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ECONOMIC BENEFIT OF TORT REFORM

David Baxter

The purpose of this paper is to display the economic benefit of reforming the U.S. tort system. The reform of this system has become one of the most heated political debates in recent years as a result of the direction the system has taken. As the country has become more litigious, the state of the tort system has come to be regarded as a crisis. Frivolous law suits that result in large awards handed out by juries have caused the system to grow with large increases in the cost the system imposes upon the economy. This paper will explain just what the U.S. tort system is and how it is currently running into a trap. It will also explain the benefits that would arise from reforming the system and provides examples of this on the state level. Through statistical evidence and well researched information, this paper will show just how the reform will reduce costs and improve the economy in areas where it currently is lacking. As the country continues on its litigious path, tort reform will prove to be economically beneficial in different areas of both the private and public sector, and, as a result, will increase development and innovation in our nation's economy.

"A tort is an injury to someone's person, reputation, or feelings or damage to real or personal property" (cbo, 2/26/05). A large amount of these types of injuries are usually a result of accidents or unintentional harm. As is clearly apparent to most Americans, accidents are a part of our human experience, and nearly 20% of Americans suffer some type of accidental injury each year (News Batch). There are also tort cases involving intentional harm that are not considered criminal acts, which are present in this system. In the case of the tort system, it is actually a system used for compensating victims of these accidental and intentional injuries. This type of law is generally a matter of "common law" and is performed at the state level where nearly 95% of tort cases are filed (cbo, 2/26/05).

"Economic analysis suggests that the primary reason for utilizing the tort system is to allow risk-creating activities to be carried out only if the social value of the activity justifies the risk created" (Matiacci, 3). When this risk is acted on, it is the job of the jury to determine who is liable. Tort liability is assigned using two basic standards: strict liability and negligence (Injury Board). Under these rules, the incentive to take precaution along with the standard of care under negligence varies. Strict liability is a situation in which the potential injurers take care and the potential victims don't, resulting in full compensation of the injured with the injurer bearing the entire cost (Stull, 2/23/05). Negligence is used to determine just how much care should be taken into consideration by the potential injurers and help determine the cost and fault. Contributory negligence and comparative negligence are two different types that are used depending on the tort laws presiding over a particular jurisdiction or state. Contributory negligence is a modified negligence standard that does not place liability on an injurer if the injured party fails to take the proper precautions (Stull, 2/23/05). The contrary to this standard is contributory negligence which places the entire liability on the injurer without assessing any blame to the injured party (Stull, 2/23/05). These different standards and rules are all used in the decisions by juries to determine cases under the current tort reform system.

Many reasons support the increased litigiousness of our society. Over the past several years, law profession has undergone significant specialization and has benefited from technological advances particularly in the areas of medical malpractice and product

liability (News Batch). This has also been affected by the “contributory negligence” rule which used to limit the number of persons who could claim damages. Today, all but a handful of states use “comparative negligence” rules which place no restrictions on the ability of people to claim tort damages (cbo, 2/26/05). Also the contingency fee system of compensating attorneys has greatly increased the ability of injured parties to claim damages. No longer is it necessary for individuals to front court costs because under contingency fee rules, the lawyers pay the full cost of trial preparation and are only paid in a case that results in a favorable verdict (cbo, 2/26/05). All three of these have greatly contributed to the increased ability to claim torts over the past 20 years.

Over the past 50 years, the total tort cost has raised a hundredfold (Towers Perrin 2004). Over this time, the average annual tort system costs have grown at 9.7% (Towers Perrin, 2004). While this data has undisputedly grown and supports the litigiousness of our society as stated before, it does not grasp the detrimental effect on the nation’s economy. Since 1950, the total tort cost as a percentage of gross domestic product has grown from 0.62% to 2.23% in 2003 (Towers Perrin, 2004). This data shows that the average cost per citizen has undoubtedly grown along with the way our legal system operates within the U.S. economy. The cost of insurance for medical has grown as a result, costing a larger percentage of our incomes. This is money that is not placed into the economy where it could benefit companies and workers who are hurting for profits and jobs.

With the increased cost of the tort system and increase in damage awards, it is very difficult to not acknowledge the movement for tort reform. “Analysis suggests that tort law should be designed in such a way as to provide potential injurers and victims with appropriate incentives to avoid the accident by internalizing the externalities created by their activities” (Matiacci, 4). Currently there are three specific issues that illustrate this inefficiency of the tort system that has increased tort system costs. The three most popular issues regarding reform are through medical malpractice, auto-choice insurance, and product liability. While all different, the reform of all three of these areas intends to decongest the system. With the incredible expenses that the increased litigiousness has created, reform in these three areas would be economically beneficial.

While the number of cases involving medical malpractice claims has decreased, the system has seen steady increases in claims and premiums. Medical malpractice cases account for approximately 12% of all tort cases (Injury Board). With the increased specialization by attorneys, doctors are now dissected in front of juries across the country as a result of mistakes made on the operating table. As a result, doctors are forced to take out more malpractice insurance and as a result raise the cost of services. The willingness of patients to sue doctors has also increased, as well as the emergence of medical experts who are willing to testify against doctors. Doctors are currently forced to retire early because of the great cost of practicing and the cost of health insurance for citizens has increased. A Towers Perrin survey conducted last year predicts that health care costs will rise by eight percent in 2005. “This is on top of average annual increases during the period from 2000 to 2004 that ranged from 12 to 16 percent. Depending on a plaintiff’s age and degree of medical impairment, medical costs resulting from medical malpractice incidents may continue for decades” (iii, February 2005).

The tort system is the foundation for the settlement of claims resulting from traffic accidents. While overall there has been a decrease in the accident rate, automobile insurance costs have increased dramatically throughout the country (News Batch).

Insurance costs are about seven percent of household expenditures, and about of third of that expense is automobile insurance (News Batch). The problems that have arisen in the area of automobile liability are through the 16 states that use “no fault” insurance systems (News Batch). This no-fault system, which doesn’t award non-economic damages, compensates all injuries regardless of fault. This has led to fraudulent claims that are eventually paid for with the money people pay in to cover their automobiles. This system, if it were changed, would save the average family 28.6 percent off the average citizens’ insurance premium (Saxton, 3/96). It would also decrease the tax burden on lowest one-fifth of income earners 61.7 percent if reforms were made under this system (Saxton, 3/96).

Product liability has been one of the major developments within the tort system over the past half century. These suits are brought on by consumers who bought products that were defective and caused injury (News Batch). Today, nearly all states impose strict liability requirements in product liability cases, which are generally brought about through class-action suits (News Batch). Through the use of strict liability requirements and the fact that class-action suits are generally used, exorbitant awards have been handed out by juries in these types of cases. To date, nearly \$54 billion has been passed as compensation in asbestos-related litigation alone (News Batch).

In 1995, the Texas Department of Insurance adopted a reform of Texas Insurance Code that guaranteed yearly reductions in insurance that “requires that insurers pass through to policyholders the savings that accrue from the tort reform legislation on a prospective basis” (Texas Department of Insurance). This reduction has established across-the-board rate reductions as a result of tort reform legislation. The legislation that was considered by the state legislature focused on six pieces of tort reform legislation: changes in joint and several liability, changes in recovery of exemplary damages, penalties for frivolous lawsuits, changes in the Deceptive Trade Practices Act (DTPA), changes in venue requirement, and medical negligence reforms (Texas Department of Insurance). These reforms, which were created by the 73rd and 74th state legislatures of Texas, have led to nearly \$2 billion in policy holder savings (Texas Department of Insurance). These changes made by the legislature and the Texas Department of Insurance have led to these billions of dollars worth of savings and have all come as a result of tort reform.

The tort reforms made by the Texas State Legislature placed caps on exemplary damages at \$200,000 and placed limits on non-economic damages at \$750,000 (Texas Department of Insurance). The legislature also chose to punish lawyers and civilians for filing frivolous law suits. As a result of these reforms that the Texas State Legislature made, the people of the state have done nothing but reap the benefits. “Thanks to the civil justice reform, the average Texas household has benefited \$1,078 a year in reduced prices and increased personal income” (Perryman, 2/15/00). Having once been a considered a state with a widely imbalanced judicial system, the state has been able to increase its legal efficiency and, in the process, created nearly 300,000 new jobs, \$15.6 billion in additional personal income, and \$28.5 in gross state product (Perryman, 2/15/00). While all these numbers are certainly very impressive, the change in the legal system has revitalized Texas’ economy, enabling it to once again be competitive at the state level. With the reduced cost on both business and citizens, the economy is now capable of enhancing consumer choice, greater innovation, lower prices, and higher output. Overall, the state has had nearly \$7.63 in savings and, as a result, separated

themselves from other states (Perryman, 2/15/00).

The Bush Administration has made tort reform a top priority of the president's second term agenda. While very interested in general reform, the administration is most interested in medical malpractice reform that would place caps of \$250,000 on non-economic damages and limit punitive damage awards (iii, February 2005). Their agenda would also place limits on the time allowed to injured patients to file a lawsuit and establish a fee schedule for lawyers' contingency fees. "A provision would also provide liability protection for pharmaceutical firms. In recent years the House has approved a bill limiting lawsuits on medical malpractice claims seven times; each was defeated in the Senate" (iii, February 2005).

Other proposals seen intend to do a better job of disciplining incompetent doctors. Currently in Florida there are processes to control the practice of doctors who have multiple claims against them. In Texas, changing the way rates are set on insurance has saved money and prevented increases. Attempts at legislation to do the same in other states are currently taking place. Also, reforms are being considered to emphasize risk management, which would likely regulate the risk of torts in the medical field. This would be done by making doctors study medical malpractice litigation and set standards for doctors in the profession, particularly new ones (iii, February 2005). Auto-choice standards have also been proposed which would limit the expenses of the current auto insurance system. Like the no-fault system mentioned above, other no-fault systems have been proposed to try and limit expenses in the medical field, and reform the system under auto insurance.

On February 18, 2005 President George W. Bush signed into law the Class-Action Fairness Act of 2005. This law enables class-action lawsuits to be heard at the federal level rather than at the state level. "This will prevent trial lawyers from shopping around for friendly local venues. The bill will keep out-of-state businesses, workers, and shareholders from being dragged before unfriendly local juries, or forced into unfair settlements" (Whitehouse, 2/18). The bill also requires judges to consider the real monetary value of coupons and discounts. This enables victims of a tort to count on true compensation for their injuries through judges and not through juries that often over or under compensate the true value of a particular claim. This bill is just one of several reforms that have been made at the national level in an effort to decrease the total cost of tort reform.

The passing of this legislation at the national level doesn't stop insurance costs for doctors and drivers to continue to rise. It also doesn't stop companies from going out of business as a result of product liability cases. These reforms, like the ones made in Texas, have become a part of a political agenda for both political parties. The tort costs are expected to rise in the following two years, and by 2007, will make up an even larger percentage of the gross domestic product (Towers Perrin, 2004). To stop this, the medical malpractice legislation must be signed, auto-choice reform must be passed into law to allow drivers more control over the money they pay to protect themselves in case of an emergency, and product liability reform must also be passed to prevent companies from having to close as a result of suits. All of this legislation will enable companies to lower prices, improve innovation, and higher output. This will prevent individuals from paying damages that they can not afford. It will also allow companies to be able to process more output and will push reform of tort liability in the future. All of these reforms will create a more competitive market and be economically beneficial.

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