



Cato Handbook for Policymakers

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11. Tort and Class-Action Reform

State legislatures should

- enact punitive damages reforms,
- eliminate joint and several liability,
- require government to pay all legal costs if it loses a civil case, and
- illegalize contingency fees paid by government to private attorneys.

Congress should

- constrain courts' long-arm jurisdiction over out-of-state defendants,
- enact a federal choice-of-law rule for multistate litigants in product liability cases, and
- implement multistate class-action reforms.

After a Florida jury conjured up punitive damages of \$145 billion for a class of smokers, even anti-tobacco advocates were incredulous. Then, two years later, a California jury recommended a \$28 billion treasure trove for a single claimant. So it goes. Not just tobacco, but guns, asbestos, and a cross section of American industry have become victims of an unrestrained tort system.

The Pacific Research Institute estimates that the cost of that system in 2006 exceeded \$865 billion—less than 15 percent of which was paid to injured claimants. To put the number in perspective, the budget that year for Iraq and Afghanistan was roughly \$500 billion—about 58 percent of tort costs. For a family of four, the annual “tort tax” was \$9,827—

mostly reflected in higher prices. In a global marketplace, that means noncompetitive products, lower profits, fewer jobs, and reduced wealth.

When costs explode, proposals for reform are never far behind. As a result, we have been deluged by congressional schemes to ban lawsuits against gun makers and fast-food distributors, cap medical malpractice awards, and otherwise enlist the federal government in the tort reform battle. But no matter how worthwhile a goal may be, if there is no constitutional authority to pursue it, the federal government must step aside and leave the matter to the states or to private citizens.

Can Tort Reform and Federalism Coexist?

In its quest for constitutional authority, Congress often invokes the commerce clause. Yet consider medical malpractice, for example. No doubt we have a nationwide mess. But not every national problem is a federal problem. A majority of states have capped damages, and virtually all states have considered various other reforms. Mississippi is a case in point. Because of “jackpot justice,” doctors fled, insurance companies pulled out, and fewer companies opted to maintain in-state facilities. The result: new laws that capped pain-and-suffering, medical malpractice, and punitive damages.

That’s an example of tort reform compatible with federalism. Nowhere in the Constitution, however, is there a federal power to set rules that control lawsuits by in-state plaintiffs against in-state doctors for in-state malpractice. The substantive rules of tort law are not commerce and they are not the business of Congress. On those occasions when a state attempts to expand its sovereignty beyond its borders, federal procedural reforms—about which more in a moment—can curb any abuses.

State-Based Tort Reform

With that in mind, here are six remedies that the states can implement without federal involvement. The first three are directed at punitive damage awards; the final three apply to tort reform more broadly.

First, take the dollar decision away from the jury. For instance, the jury might be instructed to vote yes or no on an award of punitive damages. Then a judge would set the amount in accordance with preset guidelines.

Second, limit punitive damages to cases involving actual malice, intentional wrongdoing, or gross negligence. Whatever the heightened standard,

the idea is that accidental injuries arising out of ordinary, garden-variety negligence are unlikely to respond to deterrence for which punitive damages are designed.

Third, states could implement procedural guarantees like those available under criminal law. Punitive awards serve the same purposes as criminal penalties, but defendants are not accorded the protections applicable in a criminal case. Among those protections is a higher burden of proof than the usual civil standard, which is preponderance of the evidence. Also, there is no double jeopardy protection in civil cases. Current rules allow punitive damage awards for the same conduct in multiple lawsuits. And there is no protection against coerced self-incrimination, which criminal defendants can avoid by pleading the Fifth Amendment. In civil cases, compulsory discovery can be self-incriminating.

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

Fifth, government should pay attorneys' fees when a government unit is the losing party in a civil lawsuit. In the criminal sphere, defendants are already entitled to court-appointed counsel if necessary; they are also protected by the requirement for proof beyond reasonable doubt and by the Fifth and Sixth Amendments to the Constitution. No corresponding safeguards against abusive public-sector litigation exist in civil cases. By limiting the rule to cases involving government plaintiffs, access to the courts is preserved for less affluent, private plaintiffs seeking remedies for legitimate grievances. But defendants in government suits will be able to resist baseless cases that are brought by the state solely to ratchet up the pressure for a large financial settlement.

Sixth, contingency fee contracts between private lawyers and government entities should be prohibited. When private lawyers subcontract their services to the government, they bear the same responsibility as government lawyers. They are public servants beholden to all citizens, including the defendant, and their overriding objective is to seek justice. Imagine a state attorney's receiving a contingency fee for each indictment, or a state trooper's receiving a bonus for each speeding ticket. The potential for corruption is enormous.

Federal Procedural Tort Reform

Aside from state-imposed reforms, there are at least three areas where the federal government can intervene without offending long-established state prerogatives. The guiding principle is that federal legislatures and courts are authorized to act when there is a high risk that states will appropriate wealth from the citizens of other states. One federal reform consistent with that principle is to amend the rules that control state exercise of so-called long-arm jurisdiction over out-of-state businesses.

Congress could, for example, preclude a local court from hearing a case unless the defendant engages directly in business activities within the state. A company's mere awareness that the stream of commerce could sweep its product into a particular state should not be sufficient to confer jurisdiction. Instead, jurisdiction should be triggered only if the company purposely directs its product to the state. A sensible rule like that would give firms an exit option—that is, they could withdraw from a state and thereby avoid the risk of a runaway jury, even if a product somehow ends up in-state. Today, federal limits on long-arm statutes remain lax or ambiguous. For that reason, oppressive state tort laws remain a threat to out-of-state defendants.

There is a second federal reform that is compatible with federalist principles: a federal choice-of-law rule for product liability cases. Here's how that might work.

Basically, choice of law is the doctrine that determines which state's laws control the litigation. Generally, plaintiffs can and will select the most favorable forum state on the basis, in part, of its tort laws. But suppose a federal choice-of-law rule were enacted for cases in which the plaintiff and defendant are from different states. Suppose further that the applicable law were based on the state where the manufacturer was located. A manufacturer could decide where to locate, and its decision would dictate the applicable legal rules. Consumers, in turn, would evaluate those rules when deciding whether to buy a particular manufacturer's product. If a manufacturer were located in a state that did not provide adequate legal remedies for defective products, consumers would buy from rival companies.

Would there be a race to the bottom by manufacturers searching for the most defendant-friendly tort law? Maybe. But more likely, states would balance their interest in attracting manufacturers against the interest of in-state consumers, who want tougher product liability laws. In effect, healthy competition among the states would enlist federalism as part of the solution rather than raise federalism as an excuse for failing to arrive at a solution.

Class-Action Reform

The third set of procedural reforms that Congress can and should enact is aimed at multistate class actions. In the last 20 years, class actions have morphed from a rarely used procedural device, designed to litigate a large number of unusually similar claims, into a commonly used device for coercing a settlement from companies that often have done nothing wrong.

The 108th Congress attempted to address that problem in the Class Action Fairness Act—by giving defendants the power to remove some class suits from state to federal courts. But after three years of experience, it's clear that CAFA is an incomplete solution to the class-action problem. Congress can do more to directly address key problems associated with modern class actions at the state and federal levels. Here are seven suggestions:

First, CAFA says a class action can be removed to federal court so long as at least one-third of the class members reside outside the state where the suit was filed and the amount at stake in the class action exceeds \$5 million. CAFA does not explicitly say, however, whether plaintiffs or defendants bear the burden of proving that those requirements have been met. That threshold question is generating an enormous amount of unnecessary litigation. Even worse, many courts have held that CAFA places the burden of meeting those requirements on defendants—creating, in effect, a presumption against removal under CAFA. Congress should enact a presumption *in favor* of removal, by explicitly providing that plaintiffs bear the burden of showing that the conditions for removal *have not* been met.

Second, CAFA does nothing to solve a thorny problem that often occurs after a federal court refuses to certify a class. Imagine that a federal judge decides that a suit doesn't meet the requirements for class treatment. Currently, nothing prevents class members from asking a second court to certify the very same claims as a class action. As a result, one federal court's decision to deny certification doesn't end the cycle of litigation. That's perverse and unnecessary: as the Seventh Circuit has recognized, the Constitution allows a federal court to "enjoin," or bar, efforts to relitigate the merits of certification in another court, so long as class members were adequately represented when the certification question was initially decided against them.

Unfortunately, while the Constitution allows federal courts to stop class members from shopping their failed lawsuit to other courts, Congress hasn't expressly given federal courts a green light to do so. Some courts,

therefore, think they are powerless to stop would-be class members from seeking a second bite at the apple. Congress should clarify that federal courts may enjoin putative members of a rejected class, who have been adequately represented, from relitigating the question of whether their claims can be certified.

Third, CAFA doesn't stop plaintiffs' lawyers and defendants from collusive forum shopping. Acting jointly, they can keep suits in state courts that are willing to approve a sweetheart settlement—ensuring that the lawyers get a big payoff, defendants get a slap on the wrist, and absent class members recover little or nothing. Congress can prevent such collusion by giving absent class members, as well as defendants, the right to remove multistate class actions to federal court.

Fourth, Congress should do more than plug gaps in CAFA. It should rethink the class device itself. Currently, class-action rules create a presumption that individuals out of court, who have not affirmed their connection to the class, favor being “represented” by a trial lawyer who files a class action, supposedly on their behalf. That presumption is based on nothing more than the trial lawyer's say-so. Considering that modern class-action lawyers often claim to “represent” the interests of thousands—or even millions—of people, the presumption is a legal fiction. Many litigants have no idea that their interests are being represented in court, and are silent pawns of plaintiffs' lawyers seeking to coerce settlements and line their pockets. The rule should be changed, by requiring would-be litigants to affirmatively “opt in” to a class action (for example, by mailing a consent form to the court) before they can be counted as part of the “class.”

Fifth, Congress should prohibit class actions that deprive defendants of their due process right to assert specific defenses against individual plaintiffs. Presently, classes are certified even when a governing statute or common-law rule requires that key elements of proof—such as reliance, causation, or damages—be shown on an individual basis. That means trial lawyers can use the class device to combine tens of thousands of factually dissimilar claims into one proceeding, making it impossible for defendants to adequately smoke out and identify weak or meritless individual claims. Congress should enact a rule stating that, unless a federal statute clearly provides otherwise, liability in class actions arising under federal law requires case-by-case proof of the elements of each class member's claim.

Sixth, Congress must ensure that only meritorious class actions become certified. Class certification decisions are made very early—before plaintiffs have demonstrated that they have evidence to support their allegations.

That allows trial lawyers to game the system by including numerous meritless claims in one lawsuit, in the hope that corporate defendants will settle before the suit goes to trial. That's not a bad strategy, given the stakes involved: even when faced with clearly weak claims—given the enormity of large classes, which can comprise millions of individuals—few corporations want to bet the company that a jury will get the case right. Congress should nip meritless class actions in the bud by providing that classes may be certified only after the class “representative”—the main plaintiff—is able to make a preliminary factual showing that he or she has a reasonable likelihood of success.

Seventh, Congress must deal with class actions that use flawed statistics. Class actions generally must be proved using evidence “common” to all class members, but some federal statutes allow statistical sampling to prove injuries to a large group. Where this is so, plaintiffs have often used shoddy statistics purporting to show that all class members suffered the same injury. Under current law, unreliable expert evidence cannot be submitted to a jury. Even so, a number of courts have held that judges can certify a class without rigorously reviewing the reliability of plaintiffs’ statistics. Congress should, at a minimum, provide that plaintiffs’ statistical evidence must meet, before a class action can go forward, the same demanding reliability standards imposed on expert evidence sent to a jury.

Conclusion

When a state exercises jurisdiction beyond its borders or discriminates against out-of-state businesses, federal intervention may occasionally be appropriate. For the most part, however, the states have reformed and are continuing to reform their civil justice systems. Under those circumstances, time-honored principles of federalism dictate that each state exercises dominion over its substantive tort law. Congress can then focus on procedural matters. In that regard, we suggest three reforms: (1) tighten long-arm jurisdiction over out-of-state defendants, (2) implement a federal choice-of-law regime, and (3) restructure the rules for multistate class actions.

Suggested Readings

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HEALTH CARE AND ENTITLEMENT REFORM

