Suffice it to say, for institutional reasons and reasons of democratic legitimacy, I favor regulation through legislation and delegated authority to the executive branches of government. Further administrative regulation is preferable to litigation from an economic efficiency standpoint.

The first question to ask when considering any particular regulation, whether it's by litigation or by administrative agency, is, is it warranted? I'm very conventional here. I think that the need for regulation is determined by market failures, such as a breakdown of competition, or identifiable social costs that are not being internalized in the price of goods or services. It is also important to ask whether administrative costs permit firms to internalize the social costs by private ordering. The framework for deciding this question was provided by Ronald Coase. If the answer to the regulatory question is "yes," then the issue is how the social cost question should be solved. Even when the private ordering is not superior, however, we have to ascertain whether regulation will do more good than the social harm of not regulating.

Having set these hurdles for regulation, I still think that much, maybe most, of our health, safety and environmental regulation over the last thirty years—at least the statutes—pass these tests. This is not to say that *specific* regulations always do. Indeed, I think many regulations don't pass the rudimentary cost benefit test, especially at the margin. Often they ignore risk-risk trade-offs, which are very important.

If these are the questions that need to be asked, it seems that the courts are ill suited to answer them. There is no reason why courts should defer to self-interested private attorneys—for the plaintiffs or the defense—in trying to address these issues. I don't think government attorneys, including state attorneys general, are going to be any more effective, objective, or neutral in answering these questions. Public choice concerns and all the problems with legislation

notwithstanding, democratically elected legislatures enacting statutes administered by executive branch officials are much more likely than the courts to get these questions right.

Despite my concerns about institutional competency and economic efficiency, I do not expect that judges are going to be excusing themselves soon from the regulatory scene. There are some things we can do, however, to mitigate the excesses of the present system. First, we have to recognize that administrative regulatory statutes and the tort system often overlap directly. They regulate the same problem, sometimes in an inconsistent manner. This overlap can be reduced by a more generous recognition of the scope of federal preemption in appropriate cases and by broader acceptance of compliance with federal standards as a defense in tort actions.

Second, courts can be encouraged to follow the Supreme Court's *Amchem* case. They can also refuse to exercise continuing jurisdiction when consent decrees extend far beyond the underlying case or controversy. This kind of activity transforms the court into a *de facto* administrative agency. During the AT&T breakup in 1984, for example, Judge Greene became a virtual alternative to the FCC. This is a growing problem.

Finally, as Kip has said, we need to reassess the use of punitive damages. There is no relationship, it seems, to the economic basis for regulation. That concept needs to be abandoned, or at least reevaluated, and reformed to a substantial degree.

MR. BUCHHOLZ: The UK, Canada and Australia don't have juries handling personal injury cases. My question for Judge Calabresi: does his enthusiasm for the court system extend to issues of personal injury and other liability cases?

JUDGE CALABRESI: The question of juries is what people focus on in this debate—as if a system of incentives requires juries. It does not. My impression is that juries are not bad when it comes

to determining liability: who ought to pay, where the loss ought to lie. Juries are problematic, however, when it comes to determining the size of damages. I don't think, though, that it does any good to refer to the lack of juries in England or Australia. The reason that juries do what they do in America is clear enough. They are concerned with something more than appropriate levels of safety. Juries in the United States understand that, in many accidents, the only way the injured party will get medical coverage is through a huge verdict. Decisions are made on this basis, whether or not it is fair to the defendant. It is silly to charge juries with doing something wrong when they see their role differently than we do. If I could redesign the system, I would have a system of automatic incentives. And juries would not determine the size of damages. But unless we move to such an automatic liability system we are not going to get very far politically with a plan to get rid of juries.

I agree with the other panelists that one has to look at many different areas to see whether regulation works better than incentives. And I specifically agree with Dan Kessler that incentives in the medical malpractice area work terribly. People in this industry respond to incentives but they respond the wrong way. The incentives we have created here are wrong; but we do not seem to be capable of figuring out a system of incentives that works in this area. Incidentally, we have also yet to figure out a system of regulation that works in the health care insurance context. This area is so dynamic that all the worst faults of regulation emerge there, too.

The problem with health care reform is this: we would like things to be better than they can be. As a result, we look for ways to control the industry, and this simply makes things worse, whether it's done by regulation or litigation. It would be far better to get out of the business entirely—we should figure out what level of medical insurance is needed, establish that, and beyond that realize that the true horrors will be taken care of regardless of what we do. Unless we create such a compensation system, however, juries are

going to continue to respond to the fact that they think people need to be compensated.

PROFESSOR VISCUSI: Let me speak to the jury issue. My view is not that we need to abolish juries. Indeed, I think there is value in citizen participation in the legal system. Having said that, I think the right question—which is the question Judge Calabresi posed—is what is appropriate to expect from lay jurors when they decide complex cases?

EDWARD WARREN: About a hundred years ago, Learned Hand wrote a piece in the *Albany Medical Annals* on expert testimony and what we ought to do about it.⁶ For Judge Hand, expert testimony is simply a form of opinion testimony—in the common law, strongly disfavored. What we are asking jurors to do is to decide between competing experts who are presenting testimony that is beyond their comprehension. With respect to these kinds of scientific questions, Hand argued that the court should have its own outside expert or panel. Judges should empanel a series of experts to address the questions, and then instruct the jury on questions of science just as they are instructed on questions of law.

It has taken 100 years, and we still haven't come around completely to Judge Hand's position. The Supreme Court's decisions in *Daubert*,⁷ *Joiner*,⁸ and *Kumho Tire*,⁹ however, are moving in the right direction. Justice Breyer has been a very thoughtful participant in this debate.

Setting damages—especially punitive damages—is exceedingly difficult for lay jurors. They do not understand that health, safety, and consumer protection issues are major economic regulatory questions. They treat these cases simply as judgment calls about the fault of the defendant before the court in a particular instance. The jury is asked, “Is a punitive award justified? Is the conduct willful and wanton?” and little more than that. The charge which is

given to the civil jury in the punitive damage context is terrifically open-ended. With little or no guidance or instruction from the judge, it's hardly surprising that wildly varying and capricious awards exist. Even assuming, for argument's sake, that the rules that govern punitive damages make sense, they are impossible for jurors to carry out in any realistic way.

In sum: when considering punitive damages, just as when considering expert testimony, we have to be realistic about what we can fairly expect of lay jurors. We need to develop a system, if we're going to retain punitive damages, where the courts play a much more substantial role in guiding and governing the process.

JUDGE CALABRESI: On the topic of punitive damages, I think the courts should be more directive on damages in general. Judges should use remittitur and things of that sort, and that applies to punitive damages as well.

When we talk about punitive damages, though, we often confuse two things. There is the way punitive damages are actually awarded, which has all of the flaws that the various speakers have referred to. This is quite different from the question of whether there is a role for damages that are more than what is necessary to compensate a particular victim in a particular case. On this latter issue, there is a fine article by Mitchell Polinski¹⁰ that explains that one of the functions of punitive damages is not all to be punitive. These damages are there to insure that the cost allocated isn't merely the compensatory damages awarded in the relatively few cases that go to court and in which recovery is given. The true cost also includes those damages suffered in all the cases that do not go to trial. If the fine that is levied on a thief were the value of the property stolen, thieves would steal all the time because they do not get caught that often.

Similarly, people do not pay damages all the time that they do harm. Accordingly, punitive damages are used as a kind of

multiplier—a company must think beyond particular cases to make a correct cost benefit analysis. But, though correct, this conception of damages is also highly problematic. This is because it, in effect, gives juries the freedom to create a monster, and this is so even though the awarding of some punitive damages does have an underlying reason.

When you call that “punitive,” and you give it to the jury, and then you say that these go to the particular victim, you’ve created a monster, a monster to do something that, in an another context, would make sense.

As I stated earlier, the issue isn’t litigation versus regulation, but rather what kind of incentive system is preferable to the bureaucratic system of regulation. For that reason, there should be a role for damages that are not punitive, as we call them today, but that perform a similar function.

There is another important consideration in this context. When a defendant in a tort case, like Ford or General Motors, tells the court that it made a cost benefit analysis and, on that basis, decided that a safety feature was not worthwhile, a jury is going to award huge punitive damages. No jury wants to be told that safety was not the primary concern. The public does not want to know that, in fact, we are always deciding between life and the cost of saving life. That’s the nature of the human condition. The solution is a system where costs are assessed and paid and nobody speaks a word about cost benefit analysis. There is a tragic cost to being too truthful.

PANELIST: As Plato observed, there is a place for noble lies in any kind of government. Another related problem is that the jury, by the time it is making an assessment about damages—especially punitive damages—has obvious sympathy for the plaintiff. Perhaps damages should be assessed by jurors who are under a veil of ignorance regarding the particular plaintiff. Imagine if a general or

a president, in sending young men into war, was forced to choose soldiers on a personal basis and explain his decision to each man's parents. There are times when objectivity is crucial and sentimentality utterly distracting.

PROFESSOR KESSLER: I agree with Judge Calabresi: regulation versus litigation is really a question of regulation versus incentives. I too favor using incentives through the tort system. The problem is, in some sectors, like health care, we can't get the incentives right. Because of this limitation, I have a slightly rosier view of the regulatory approach. With regulation, you can aim directly at the social problems that are causing particular losses. The system of incentives, when it is fouled up, is almost impossible to fix.

In the context of health care, the two main problems are getting information to people so that they can make appropriate decisions and dealing with people's fear of uncertainty, or natural risk aversion. This is what the patients' bill of rights debate is about. Something that gets people information and that reduces the possibility of having a bad outcome is more appropriate than trying to work with a terrible system of incentives.

PROFESSOR VISCUSI: Let me clarify my argument about juries. I agree that punitive damages are a "monster," as Judge Calabresi calls them. I don't advocate getting rid of juries; I advocate eliminating punitive damages. As for the regulatory compliance defense, I would like to take out of the courts all the cases where the companies have complied with government regulations. Again, this is not a question of getting rid of juries. It is a question of keeping things out of the courts that involve market-wide decisions, choices of hazard warnings, and choices of overall levels of product safety that hinge on judgments regarding the market. This is different from whether some particular individual chose not to read the warning or some particular individual chose not to take the precautions.

We might as well talk about a series of cases that are really the motivation for this panel. We have had the state tobacco cases. We currently have gun and lead paint litigation. We have many new lines of litigation emerging in which the products involved are highly regulated already. The question is: should we be using the courts to achieve additional regulation? Consider the state tobacco settlement. As a part of the agreement, in addition to transferring billions of dollars to the states and their attorney friends, there are substantial new regulations in effect that affect the cigarette industry and the selling of cigarette products. Cigarette advertising, for example, is controlled by the court agreement. None of these regulations had their benefits assessed. Nobody assessed the costs of implementation. None of these regulations were offered up for public comment and evaluation. If a government agency had proceeded in this way, it would have been clobbered by OMB. Unsubstantiated assumptions do not survive the federal regulatory process.

My point is simple. If we're going to start promulgating new and far-reaching regulations, we should do it the right way. Apply procedures that are set up for federal regulations, and don't hedge when back room deals are made and people begin to barter. I would favor relying on regulation rather than government suits because it is a surer way to establish sound rules and accountability in the system.

MR. WARREN: *We should* focus on the cigarette litigation and discuss what really happened. The companies settled with the states pursuant to a consent decree that was presented to a judge. That decree was, in essence, a book of regulations. This has two pernicious aspects. First, this is regulation that did not go through any of the economic efficiency evaluations we all recognize as important. Second, and even more disturbing, this process thrust the courts into a new and improper role.

Let's put aside for a minute the fact that these things were done by state rather than federal courts. It is worth recalling that suits have

a case or controversy requirement. The exercise of equitable jurisdiction by the court thereafter, as a matter of continuing jurisdiction, ought to bear some relationship to the original controversy. The idea that lawyers can come into court with a consent decree—a bounded set of federal register regulations—and have the court take responsibility for carrying out those regulations for the indefinite future strikes me as wrong. It is a transformation of the role that the judiciary was intended to play.

JUDGE CALABRESI: I have a couple of correctives. We should not be too guided by the cigarette situation. If we decide on the basis of what happened there what is an appropriate system of regulation versus what is an appropriate system of incentives for safety, we will be highly misled. I happen to dislike the cigarette settlement for many reasons, not the least of which is because it puts the courts in the position of regulating. And that is a mistake. This is, however, not what courts normally do in tort cases.

I also think that the statement Kip made about the benefits of a regulatory defense is unduly influenced by a couple of almost unique instances. All of us would agree that a certain amount of regulation in automobile situations is worthwhile. As a society, we do not say, “go through red lights, and if you have an accident, pay the cost of it,” because we all agree that it is cheaper to have a regulation that tells people they can go through green lights, but can not go through red lights. We all think that it is too dangerous for someone to drive at the age of seven and so we have a regulation prohibiting it. We do not allow a seven-year-old to drive even though she may be able to pay her costs.

That said, none of us would think that because there is permission to drive through a green light or that because somebody over sixteen is allowed to drive that is the end of the story. No one thinks a seventeen-year-old can drive as badly as he wishes and not be subject to paying damages.

Because we have agreed that there are certain minimum levels that everybody should live up to, we have not also agreed that those are the maximum levels. Let me suggest that it is often possible for bureaucrats to determine what the minimum level of behavior should be, but it is particularly difficult for them to determine what is the highest level of safety that is worthwhile. This higher level is exactly where innovation changes things. Once you have set both a minimum and a maximum level, you've taken away important incentives. Traditionally, under tort law, the fact that there was a prohibition did *not* mean that living up to the prohibition protected you from a tort suit. Now, through federal preemption, we are getting just that. This should concern anyone who considers himself a federalist; it is yet another way in which the federal government will destroy state authority.

One further thought about democracy. Yes, courts are less democratic than legislators. Whether they are as democratic as administrative agencies—which I happen to think are not very democratic—is another matter. There is, however, one factor that everyone forgets: who pressures legislators to make changes? Essentially it is repeat players, or those who have a continuing interest in an issue. Those who pay damages will lobby for regulations that they think are right; so will the plaintiffs' lawyers. The people who are not there lobbying are people who are actually injured. They are not there because, at any given moment, there are relatively few people who are injured. Further, government action is generally prospective only, so the injured won't necessarily gain from legislative changes. The one thing to be said for courts—perhaps not much, but something—is that they are a place where the individual victim comes in and has the chance to be heard. That makes the discussion of democracy in this matter more complex than Mr. Warren suggested.

MR. BUCHHOLZ: This is why, at the outset, I posed the choice between the ignorant jurors or the conniving legislators and their lobbyist friends. Kip, you suggest that satisfying a federal regula-

tion should be a defense against liability claims. In an age where we applaud the deregulation of many industries, would that be an invitation for re-regulation? Wouldn't industries want more rules, and thus more defenses available at trial?

PROFESSOR VISCUSI: Most of the deregulation efforts have been applied to things like trucking, banking, and airline fares. There has not been a big cry for deregulation in health, safety, or environmental areas. We have had many attempts—mostly unsuccessful—to pass regulatory reform bills to reform what regulators do and put rules on a sounder basis. No one, however, has advocated getting rid of health and safety regulations because there are legitimate market failures with things like pollution. You can not leave people to their own devices. OMB has long advocated efficient regulations for health, safety and the environment, as opposed to deregulation. I personally would restrict deregulation to the area of economic regulation.

That's not to say we don't want better regulations, like the kind that would retain safety incentives. If you have specification standards as opposed to performance standards, you are not providing enough incentives for safety. Nevertheless, you still have companies like Volvo which will find a way to make safer cars than other car companies. We want to have regulations that retain, as much as possible, incentives for safety. We want to augment those incentives that are already present. The most powerful incentive for safety is not going to come from the regulation. It's not going to come from the courts. It's going to come from the markets. Safety incentives are transmitted through the market, through the price that firms face when they're making these safety decisions. This should be the case, at least for products and jobs involving market transactions.

MR. WARREN: I would like to distinguish between two concepts that appear in the intersection between the tort system and the federal regulatory system. On one hand, there is federal

preemption. It is not easy to say what rules should be applied in regard to field preemption and implied preemption. As a general rule, however, there ought to be a greater use of preemption in the appropriate cases. This reduces overlap considerably.

On the other hand, there is the question of whether compliance with federal standards can be asserted as a defense in a tort suit. This is governed by state tort law which is informed by the *Third Restatement*. You can easily find situations where a company has not only complied with a federal standard but has considered and documented alternatives which would be highly costly and achieve very little. The company then gets punitive damages assessed against it because it engaged in the very documentation that is worthy of commendation.

I think Kip is whistling in the dark if he thinks that you can have regulation with respect to safety and not have it encourage other regulation. That isn't the way regulators work. Once regulators are allowed to decide that a certain level of safety is appropriate, it is a very small step to allow them to determine that one kind of car is better than another kind of car or that a certain number of businesses should be engaged in a certain business. Of course, everyone wants the regulation that they can control or the regulation that does what they think is right. This is wishful thinking.

In 1984, a rather conservative Supreme Court told courts that they had to give deference to regulators in *Chevron*.¹¹ This was at a time when the regulators were, by and large, non-aggressive. We now have another group of regulators who are considerably more active. Many courts are very uncomfortable because they have to show them similar deference.

We have to adopt a longer vision of what's going to happen. Think about the enterprise system as a whole. Do we say that people can go into a business and go bankrupt only if a reasonable person would not have entered that business? Do we go into

a business only if people who know best about it, i.e. regulators, grant a certificate of necessity? There are a few regulated industries, and by and large, they are not very efficient precisely because they work that way. We allow people in our system to make risky decisions, to bear the costs of those decisions, and to win if they decide correctly.

The ideal is an administratively efficient way to encourage safety. You want a system where, wherever possible, costs are imposed instead of regulation. Those who are best at innovation, i.e. entrepreneurs, should be encouraged to figure out a way of reducing those expenses. Now, there is no guarantee that if a safer product is made, people will actually buy it. Hudson tried to do that a long time ago, and we learned that safety doesn't necessarily sell. The people at large—those ignorant jurors—don't understand that a car is safer. They do, however, understand that a car costs less. Cars cost less because they are safer; manufacturers have less to pay. The market works better than a direct safety appeal.

AUDIENCE MEMBER: My concern is that we are overlooking the issue of notice of what the law requires. Consider the Honda case now pending before the Supreme Court. There were elaborate federal regulations dictating when airbags were required in cars. The regulations set dates by which certain percentages of fleets had to be equipped with airbags. Honda followed the regulations closely. Honda, however, was sued by a woman who was seriously injured in a crash because her 1987 Accord did not have an airbag, despite the fact that when the accident occurred, airbags were not required.¹²

The market would not have rewarded a car company for putting airbags in vehicles prior to federal regulation. Doesn't the whole issue of notice of what the law requires come into play when a business is sued for failure to do more than what the regulation required? Does this come down to an issue of federal law preempting state tort law?

JUDGE CALABRESI: The traditional libertarian says if it turns out that something you did was costly and did harm, you should pay. If you guessed right, you'll make a lot of money. That person will have been able to charge more (indeed everybody will have been able to charge more), a free marketeer says, precisely because of taking a prior risk. It's the same kind of risk as the risk that the market will turn down. It's the same kind of risk that one takes when he or she makes an innovation. It's the kind of risk that gives rise to profits because, if the entrepreneur guessed right and developed, say, the airbag/seatbelt combination that gave the greatest safety for its cost, that entrepreneur would make a lot of money. Are we willing to go this far? If we don't believe we can stand that degree of free enterprise, then we are going to have regulation and control. But such regulation and control calls into question the whole market idea.

AUDIENCE MEMBER: Judge, you yourself say that safety does not sell. Had Honda put airbags in before anyone else, they would not have been rewarded in the market.

JUDGE CALABRESI: Let me explain this with a simple scenario. Take a situation where people have automobile accidents. The automobile manufacturers, let us assume, pay all such accident costs. Imagine that these costs are properly evaluated, not by juries, but through a rational system. In this situation, automobile manufacturers would be able to charge an amount for cars that would cover the costs of accident risks. That cost would become part of the price of cars, as is the price of steel. The automobile manufacturer who came up with a seatbelt/airbag combination that reduced the number of accidents would keep more of that higher price because that manufacturer would have to pay fewer damages. The manufacturer who came up with another combination that resulted in more accidents would end up broke. Safety in this scenario would not be a matter of selling. The consumer would never face the question of safety directly.

MR. WARREN: The Honda case is an illustration of the point that I've been trying to make. It is the worst of both worlds to have two systems operating on the same problem. We'd be better off with the tort system that Judge Calabresi advocates, or the regulatory system that Kip advocates. Either one would be better than both. The point about notice gets to the very heart of this matter. Even the definition of a rule in the Administrative Procedure Act is a matter of prospective application. When we have rules coming out of the Department of Transportation, if there is not fair notice, those rules will get reversed by the court of appeals. And yet, here we have a situation where there is the complete absence of any kind of notice as to what the rule is because the rule is established by the court in a particular case. Since the courts' role is to decide individual cases using retrospective information, they cannot possibly provide fair warning.

A new kind of tort law has been in vogue for the last fifty or seventy five years. The new understanding is that the tort law is a system for establishing incentives—like regulation, it is forward looking. This is a highly questionable proposition, especially in a world where you have dual regulatory systems dealing with the same problems.

AUDIENCE MEMBER: A question for Judge Calabresi. You argue that some form of incentive system through the tort process is better than a kind of mixed up regulatory system. It's hard to argue with that proposition. If the choice is between the common law tort regime and the kind of modern unreformed regulatory system that exists, I would agree. Unfortunately, this is not the choice we have. Our choice is between the flawed, unreformed regulatory system and a completely unworkable and unpredictable tort system. Certainly the current condition of the tort system makes a tremendous difference. It is hard to defend a system where a coin toss determines liability and a roulette wheel determines damages. If you want to ignore the tobacco case, that's one thing. But the gun cases illustrate an increasing trend: the litigation system is

completely random and unresponsive to old common law rules, which I think generally were efficient. How can you defend a system that continues to move away from that ideal?

JUDGE CALABRESI: I confess to be something of an idealist. As a judge, I make decisions every day trying to make the system that we have a better one, within the limited authority I am given. But when we're talking here, in the presence of people who can move and shake the system, I think we ought to think broadly about what kind of system we want. If we don't set our goals high enough, we will get a system that may work for a little while but will ultimately fail.

Many years ago, I worked on a plan to reform automobile accident law in the state of Hawaii. It made no sense to have a different system of law in Connecticut from that in New York or Rhode Island because Connecticut people drive across state boundaries all the time. But Hawaii, because of its location, presented the opportunity of actually accomplishing something. I came up with a system that would have created an adequate system of incentives without regulation. It was not a system that put the liability on the automobile manufacturers, it was a form of first-party system. It was going through the Hawaii legislature until the trial lawyers bought a half time spot during the Super Bowl and managed to kill it off.

The advertisement showed how much money was at stake. Even in those days, half time during the Super Bowl was an expensive proposition. The real problem, however, was that the Chamber of Commerce was asleep. They simply weren't present. If you think the existing choice between litigation and regulation is a Hobson's choice—which it probably is—then you ought to support the right people in the right situations and then wait for the political moment when something can actually happen. Senator Danforth tried to operate in this way; he viewed things in the long term unlike many of his colleagues. I would urge you to think in those terms.

If you want us to focus on how we can improve the current system, then I believe we should think at a deeper level.

AUDIENCE MEMBER: I'd like to ask a question about rule implementation. In many instances, because of things like capture by regulated industries, agencies have not implemented statutes to the extent that many think they should. The EPA, for example, has essentially given up on many of the businesses it is trying to regulate. Agencies say, in effect, "here is what the law is. Violate it at your peril." Perhaps I've caricatured this position to an unfair degree, but this seems to be a classic example of regulation by litigation.

MR. WARREN: I know something about this issue because I'm dealing with a related case for an automobile manufacturer. Agencies increasingly feel—especially the EPA—that they are unfairly constricted. Agencies do not feel like they can impose additional requirements by regulation; nor do they feel they can push the frontiers of law through enforcement and requirement interpretation. There is, I think, a fundamental fair notice problem presented in these cases. There's a couple of important D.C. Circuit cases that speak to this issue, specifically the GE and Chrysler cases where that sort of thing happened.

Announcing in a policy statement that rules are changing from X to X plus ten doesn't satisfy the requirements of the Administrative Procedure Act. Accordingly, these issues are going to be fought on a fair notice basis. Having said that, the phenomenon you identify is one of increasing importance. The best defenses that exist right now are basically arguments about notice and the lack of deference that ought to be given to the prosecutorial staff, as distinct from the rulemakers, which certainly they should get deference. These are important issues, but the solution is for judges, not lawyers to decide.

AUDIENCE MEMBER: I think what prompted the previous discussion of juries was Mr. Buchholz's observation that in

Britain, Canada and Australia juries are not used to decide certain kinds of civil cases. Beyond the role of juries, do any of the panelists think that the experience of other economically advanced democracies has anything to teach us about the proper balance between regulation and litigation? The United States surely isn't the only place in the world that's engaged in the quest for consumer protection and human health and safety.

PROFESSOR VISCUSI: To some extent, it may be. I routinely go to conferences organized by groups such as the OECD and talk about regulation. What I'm thinking about is health, safety and environmental regulation; they're thinking about things like taxi medallions. Regulations, of course, exist in other countries, but our health, safety and environmental regulations dwarf those of any other country. We are way ahead of everyone else, which is not necessarily a good thing. Other countries don't know what we're talking about when we refer to the problems of punitive damages. They don't know what we're talking about when we say that hazardous waste site cleanups are inordinately expensive. There are certain excesses of the United States system that have yet to emerge in other countries.

JUDGE CALABRESI: It is true: most advanced countries in the world don't have our systems of regulation. It may be one reason why they're advanced. Unfortunately, many of these countries are beginning to copy the worse aspects of our system. Instead of moving towards a system of incentives that would move regulation out of the courts—linking damages to real costs and so on—they are moving in the direction of copying our tort system. While they don't have things like punitive damages yet, this trend still causes me great concern. When I visit other countries, I find myself sounding very different from what I'm sounding like here. I tell my non-American colleagues to be careful and not assume that these things work that well in the United States. I tell them that if they just buy the American tort system, they are buying something that has plenty of problems.

AUDIENCE MEMBER: Isn't it the case that, until very recently, Australia, Canada and the UK strongly discouraged contingency fees for plaintiffs' attorneys? Weren't they considered unethical?

JUDGE CALABRESI: That is true. Most countries did not have contingency fees until recently. Now many do. But what is happening with contingency fees in Europe is, nonetheless, very different from contingency fees in the United States. Contingency fees in the United States are a percentage of the take. What that does is to create incentives for people to bring suits that have a low probability of success as long as they have a very high yield. Accordingly, in the United States one sees many risky, high paying suits being brought. The English version allows a lawyer to recover nothing if she or he loses. But if the lawyer wins, the take is three times, maybe four times, maybe two times, (depending on the contract) what the normal fee would have been under a traditional fee arrangement. That means that a suit that has a very low probability of success is not going to be taken on a contingency fee basis regardless of the probable size of damages. On the other hand, a suit that has a moderate or low payout, but a pretty good chance of success, would be attractive to a lawyer. If we thought about this practically, and not in broad or ideological terms, we could ask if this is better or worse than the American method.

AUDIENCE MEMBER: And if we did ask, how would you respond?

JUDGE CALABRESI: One has to consider this question in the context of the society. In a society where many costs, like medical care, are covered outside of torts, the English way is surely better. For that reason, I think one of the greatest tort reforms we could enact, actually, would be to provide most people in this country with medical insurance. If that were done, we would find that many of the silly things we do in torts today would lose their appeal.

Panel Two

A Public Choice Comparison of Litigation and the Regulatory State

Honorable C. Boyden Gray

Partner, Wilmer, Cutler & Pickering

Honorable Theodore Olson

Partner, Gibson, Dunn & Crutcher

Professor George Priest

*John M. Olin Professor of Law and Economics,
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Professor Christopher Schroeder

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*Georgetown University Law Center;
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MR. C. BOYDEN GRAY: This is an impressive panel, and I imagine that what has already been said will not steal any of its thunder. I'll save my remarks for later, except for this: if you look at litigation versus regulation as a question of public choice—who benefits the most in terms of rent seeking—litigation wins hands down. The lawyers make considerably more money out of litigation than they do out of rule making, notably here in Washington D.C. That does not mean that this is the right way to go.

PROFESSOR GEORGE PRIEST: My comments today are based on a simple question: How should those who are dedicated to limited government think about regulation through agencies versus regulation through the litigation system?

The public choice approach, which is the subject of our panel, tells us something about that subject, but there are limitations to public choice in answering the question. Public choice teaches us that all individuals will pursue their personal interests. Pursuit of self-interest will affect the outcomes of any process, whether it is agency regulation or the courts and litigation. The pursuit of interest itself, however, is affected by the normative structure of the regulatory system in which the pursuit takes place.

How might we compare the normative structure of regulation through agencies versus the courts? The normative structure of agency regulation is substantially different from the normative structure of litigation. This distinction is important when thinking about whether we better achieve limited government by regulation through agencies or litigation.

The normative structure of agency regulation is constrained, for the most part, to those areas of commercial or human activity where it is believed that the market does not work. To simplify, agency regulation is tolerated in three circumstances: where industries are characterized by natural monopoly; where substantial externality problems—such as pollution—are present; or where there is a low level of consumer understanding about the characteristics of products that they are using. There is some question about the normative construct in this last category—there are arguments as to whether the lack of consumer information in, say, the auto safety area is really a serious problem. Nevertheless, some justification of one of these types underlies all of agency regulation. As a consequence, these justifications substantially constrain the scope of agency regulation and limit the extent of government involvement in our lives.

The normative structure of litigation is different. Many years ago, litigation was subject to similar constraints, perhaps even greater constraints. People thought carefully about when litigation was appropriate and what disputes it ought to address. That is no longer

true. The normative structure of our current legal system is one of cost internalization. That is, courts are willing to entertain litigation in *any* context where one person can claim that another person or entity has imposed costs upon it. The modern damages verdict serves to internalize these costs to the person or to the entity that is alleged to cause the harm. (I am not going to address punitive damages, but as Kip Viscusi mentioned, the normative structure of punitive damages extends even further, serving as some vague and often unpredictable form of punishment.)

There are substantial differences between the normative structure of regulation based upon market failures—or alleged market failures—and the normative structure of litigation based on internalizing costs. First, there is a vastly greater range of regulatory control that occurs in the litigation system. Litigation is not limited to clear market failures. It is not limited to natural monopoly industries. It is not limited to situations in which there are clear externalities. Certainly, it is not limited to situations where consumers lack information and thus one can convincingly argue that the market does not work. Litigation, as I mentioned, extends to all industries. Indeed, it extends to all activities. We see litigation today that we would never have seen twenty years ago, such as students bringing actions against teachers and even children bringing actions against their parents.

Second, the normative structure of litigation—internalizing costs—has no clear substantive bounds. For example, there are fundamental problems in the conception of causation in our litigation system that are exacerbated by the internalizing cost conception. There are many situations in which there is no clear definition of what is a cost to what. This topic has been written about both by Ronald Coase and Judge Calabresi and is exemplified in Coase's query of whether the costs of trampled corn should be internalized to the rancher or the farmer. These issues need far greater explication, particularly now, because the litigation system has expanded beyond previous limits. At the moment,

questions of causation that relate to internalizing costs have not been solved, and this uncertainty gives litigation a much broader range than agency litigation.

Third, the normative structure of litigation—the conception of internalizing costs—is not limited by an alternative regulatory conception of competition in the market. The fact that there is competition in an industry or the fact that the market provides an answer to a particular problem is often a decisive factor that makes agency regulation unnecessary. In contrast, the existence of competition or the market has almost no importance at all to the resolution of litigation. That is why litigation today is fundamentally at odds not only with agency regulation, but with the most basic conceptions and understanding of market processes.

Let me give you an example of litigation that illustrates this litigation/regulation distinction. Let me say, at the outset, that I have given some professional advice in this context, but my ideas precede my involvement. And, you will see, my views on this litigation are so extreme that they could not possibly be the result of some type of consulting bias.

Very recently, there have been a number of class action suits brought against the managed care industry. Dan Kessler referred to some of these already, such as suits where there has been some sort of harm—misdiagnosis, mistreatment—to one of the participants in a managed care program. The question in that sort of litigation is relatively simple: Should the suit be brought against the HMO or brought directly against the HMO's doctors?

There is another set of lawsuits, however, that represents a much broader attack on the managed care industry. These also are class actions. The basic claim of this litigation is that the HMO's have committed fraud on participants in managed care programs by using cost as a criteria for defining the nature of the care to be provided. Simply using cost as opposed to pure medical criteria constitutes

the fraud. It is largely irrelevant, in these actions, if there is direct harm to any victim.

Under the normative structure of litigation—the conception of internalizing costs—one cannot easily dismiss this sort of claim. These participants receive care that is defined by some kind of cost, treatment that is allegedly different than the participant would receive if the plan were defined only by medical criteria. So there is, conceptually, some type of cost involved; thus, one cannot dismiss the action in an internalizing costs framework. Nevertheless, even the most simple understanding of markets will show that these cases are incoherent. They are also contradictory to our basic form of economic organization.

All care systems must consider cost to some extent. If one were to look to European social welfare systems, cost comes heavily into play. A further incoherence in these cases, of course, is that there really is no damage: these participants have paid less for medical programs that are constrained in various cost dimensions than they would have paid if there were no cost controls on the system.

There is, however, an even more fundamental problem to this sort of litigation. The internalizing cost framework for thinking about this problem is misconceived. Deciding whether something is a cost or not a cost, and whether a cost should be placed back on the HMO so that they will organize their care program in a different way, misconceives the nature of the industry because it completely ignores the effects of competition on the organization of health care. Here the difference between regulation by an agency or by litigation becomes dramatic. In the regulatory context, regulators would ascertain if the market for health care suffered some ongoing or intractable failure and would intervene only and only to the extent that they identified such a market failure. That is not the issue at all in this litigation. These suits proceed in the absence of any identifiable personal harm or any demonstrable market failure.

These cases have only recently been filed. While many non-meritorious cases are of little ultimate importance, I suspect that these cases will greatly affect our health care system. As Judge Calabresi mentioned before, firms will adjust in response to the costs of litigation, or in response to the threat of litigation, and these costs are not insubstantial. These suits may be dismissed and should be dismissed, so their effects should not be overstated. But they show starkly the different approach of regulation by agency or by litigation; one, by agency, a sensible approach to public policy in the field; the other, litigation, essentially incoherent. Let me provide a further and more concrete example of similar litigation. A few months ago, State Farm Auto Insurance Company lost an Illinois class action suit.¹³ The central claim was that State Farm committed fraud by using what are called “after market repair parts”—repair parts made, at low cost, by producers different than the car’s original manufacturer. The plaintiffs claimed that State Farm’s practice of using “non-original equipment manufacturer” parts in auto repairs constituted a breach of its agreements with policyholders and violated Illinois’ consumer fraud law. The jury and judge agreed. Similar suits have been filed against virtually all other auto insurers.

These lawsuits are very similar to the managed care suits I described and are similarly incoherent. First, these cases do not involve safety parts. These are only crash parts—the grill, the bumper—that affect the appearance of the car; they do not in any way affect the safety of the car’s occupants. The lawsuits are incoherent from the standpoint of public policy because consumers benefit from the use of cheaper repair parts, and reap the benefits in lower insurance premiums. To give a personal example, I drive a 1987 van. The notion of having that van turned into a new automobile if I’m in a crash by the installation of originally manufactured parts is insane. It makes no sense to have a crash turn an old car into a new car. I do not want to pay an insurance premium that will guarantee me new parts after an accident. If I wanted a new car, I would pay for a new car. I should not be penalized for my preference for

getting by with an old car by having a lawsuit force insurers to charge me a high premium to restore my car to new.

Like the HMO fraud cases, there is also a circularity here that comes from ignoring the operation of the market. What exactly are the damages that result to the policyholders from the use of after-market parts? The premiums are lower as a result. Policyholders benefit from those lower premiums. There is no market damage. This lawsuit gave no attention whatsoever to competition because, as I mentioned before, competition is irrelevant in the context of internalizing costs. It is irrelevant, in regulation by litigation, that State Farm and other auto insurers are subject to competition. In the context of auto insurance, it is ridiculous from the standpoint of public policy to ignore the existence of competition. More than almost any other product, auto insurance is dominated by consumer repeat purchase. State Farm asks its policyholders to renew every six months. If there were real consumer harm, customers would turn to other firms in the market. There is no evidence of them doing so in response to the use of after-market parts. This fact would be determinative in the context of agency regulation; it was irrelevant to the lawsuit.

As I mentioned, the lawsuits against the managed care industry may still be dismissed. State Farm, on the other hand, was hit with a \$1.3 billion verdict for its policy of reducing insurance premiums by using after-market parts. It is impossible to look at the HMO and auto parts litigation and say that they contribute to sensible social policy. State Farm's reaction, as would any company's be following a \$1.3 billion verdict, was to terminate the after-market repair parts policy entirely. Neither State Farm's policy holders nor a society concerned with conserving resources benefits from this result.

Litigation of this nature resembles corruption. It is not corruption in the sense of bribes to judges or exactly in the sense of excessive benefits obtained by any untoward means. What I mean by

corruption, and it is characteristic more broadly of corruption in the Third World, is that we see in this litigation the diversion of productive resources to redistributive ends. In the Third World, productive resources are diverted into the hands of government officials, imprisoning the citizens of these countries in economic impoverishment. Here, we see the diversion of productive resources into the hands of plaintiffs and the plaintiffs' bar. The effect on the economy and the effect on the society in terms of diverting productive resources is of different magnitude, but in exactly the same direction.

To return to my original question: From the standpoint of those who believe in limited government, how do we analyze the question of regulation through agencies or regulation through litigation? We cannot simply compare the process of agency regulation to the process of litigation. It is difficult to compare the outcomes of the two processes, because we have so little information about the magnitude of the welfare effects of litigation. It is helpful, however, to compare the normative structures of these two methods of regulation. The difference between these two methods was not so strong in the 1960's when the agency deregulation movement began. It is true today, however, that agency regulation has been constrained by clear ideas of what is and what is not in the public interest. It has been constrained by the notion that regulation should be limited to the small, and growing smaller, set of conditions in which the market will not work.

There is no reason to support greater agency regulation on these grounds. But there *is* a reason to support agency regulation over litigation. The problem that we see here—again from a limited government standpoint—is that the normative structure of litigation is not constrained by the same conceptions. Put differently, we have not seen a deregulation movement in our civil justice system. This is quite unfortunate. We need to roll back liability standards. We need to reduce the number of occasions in which individual classes or individuals can bring actions against other

parties for recovery on grounds that ignore the operation of the market and broader public interests. Until we achieve that end, however, there will be much greater danger from regulation through litigation than regulation through the agencies.

PROFESSOR CHRISTOPHER SCHROEDER: I took it as the charge of the second panel to offer some comments on the political economy of regulation versus litigation, and perhaps to offer some observations about the relationship between litigation and democratic values. These are two vast topics. I will make three relatively discrete points.

First, in the context of environmental health and safety regulation, the customary problem of agency capture is not an issue. By agency capture, I mean the cozy, symbiotic relationship that exists between agencies and the regulated community or constituent groups. Perhaps that was a major problem in the area of the older economic regulation, but it's not a major problem with respect to health and environment and safety regulation.

Different standards apply to review of agency rule making in the federal system, but I don't think you could persuade people at the Environmental Protection Agency or OSHA that their rules have very high rates of survivability. There was a question raised earlier about the joint EPA/New York State suit against Midwestern power plants.¹⁴ This suit is a direct result, I think, of the remand in the American Trucking Association case of the ozone standards. Both lawsuits suggest a phenomenon that Jerry Mashaw at Yale and others have commented on extensively: when the rule making process becomes too cumbersome, it drives agencies to less expensive means of conducting their business.¹⁵ Those means may be less transparent, less fully participatory than rulemaking through the notice and comment period, and less subject to strictures of reason, decision making, and review. They are, as a result, less desirable than the typical notice and comment process.

There are, then, real problems inherent in agency regulation. Those who are in favor of regulation in the health, safety, and environmental context need to think about supporting measures to modernize the rule making process. Unfortunately, in the last several Congresses, the forces interested in regulatory reform have become intermingled with the forces that are interested in regulatory obstruction. Regulatory reform legislation has become paralyzed as a result. Agency capture, to repeat, is not the problem; regulation varies in laxity and stringency depending on electoral politics. The post-materialist interest in quality of life, health, safety, and environmental concerns have been politically salient for a long time, from Anne Gorsuch Burford to today. Electoral politics has a greater role in the political economy of this type of risk regulation than capture does. Electoral politics, of course, is not the only factor affecting risk regulation. Changes in the budget allocated to enforcement by agencies, appropriations riders, and the appointment process all have a great impact on the efficacy of regulation. These factors are less visible, and therefore are not generally affected by electoral politics.

In terms of public choice considerations, is it better to favor regulation or litigation? This is difficult to tell. There are ways that interest groups can influence the litigation process just as they can influence regulation. This is particularly true in states where judges are elected, but interest groups can play a great role in the appointment process, forum shopping, selective settlement of litigation, and closure of adverse cases from disclosure via settlement. We do not have much research on this issue. However, some research suggests that repeat players in the litigation process have advantages across the board. I suspect that there is an interest group problem with respect to the litigation process that is as serious as the threat posed to the regulatory process, but we simply don't know at this point which process has a comparative advantage.

Earlier panelists have referred to a democracy deficit, or the conflict between regulatory litigation and democratic principles. It is

important here to distinguish between different kinds of litigation. *Qui tam* citizen suits, for example, do not present much of an issue with respect to democratic values. These whistle-blower suits may create problems with prosecutorial discretion and the Take Care clause, but that's a separate issue.

Within tort litigation, there is a distinction between cases that build upon and evolve existing common law doctrine and cases that are based on novel rules. Both of them, in some sense, are undemocratic, but this is insignificant; we don't live in a society or a culture that is purely democratic. Embedded in our system of social organization is a respect for the common law system. As a society, we understand that, within bounds, judicially evolved doctrine and the application of this doctrine to specific cases is a legitimate form of dispute resolution.

PROFESSOR DAVID VLADECK: The question before this panel is one that has vexed those interested in health and safety regulation for a long time. Which institution, the courts or administrative agencies, is best suited to engage in regulating risky private conduct? There is no one answer that fits all circumstances. One point, hammered home today, is that this is not a binary question. Regulation and litigation regimens *ought* to exist side by side—they serve very different interests.

Consider the Titanic. When the ship set sail, it was in full compliance with all of the then applicable standards for lifeboats, even though there were fewer than half the necessary spaces in the lifeboats for the passengers and the crew. British Maritime authorities, after the crash, changed the standards, but that proceeding took years to complete. The existence of the tort system provided an alternative discipline, an alternative check on commercial activity. Agencies are not capable, alone, of enacting all appropriate regulation. Nor of course do agencies serve the vital compensatory function that is the hallmark of the tort system.

Three general points can be made about regulation versus litigation. First, if one could discount, for a moment, all the problems that plague our administrative agencies, agencies ought to be the first line of policy setters when it comes to consumer health and safety. Agencies have expertise. They are, at least in theory, non-partisan. Agencies are equipped to make the complex judgments that lie at the core of these problems. In a perfect world, we would simply go back to the conception of what our agencies ought to be, which is reflected in the Administrative Procedure Act as signed into law in 1946.

My second point is about the problems plaguing regulatory agencies. It is hard to argue with the position that preventive regulation is preferable to compensatory justice. If you look at today's agencies, however, they are largely incapable of action. The reason for their immobilization should not escape our attention. Agency capture is still a problem. As much as I respect Chris' opinion, I constantly see agencies—like the NRC—that work hand in hand with the industries they're supposed to regulate. Many agencies are no longer “cops on the beat,” using enforcement tools to compel compliance with the law. Why is this the case? Agencies have inadequate staffing and resources. The FDA, with its staff of fewer than 10,000, regulates 25 cents of every dollar spent in the United States. It has responsibility for ensuring the safety and efficiency of every drug and medical device sold in this country; the purity of virtually all the foods we consume (including those we import); the safety of all the cosmetic products we use; and the safety of all medications given to animals. This is a vast responsibility. And fewer than 3,000 of the FDA's employees worry about enforcement. Further, agencies have a very difficult time obtaining necessary data. In the context of rule making, there is not an agency in this city that has subpoena authority. Agencies are highly dependent upon the industries they regulate to get information.

Staffing and information shortages, unfortunately, are not the only problems. There is a revolving door that sucks away agency exper-

tise. There is OMB interference, an issue that Boyden and I have debated for approximately eighteen years. Congressional interference should not be underrated. Whatever strength the *Pillsbury v. FTC* doctrine (which nominally forbids coercive Congressional interference with agency proceedings) used to have in terms of insulating agency staff, that doctrine has simply vanished. Talk to regulators: they are constantly being hauled down to the Hill and asked to justify their decisions.

Adding to this list, agencies frequently have to deal with hostile court reception. The “arbitrary and capricious” standard has not been much of a cushion for agencies that are engaged in rule making. Courts now routinely overturn EPA rules; the FDA’s regulation of tobacco products was recently overturned by the Supreme Court, marking the first time that agency ever lost a Supreme Court case; and OSHA rules have fared very poorly in the courts as of late. When faced with hostile judicial receptions, agencies understandably become gun shy. One reason why Ronald Reagan’s OSHA did far more for American workers than Bill Clinton’s is that, in this day and age, agencies are wary of engaging in rulemaking when faced with unreceptive judicial audiences. To take one example, during the Reagan administration, OSHA issued 10 health and safety standards; under Bill Clinton, only 2.

By any measure, the output of the regulatory agencies a decade ago was far higher than it is today. Given this change, it is little wonder that people are going to the courts instead of agencies to address regulatory business. Do litigators overreach? Of course. But they are responding to regulatory failures. Seventeen public school children in D.C. have been killed by handguns this school year alone, and dozens more have been injured, because there is no effective regulation of handguns. No regulatory agency has been assigned that job. And this regulatory void has led to the intolerable situation where, in cities like D.C., kids can get their hands on guns as easily as textbooks. Society has a right not to tolerate that void. It is no surprise that victims of handgun

violence are venting their anger and seeking redress in the courts.

Regulatory failure inevitably leads those disadvantaged to seek regulatory solutions from the courts. We now have private litigation instituted by governmental entities to solve broad social problems. Public law is now made, to a great extent, in the context of tort litigation. This explains much of the creative HMO litigation. Congress, by casting a broad protective cloak over the HMO industry, has incited the response that you see through class action suits.

My third point is this: even though it is preferable to assign principal decision making responsibility to agencies, courts are not ill-equipped to engage in risk regulation. Regulatory agencies are a relatively new phenomenon. Courts have been engaged in this type of activity much longer. In some ways, courts are as well or better suited than agencies to perform these tasks—for one thing, they have better access to information. If you look at the asbestos cases, the courts were decades ahead of the agencies in terms of understanding the dimension of the problem and trying to do something about it. The same is true with the Dalkon Shield litigation. Civil discovery is a great engine for truth finding—an engine unmatched in the regulatory context. Courts also have the ability to secure neutral advice through the court appointment of experts. Little of the advice agencies get from experts is unbiased since virtually everyone has a direct stake in the outcome of agency rulemakings.

Courts adapt to revolutionary changes in the market quickly, sometimes more quickly than agencies can. There is a type of diagnostic software that is used frequently in medical procedures. The FDA has been struggling for years with the question of whether it is permitted to regulate medical procedures. The tort system, alternatively, has already imposed appropriate constraints. The notion that only regulatory agencies can effectively impose a sensible discipline on economic activities is simply not correct.

It has been suggested today that the courts' involvement in risk regulation is new. I have already suggested that it is not. The English Parliament did not give us *Rylands v. Fletcher*, which held that entities engaging in ultrahazardous activities would be subjected to heightened liability standards. And it was not the New York legislature that created strict liability or abolished the rules of privity in tort cases; it was the New York Court of Appeals, led by then justice Benjamin Cardozo, in *McPherson v. Buick*. Common law courts for centuries were society's main risk regulators. The revolutionary changes in the tort law that Professor Schroeder alluded to in his comments came from judges—more specifically, common law judges—trying to adapt the law to new circumstances.

It has also been suggested today that the courts' involvement in risk regulation is not democratic. There is nothing undemocratic about having our court system involved in risk regulation. There are few institutions in this nation that are as democratic as common law juries. You may not like them because they're not sufficiently predictable, but they are your neighbors and your friends. Everybody sits on juries. If the juries did not think strict liability ought to be applied, the rules of strict liability would vanish. Common law juries were the principal means of regulating risky conduct until the 1940's. To make the argument that there's something inherently undemocratic about this process is simply to ignore history.

MR. THEODORE OLSON: It is interesting that Boyden put the academic people first, and left David and I in the trenches. You will be able to hear the difference because David and I do not use expressions like "circularity," "normative structure," "internalizing costs," "externalities," or "conceptions of causation." I will not address those subjects because I don't think I understand them. I will, instead, talk about some of the trends I see in modern litigation and regulation. Make no mistake about it: courts, juries, and the tort system are taking over the regulatory systems. It is not being done, moreover, in an orderly, systematic, or predictable way. There's no agenda being set by anybody that's elected.

The current issue of the *National Law Journal*¹⁶ describes the top ten jury verdicts in 1999 in the United States. Two years ago, Chrysler asked me to handle a product liability case. It was a 262 million dollar verdict—12 million dollars in compensatory damages and 250 million dollars in punitive damages—in connection with the death of a six-year-old boy in South Carolina. At that point, I think, that was the largest product liability verdict against an automobile manufacturer. Well, we're just now getting around to filing the appeal, and I think we have been bumped to the fourth largest automobile product liability case. According to the *Journal*, the biggest award for 1999 was 4.93 billion dollars. That will get anybody's attention. The next one is 1.2 billion, and then 1.02 billion, 900 million, 600 million, and 580 million dollars. The tenth largest verdict was for 158 million. These amounts apply all to cases across the board—automobile fraud, products liability, and so forth. These decisions, with their immense compensatory damage awards and extravagant punitive damages awards, are the likes of which we have never seen.

If you chart the growth of punitive damage awards sustained on appeal in the courts over the years, you will see a revolutionary change. David may say that this is nothing new, but the largest punitive damage award affirmed by a court of appeal in the state of California until the sixties was \$10,000. Now we're talking about million and billion dollar cases. In addition, there are also class actions. There are also consumer fraud cases brought under various state statutes. Individual cases, simply put, are the instrument for change in regulatory standards. Courts are telling society how manufacturers, insurance companies, and banks should operate. This is not the way the system should work.

Let me mention a few characteristics of the tort system that make it unsuitable as a regulatory mechanism. First, a tort case usually results in developing a broad rule. Yet, verdicts are based upon a single set of facts in a single case. Courts may be able to get all kinds of information, such as David was suggesting in the

asbestos case, but most cases involve one set of facts in one incident. The type of information that is available to legislative bodies or to regulatory agencies isn't usually available in litigation. In fact, the opinions and the data having to do with other circumstances is generally inadmissible.

Secondly, jurors are equipped to be triers of fact. If you study common law history, you find that juries were invented for this purpose; four or five hundred years ago, the juror's job was to, simply, ascertain what did and did not happen. Juries are ill equipped to be senders of messages to society or to develop broad rules. They have no training for that sort of thing. They do not have the necessary information before them and they consider questions for a short time period. There is typically no public notice, or the opportunity to hear from the public in connection with a particular case. The public, who will be immediately affected by the temperature of coffee or where the fuel tanks are placed, finds out about verdicts in the next day's paper.

One of the fundamental principles in our separation of powers is that legislators make laws. The executive branch enforces laws, and the courts are there to interpret them. Our Founding Fathers were convinced that a combination of authority in a single agency—be it judicial, legislative, or executive—was the very definition of tyranny. When we have regulation through the tort system or the civil justice system, we have powers combined in one place. This should give us pause.

Notwithstanding what David says, judges and juries are *not* well equipped at balancing risks. They don't have the necessary experience. Jurors see a case from a single perspective. If you are considering a case where someone died in an airplane accident, this gives you no basis to make broader, industry wide decisions. Jurors do not say "many people are going to die every year, but we have to be able to get back and forth; therefore, we ought to have these rules." They do not have that perspective. Doing justice in an individual

case is a great deal different than creating a broad, societal rule for a broad segment of the society.

In fact, if a jury *were* to worry about the broad effects of its decision, it would not be doing the job that it was entrusted to do. Juries are supposed to decide the facts within the constraints of a single case, pursuant to judge-given instructions. If jurors start worrying about after effects, judges will have to start setting aside verdicts because of jury misconduct.

Rules need to be standardized and predictable, but court decisions are post hoc, fact specific, and only occasionally binding on other situations. The uncertainty of litigation makes it ineffective as a regulatory device. Legislative branches, however long they take and however locked up they might be, are bounded. They have timetables. They can render timely decisions. Consider, instead, the uncertainty of litigation. Imagine that we are going to solve the gun or tobacco problem by saying, “Let’s wait until some trial lawyer gets the right case and is properly incentivized. Let’s wait until he is in front of the right jury with the right judge and gets the right verdict.” That is neither certain or time efficient.

In public agencies or legislatures, the people making the decisions are sworn to serve the public interest. That is not the case with judges, juries, or trial lawyers. Trial lawyers are responsible to their clients; they act to bring about the best result in their clients’ interest.

What about David’s argument: agencies are immobilized, they’re paralyzed, they’re being interfered with by the courts and legislatures. At the moment, he says, they are incapable of doing an adequate job. He suggests that we take regulation away from the democratic system where we elect people to make those kind of decisions and throw things up in the air—rules should be decided at random, by relatively capricious judges and juries, and by lawyers who decide to make a lot of money in particular cases.

If our regulatory system isn't working, abandonment is not the proper solution. I, for one, do not favor switching to something inherently and demonstrably unsuitable because of agency frustration.

MR. GRAY: I'd like to ask the panel a few questions. What, in public choice theory, explains why we have veered to courts to set standards that used to be set by legislatures working through agencies? We can't figure out how to fix our problems unless we know why they occur. Is it, as Professor Vladeck suggests, because of agency rule making ossification? Is the answer, then, to unleash rule making so it engulfs litigation? Or should we throttle back on regulation?

PROFESSOR PRIEST: The courts have adopted open-ended legal standards that allow cases to be brought and claims to be made that would have been impossible 20 years ago. This explains much of current litigation. There is also something to be said for public confidence—or lack of confidence—in agency regulation. If a jury were convinced that a regulatory agency standard was adequate and created the appropriate level of safety and protection for consumers, it would not be as willing to find liability on the part of a manufacturer that complied with the standard.

Instead, plaintiff attorneys have been very successful, in case after case, by arguing that regulatory standards are minimum standards only. They have convinced jurors that higher standards should exist, standards that would have prevented the accident in a particular case. These attorneys are armed with a theory of law—strict liability—that has been developed in a way that does not look at what the manufacturer did or whether the manufacturer's decisions were reasonable. It considers, rather abstractly, the nature of the product. That general approach has been extended to contexts well beyond products liability.

In sum, we have a system where there is increasing opportunity for plaintiffs' attorneys to bring cases and obtain recoveries.

The defining standards of the law are open ended, much more open ended than the standards of economic regulation. This has led to the greater range of litigation.

MR. GRAY: It seems to me that the development of these new standards predates agency ossification. What I'm trying to ascertain is whether regulation by litigation is related to frustration with agencies. I don't think they are related, myself, but I'm trying to get your opinion.

PROFESSOR PRIEST: I actually think there *is* a parallel: The adoption of strict liability and the expansion of standards of legal liability began to occur at about the time that the public was also supporting the creation of regulatory agencies dealing with public health and safety. OSHA, the Consumer Product Safety Commission, EPA, as well as NHTSA and other various commissions were created about the same time that these legal standards were changing. There was a general movement, in judicial and policy making contexts, towards greater incentives for safety. This was manifested in specific ways in the agency regulation realm, and in far more open-ended ways in the legal system.

MR. GRAY: Let me raise the topic of court/agency relations. During the last eight years or so, two-thirds of EPA's rules have been judicially invalidated. This activity has been primarily by one court, the D.C. Circuit; nevertheless, the litigation used there is available to environmental groups, business groups, or consumer groups. Public Citizen can use these just as the Chamber can. The EPA has been rebuffed, and rebuffed with frequency; the judiciary is saying, in essence, that the agency has gone too far. I am having trouble understanding this situation. Courts, according to Professor Priest, are open-ended, however the EPA is repeatedly remanded. I don't know what trend means what and who's doing what to whom, or what legal system is operating where in which instance. I find the whole thing confusing.

So here, the agencies are not effective. I look at the FDA. There is a user fee paradigm now where the drug companies pay in effect for their own drug reviews. And the problem with the FDA is not that they're not getting enough drugs out at the moment. The problem is with the health care system; they may be getting too many drugs out. And certainly that's what Ralph Nader has always argued, that there are very few drugs that ought to get approved under any circumstances.

The SEC, for example, is dealing with an incredible volume of material and doing it in a remarkable way. If you look at the banking system versus the mutual fund system for allocating capital, banks do about a trillion dollars worth, mutual funds maybe the same. The banking system has 14,000 regulators and the mutual funds have 400 regulators, and which does a better job? My vote is with the SEC. I think the banks are doing much better now, but we had a terrible recession and the Japanese are still struggling with their S&L crisis. I might also add, despite my anguish over the years with David Kessler, the FDA also does a pretty good regulatory job.

MR. SCHROEDER: One thing your remarks point out, Boyden, is the need to subdivide this topic. Different regulatory agencies and different risk problems are associated with different causal explanations. There are, and should be, different reform strategies and there will be different problems in their implementation.

I work primarily in the environmental area. There has not been much of a regulation by litigation explosion here in the open-ended court sense: toxic tort cases have not been very productive. We've got a lot of environmental litigation, but it's mostly statutory driven. Much of it was created by Superfund or by citizen suits.

If you look at the product liability area, you get a different set of problems. In that context, ossification of the rule making process

and the explosion of risk related litigation in the courts are perhaps causally related. But I also believe that jurors have a sense that the regulatory system has become stagnant. While people here at the Chamber—and elsewhere—might like to cabin the open-ended standards of the litigation process, reform is politically a non-starter until there are regulatory changes. Litigation looks far more attractive to many people at the moment; it does, after all, appear to be solving many public problems. It seems far preferable to a regulatory system that seems to be moving nowhere—one in which people have little confidence. At least at the level of reform strategy, litigation and regulation are related.

MR. GRAY: In terms of political popularity, I'm not sure if the tort regime is very popular. We used to say, back in the old days of the *Illinois brick fight*, that shouting “lawyer” on the floor of the House of Representatives is like shouting, “fire” in a crowded theatre. Perhaps the tort system is popular at the grass roots level—I defer to people who have been dealing with this issue.

PROFESSOR VLADECK: I don't know if the debate should be defined in that way, Boyden. I think it should be defined as a flight from accountability. One of the things I find disturbing in Ted's presentation is that, after succeeding in dismantling the regulatory state to a large degree, he—

MR. GRAY: You give us much too much credit.

PROFESSOR VLADECK: All right. Having succeeded in at least obstructing the regulatory state, Ted now complains that we ought to throttle back the tort system. This, to me, translates into a plea of “just let us be unaccountable.” That is an argument that simply will not fly. It is not a politically attractive message, but it also is not a responsible message.

To what extent is the failure of the regulatory process attributable to the rise of the kind of litigation that Professor Priest rightly

criticizes? It seems to me that the relationship is significant. It is not, however, the only problem. Congress bears some responsibility in this debate. I find it odd that we talk about institutions of government that are involved in risk regulation and we focus exclusively on agencies and courts. No one has talked about Congress. Many of the problems that have led to maverick litigation are problems that ought to have been addressed, in the first place, by Congress.

But it seems to me that the problem that we have to wrestle with is this: if there is a consensus that regulation, not litigation, should be society's first line of control over hazardous activities, then the agencies should be entrusted with that function and unshackled so they can perform it. How do we return the agencies to the position where they can actually engage in responsible rule making? I just don't think there's a credible argument that the health and safety agencies these days are up to the task.

PROFESSOR GEORGE PRIEST: We should be clear here: I'm not asking to get rid of the legal system. I don't think that any proposal, even tort reform proposals, are trying to eliminate accountability. I do think, rather, that we should try to eliminate those excessive features of the system that have no productive purpose with regard to accountability in terms of increasing safety. I do think we should retain those features of the legal system that provide appropriate incentives for safety.

Our legal system has expanded very dramatically in recent years, even far beyond what verdict statistics show. If you look at the number of lawsuits and the amount spent on legal resources, there has been a vast expansion from the 1970's to today. There is not a single shred of evidence—I've done studies, Kip Viscusi has done studies—that would suggest that that litigation has had the effect of increasing levels of safety. Of course, it's difficult to distinguish the effects of litigation from market and regulatory effects, but one would think with a phenomenon of this magnitude that there

would be *some* empirical evidence of increases in safety that would differentiate the effects of litigation from typical market forces. Nobody can find any effect.

We do not have enough time to talk about how to redesign the legal system. I repeat, however, that I am neither trying to get rid of the legal system nor eliminate accountability. I believe in accountability. I believe in trying to define a legal system that does no more than optimize safety. That would eliminate a great deal of the modern litigation that I think basically serves a solely redistributive end.

MR. GRAY: Let me follow up, David, about your comments on the responsiveness of Congress. Are you suggesting that maybe Congress is bought? Are you suggesting that there is too much money in the system, and, therefore, Congress can't respond to these problems? I would argue that if you look at the state level, at tort reform, what you have is too much money—campaign contributions—sloshing into the funds of judges who are elected. And, you know, what's good for the goose is good for the gander.

I'm not sure I know where the responsibility lies. There are several state supreme courts that have gutted state legislative reform in regards to punitive damages, joint and several liability, and liability. Legislative rules get rejiggered by the supreme courts and by judges who are elected with a lot of campaign finance help. Perhaps the answer is to alert the other side—maybe they ought to get into the fray, too, and get their own judges.

PROFESSOR VLADECK: Well, that is what happened in Alabama. If you followed the election of the Alabama Supreme Court, it was a race to the bottom, and the business community won that one this time around.

MR. GRAY: This time around?

PROFESSOR VLADECK: Yes. If you follow Texas politics, you know that Texas has elected judges as well. There are shifts back and forth in terms of which side captures the judiciary. The ABA has done an in depth study on the question of whether judges ought to be elected or not, and I think they've reached the conclusion that there ought to be very substantial changes in the way judicial selection laws work at the state level. I don't disagree, Boyden, with your observation that there are problems in the state court systems.

MR. GRAY: Maybe we ought to open things up to the audience.

AUDIENCE MEMBER: Let me cut to the chase. What would each of the speakers assign as the principal function of a regulatory system where we'll have both courts and regulatory agencies? Which principal functions would you assign to each one, and, under the current environment, which one or two reforms do you think would most likely help that institution perform these functions?

PROFESSOR PRIEST: It is very hard to put this succinctly. I think the regulatory system should deal with what we agree is market failure; it should step in when competition is seriously impeded. I'm not sure this applies to the wide range of safety and health regulations we have now—I think we underestimate the value of the market in this area. The common law system is similar: it exists to create additional incentives where there has been further market failure. It is a safeguard when incentives that are created by the market for the production of safe products have failed in some way.

MR. SCHROEDER: The theoretical explanation for why the two regimes exist side by side in the drug system is this: the regulatory system, if it's operating correctly, balances safety benefits in a cost benefit structure. It asks if the risk to the population outweighs or does not outweigh the benefits given. That is a separate question

from, when something goes wrong, whether there ought to be a transfer payment from the producer to the victim. One is a form of efficiency analysis that says it's okay to go ahead with the product if it's potentially possible to make a transfer from the beneficiaries to the victims that would leave the victims as well off and still leave a net benefit to the beneficiaries. The tort system, if you wanted it to operate as a supplement to that system, would simply say, "Let's make the transfer. Let's not make it hypothetical; let's make it actual."

To respond to the question from the floor, I think the core area where regulation is going to remain essential is in the area of diffuse harms, particularly in the environmental context. It is impossible here, or very difficult, to prove individual causation. We're essentially talking about the production of public goods or the prevention of public harm; collective decisions *should* be made about what goods should be produced or harms prevented. As far as reform measures go, we have not talked much today about the different regulatory instruments that are available.

This morning, the panelists were assuming a system of regulation in the old fashioned style of command and control. There is another style of regulation. An example is the acid rain program that Boyden Gray was instrumental in inserting in the 1990 Clean Air Act. Here, a collective decision establishes the level of the social good or social bad. Then a market-based incentive system is allowed to operate that makes allowances or licenses to pollute available after an initial allocation, available for a transfer or reallocation among the sources.

That acid rain system of regulation has not functioned ideally, but it has functioned at a level that most analysts have said is much more cost effective than the command and control structure. That sort of blending in the area of diffuse harms gets you close to the appropriate role for collective decisions. It also gets you close to the appropriate role for getting the incentives right at the private

level; entrepreneurs can figure out cost effective means of achieving their objectives either by selling excess allowances, purchasing them on the market, or making intrafirm transfers among their different pollution sources. This is a model that the EPA has done some experimentation with. It is a strategy that ought to be given increasing attention as we address future problems.

Notes

¹ Agent Don Clark directed the investigation of former Attorney General Dan Morales and the five attorneys who obtained the state's \$17 billion tobacco settlement. He is currently employed as an investigator by O'Quinn & Laminack, the firm of Morales Five member John O'Quinn.

² Daniel Kessler and Mark McClellan, *Do Doctors Practice Defensive Medicine?* 111 Q. J. Econ. 353 (1996).

³ See, for example, W. Kip Viscusi et al., *Deterring Inefficient Pharmaceutical Litigation: an Economic Rationale for the FDA Regulatory Compliance Defense*, 24 Seton Hall Law Review. 1437, 1476 (1994) and Kip Viscusi, *Alarmist Decisions with Divergent Risk Information*, 107 Econ. J. 1657, 1657-58 (1997).

⁴ *Punitive Damages: The Social Costs of Punitive Damages against Corporations in Environmental and Safety Torts*, 87 Geo. L.J. 285 (November, 1998).

⁵ W. Kip Viscusi, "Corporate Risk Analysis: A Reckless Act?" Stanford Law Review, Vol. 52, No. 3 (Feb. 2000), pp. 547-597.

⁶ This piece was later reprinted in the Harvard Law Review; see *Historical and Practical Considerations Regarding Expert Testimony*, 15 Harv. L. Rev. 40 (1902).

⁷ *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (1993).

⁸ *General Electric Co. Et Al. V. Joiner*, 522 U.S. 136 (1997).

⁹ *Kumho Tire Co. v. Carmichael*, 526 U.S. 137 (1999).

¹⁰ A. Mitchell Polinsky and Steven Sharell, "Punitive Damages: An Economic Analysis," Harvard Law Review, vol. III, No. 4 (February 1998).

¹¹ *Chevron U.S.A. v. Natural Res. Def. Council*, 467 U.S. 837 (1984).

¹² *Geier v. American Honda Motor Co.*, docket number: 98-1811, cert granted September, 1999. The issue before the Court: does the National Traffic and Motor Vehicle Safety Act, which called for a slow phase-in of airbags, pre-empt a consumer's right to sue an automaker in state court for not installing an airbag?

¹³ *Avery et al. v. State Farm Mutual Automobile Insurance Co.*, No. 97-L-114 (IL Cir. Ct., Williamson Cty) Oct, 1999. In January, State Farm filed a motion for direct appeal Illinois Supreme Court.

¹⁴ Eight states, including New York, filed petitions with the EPA under Section 126 of the Clean Air Act to address air pollution transported from upwind states. In November of 1999, the Justice Department, on behalf of the EPA, filed seven lawsuits against electric utility companies in the Midwest and South, charging that seventeen of the companies' power plants have illegally released dangerous levels of air pollutants. The Tennessee Valley Authority is also being sued.

¹⁵ See, for example, Mashaw's *Greed, Chaos, and Governance: Using Public Choice to Improve Public Law* (Yale University Press, 1997).

¹⁶ "Raising the Bar," *National Law Journal*, February 28, 2000.

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Panel Two:

***Fees in Traditional Litigation:
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Panel Three:

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