

SCOMM

101A:12

To: Legislative aides to:
Senator Drue Pearce
Senator Bert Sharp
Senate Finance Committee

Fm: Jim Sourant, legislative aide to:
Representative Brian Porter

Date: March 29, 1997
Re: HB 58 Tort reform

I bring to your attention a very important matter which has not been publicly disclosed during this session about the Governor's Task Force on Civil Justice Reform. At every stage through the House, the opponents of HB 58 have touted the recommendations of the task force as being the product of a blue ribbon bipartisan group which represents "the interests of large and small businesses, doctors...." This assertion has gone unchallenged to the present time. The fact of the matter is that nothing could be further from the truth.

The best evidence of misrepresentation is found in the attached letter from State Farm Insurance Company, which has over 200,000 automobile and homeowner insurance policies in effect in the state. The letter was written after the task force was created, but several months before the first meetings ever took place. The letter speaks for itself, but it is clear that State Farm was asking to be put on the task force. The "oversight" was not corrected, even though there was ample time to do so. Consequently, there were no representatives of the insurance industry on the task force.

Also conspicuously absent from the task force was the Division of Insurance. Had it been directly represented, there would have been evidence that over the past few years, ALL domestic insurance companies have withdrawn from high risk areas of coverage, such as the marine highway.

The task force then erroneously concluded that there was "no evidence of a crisis in insurance cost or availability, nor did it hear from the insurance industry in the course of its debate." Pages 2 and 7 of the task force report. First the insurance industry was arrogantly excluded from participation on the task force, then the task force cavalierly implied that the insurance industry was not interested in participating. Whatever the Division of Insurance could have contributed was not heard.

On those same pages of the task force report, the task force erroneously concluded that since insurance rates are not set by claims experience within Alaska, "the task force found no evidence that changes in Alaska law would affect Alaska insurance rates."! A look at the compendium of 25 letters

P.S.
BRIAN
AUTHORIZED ME
TO RELEASE THE
LETTER ATTACHED,
BUT THAT'S ALL?
THE EXPLANATION OF THE
IMPLICATIONS OF THAT
LETTER IS MY IDEA
AND I TAKE FULL
RESPONSIBILITY FOR IT
BEST TO COORDINATE
ANYTHING YOU DO
WITH BRIAN
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reasons.
Jim

(USAA Insurance Company's letter and Mike Lessmeier's letter for State Farm) previously furnished to your offices makes clear that just the opposite is true: insurance rates in Alaska are determined in part by claims experience in Alaska, and insurance rates and rebates will benefit from HB 58!

These egregious misrepresentations go a lot further than mere "spinmeistering"; they appear to be intentionally false and misleading. This is much more than "politics as usual" in my book.

It is also clear that the one physician on the task force did not represent the 500 physicians who belong to the Alaska State Medical Association. Also conspicuously absent from the composition of the task force were the 100 airlines represented by the Alaska Air Carriers Association; the 4500 Alaska small business members of the NFIB; the 700 businesses statewide represented by the Alaska State Chamber of Commerce; the 25 companies represented by the Alaska Trucker's Association; the 250 companies represented by the Alaska Forest Association; the 1000 members of the Alaska Miner's Association; the 135 municipalities represented by the Alaska Municipal League; 18 electric utility cooperatives statewide; the 33 hospitals and nursing homes represented by the Alaska State Hospital and Nursing Home Association; and the 550 general contractors represented by the Association of General Contractors.

These groups, and the tens of thousands of employees they represent, were not given a slot on the task force. The composition of the task force was skillfully skewed. Add to that a 2/3 majority required to pass meaningful tort reform measures, and it becomes apparent that the deck was carefully stacked to prevent a result not favored by the trial lawyers.

Don't be fooled. If someone starts touting the recommendations of the task force, just ask them if it is not true that the insurance industry wanted to be a part of it. If anyone denies it, show them the letter. If anyone admits it, ask them why the insurance industry was not allowed to participate. The answer will be interesting, especially since the trial lawyers were not only allowed to participate, but were allowed to dominate and write the report.

The point is that the recommendations of the task force are not credible. To date, the touting of the objectivity of the task force has gone unchallenged during this session. It is speculation on my part, but if the governor wants to veto this bill, he will do it under the political cover of the task force recommendations. Whether you or your bosses choose to preempt the governor's ability to shield himself is up to you. But record should be corrected sometime, and this is the only chance we'll have to do it.

cc: Portia Parker
cc: Annette Kreitzer

State Farm Insurance Companies

GARY L. METHNER
REGIONAL VICE PRESIDENT
PACIFIC NORTHWEST OFFICE

1000 WILMINGTON DRIVE
DUPONT, WASHINGTON 98527

4000 25TH AVENUE, NORTHEAST
SALEM, OREGON 97313

July 18, 1996

The Honorable Tony Knowles
Governor of Alaska
P.O. Box 110001
Juneau, AK 99811-0001

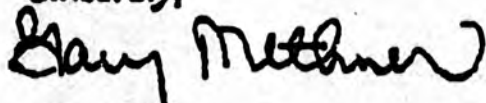
Dear Governor Knowles,

On behalf of Alaskans holding over 200,000 State Farm Insurance policies, I wish to express my disappointment at the composition of the Governor's Advisory Task Force on Civil Justice Reform (Advisory Task Force) that you created by means of Administrative Order Number 163.

In spite of the facts that insurance provides most of the money used to pay civil liability claims; that the Advisory Task Force is directed to assess the effects of insurance reforms on insurance rates in both Alaska and the Nation; and that State Farm and other insurers played a major role in the passage of HB 158, the Advisory Task Force has no direct representation from any member of the insurance industry. This omission is troubling and challenges the balance of the Advisory Task Force. None of the other members selected, business or otherwise, has the background, information, or concern to represent adequately the interests of policyholders and their insurers.

Failure to grant insurers seats on the Advisory Task Force has denied a voice to the hundreds of thousands of Alaskans whose premiums pay for the civil justice system that the Governor agrees needs reformation. Hopefully, you will recognize the gravity of this oversight and expand the Advisory Task Force to include as many of Alaska's major insurers as wish to participate. State Farm, for one, volunteers to sit on the Advisory Task Force should you choose to expand it. I await your response.

Sincerely,



Gary Methner

GM:la

Post-It® Fax Note 7671		Date 3.26	# of pages 1
To LACEY	From Rep. J. Porter		
Co./Dept. Sen. Mearns	Co. Jim		
Phone #	Phone # 465-3727		
Fax # 486-5264	Fax #		

To: Gary

Fm: Jim

Re: POMs

1. There has been a lot of disinformation about the impact of HB 58 on the Exxon case. The truth of the matter is that the Exxon case is on appeal in a federal court from another federal court which applied federal laws, and not Alaska laws. The point is that no matter what Alaska law says about punitive damages, it has absolutely no bearing on the Exxon case. If Alaska punitive damage law was not applied at the trial level in the federal court, it can in no way be applied in the same federal court system on appeal.

Aside from the total inapplicability of Alaska law on the Exxon punitive damages issue, HB 58 does not apply retroactively. It applies only to cases arising 90 days after HB 58 becomes law.

Even assuming that Alaska law could somehow be applied in a future Exxon type of case, three or four times compensatory damages will be a huge number. Exxon paid out 287 million in claims to fishermen, but it also paid \$900 million into a trust for restoration. Attorneys involved in the case tell us that the \$900 million was compensatory. So, that makes about \$1.2 billion right there. Times 3 is \$3.6 billion. Times 4 is \$4.8 billion. \$5 billion is the amount of punitives which were entered in the federal case, so what is the big to do about?

You have to ask yourself frankly if the opposition is being stirred up because the trial lawyers want to keep on extracting their exorbitant fees under the present system, with no caps on punitive damages and on certain types of noneconomic damage under Alaska state law. In the federal Exxon case, the plaintiffs' lawyers have recently asked the court to award them "only" 20 % of the amount of the judgment. That pencils out to over \$1 billion dollars. Ask yourself this question, and try to be objective. Who stands to gain the most from keeping things like they are? I bet you can give me the answer, and it has to be the tort legal industry. If we want a vibrant economy with real jobs, we cannot be chasing businesses of all sizes out of the state.

Alaskans For Liability Reform

MARCH 18, 1997

MEMORANDUM

**TO: ALL MEMBERS OF THE ALASKA
HOUSE OF REPRESENTATIVES**

FROM: ALASKANS FOR LIABILITY REFORM

**WE WOULD SUPPORT AN INTRODUCTION OF THE FOLLOWING PROPOSED
AMENDMENT TO HB 58 TO INSURE THAT MORE OF ALL SETTLEMENT MONEYS
BE DIRECTED BY THE LEGISLATURE TO TORT VICTIMS. ACCORDINGLY WE
PROPOSE THE FOLLOWING NEW SECTION:**

LIMITATIONS ON CONTINGENT FEES.

The total of all contingent fees for representing all claimants in any liability claim or action shall not exceed the following limits:

- (1) Forty percent (40%) of the first fifty thousand dollars (\$50,000) recovered by the claimant(s);
- (2) Thirty-three and one-third percent (33 1/3%) of the next fifty thousand dollars (\$50,000) recovered by the claimant(s);
- (3) Twenty five percent (25%) of the next five hundred thousand dollars (\$500,000) recovered by the claimant(s);
- (4) Fifteen percent (15%) of any amount by which the recovery by the claimant(s) exceeds six hundred thousand dollars (\$600,000).

DEFINITIONS. for purposes of this section-

- (1) "Contingent fee" includes all compensation to any person or persons which is payable only if a recovery is effected on behalf of one or more claimants.
- (2) "Recovery" means the net sum recovered after deducting any disbursements or costs incurred in connection with prosecution or settlement of the claim, including all costs paid or advanced by any person. Cost of health care incurred by the plaintiff and the attorney's office overhead costs or charges for legal services are not deductible disbursements or costs for such purpose

SUE CITY

The Case Against the Contingency Fee

WALTER OLSON

For years the New York City firm of Morris Eisen P.C. ran one of the nation's biggest personal-injury law practices, employing 45 lawyers and handling hundreds of cases at a time. Like all law firms that specialize in injury lawsuits, it worked on contingency—keeping a share of its clients' winnings, if any ("no fee unless successful").

It all came undone in 1990 when a federal grand jury indicted Eisen and seven persons associated with his firm on charges that included bribing witnesses and court personnel, suborning false expert testimony, doctoring photographs, and manufacturing other physical evidence. Among those charged along with Eisen were two lawyers, a former office manager, and four private investigators who worked regularly with his firm.

Federal prosecutor Andrew Maloney detailed the charges. "They produced an eyewitness to two automobile accidents," he said. "The witness was never at either accident and, at the time of one accident, he was serving time on a forgery charge." In another case, where one of Eisen's employees claimed to have tripped at a racetrack parking lot, Maloney said one of the suspects used a pickaxe to widen a pothole so it could be blamed for the supposed incident. Two of the group were charged with causing a witness to give false testimony in another lawsuit where an injured woman claimed that a bus driver had signaled for her to cross the street into traffic; New York City settled the case for \$1 million. Altogether the 19 lawsuits where wrongdoing was alleged had brought in \$9 million in awards and settlements, of which the lawyers had pocketed an estimated \$3 million in contingency fees, along with some additional sum to cover their reported expenses.

Around the rest of the country a wave of similar scandals was breaking. A front-page series in the *Miami Herald* told how a North Miami legal practice had conspired to manufacture and exaggerate injury claims. Florida prosecutors followed with a 32-count indictment of three lawyers, two doctors, and three associates. A federal indictment charged two New Jersey lawyers and a doctor with 58 counts in an alleged scheme of massive fraud in auto-accident claims.

America's legal profession, it seems, is being cleaned up. Or is it? What may be needed is not just more

crackdowns like those underway, but a rethinking of the modern American wisdom on legal ethics.

Temptations for Dishonesty

Lawyers as a profession face unusual temptations to engage in unethical conduct. No one knows better how to skirt or evade the law than someone trained in it, and huge amounts of money can hang on the choices made when no one is looking over a lawyer's shoulder. This can be tempting enough for the ordinary lawyer who guides inexperienced clients through large financial transactions. It can be even more tempting for the trial lawyer who specializes in lawsuits or threats of lawsuits. Litigation is mostly about the violent and chancy redistribution of wealth. It abounds in opportunities for perjury-coaching and witness-tampering, the faking of evidence, and the bribing of court personnel, all for what can be dizzyingly high stakes. It offers many chances for dishonest persons to become rich.

A job that offers enormous rewards for unscrupulousness will attract many unscrupulous people, and corrupt many people of ordinary character. Yet most of the ways to sort out the bad apples are not very promising. Criminal prosecution, disbarment, and other heavy-duty disciplinary measures can help in the few cases where abuses can be brought to light and proved conclusively. In practice, only a few relatively flagrant cases of lawyer misconduct are caught and corrected in this way, mostly embezzlement of client funds and the like. Advance screening of bar applicants for "good character" is a subjective affair that can imperil the merely unpopular applicant along with the shady one; it has fallen largely into disuse. Civil lawsuits against lawyers provide occasional recourse for victimized clients but next to none for victimized opponents.

What is really needed is a reduction in the temptations for dishonesty within the practice of law itself.

WALTER OLSON is senior fellow at the Manhattan Institute. This article is excerpted from his forthcoming book *The Litigation Explosion: What Happened When America Unleashed the Lawsuit* (Dutton/Truman Talley Books). © 1991 by Walter K. Olson.

Ethics in Sports

The ethical rules of many professions share a common underlying principle: if temptations are allowed to get out of hand, many will yield. To put it in raw dollar terms, if under system A people can grab \$1,000 by telling a lie, and under system B they can grab \$1 million by telling the same lie, more people—not all, but more—will tell the lie under system B. No system could block all chances to profit from lying, cheating, and corner-cutting; that would be hopelessly utopian. Rather, a practical system of ethics tries to fence off the steepest and most slippery slopes. It lowers the rewards for dishonesty not to zero but to a point where most people will resist.

One of the standard ethical rules of professional sports forbids athletes to bet on their games. There are obvious reasons for not letting them bet against their own teams. The reasons for not letting them bet in favor are in the end no less compelling. Some athlete-gamblers would throw their strengths into certain contests at the expense of the season as a whole. More generally, kneeling and below-the-belt gouging of opponents would run wild: badminton would soon get as mean as hockey, and who can think what hockey itself would be like?

Likewise doctors have never been allowed to charge contingency fees—to place, in effect, bets with their patients on the success of their therapies. Under such a system, doctors would dispense with their fees if a patient remained sick. If on the other hand he rallied, they would charge higher than normal fees. And if the patient got well enough to go back to work, doctors might even arrange to take a share of his future earnings.

Why would this be unethical? In part because it would tempt doctors to depart from honesty. Under such a fee arrangement some doctors would portray transient maladies, best treated by doing nothing, as life-threatening to scare patients into promising a whopping contingency. Some would cure an illness with harsh remedies that left the body vulnerable to worse assaults later on. Some would allow patients who were still sick to believe they were cured, perhaps administering feel-good potions toward that end. Falsification of test results, bedside

**As other nations recognize,
the contingency fee can yoke
lawyer and client in an assault
on the general public.**

charts, and autopsy findings would go on constantly. Even doctors of ordinary integrity would feel their objectivity subtly disoriented, and the truly unscrupulous would find chances to become very rich indeed.

And so the custom arose of paying doctors by the hour, whether their patients recovered miraculously, feebly, or not at all. By achieving a surprise cure a doctor might hope to get valuable word-of-mouth and repeat



The Bettmann Archive

Lawyers are delegated quasi-governmental authority to invoke compulsory process. Ethical rules limit the overuse of these coercive powers.

business. But that is the difference between more and some, not between feast and famine. Many of the subsidiary rules of medical ethics, such as the separation of medicine from pharmacy, follow similar lines. By shielding doctors from a financial interest in drug-dispensing, we avoid clouding their decision whether to prescribe or withhold drugs in borderline cases.

America's Legal Exceptionalism

In virtually every other country, society has deemed that lawyers, like doctors, should be shielded from the temptations of the contingency fee. The English common law, French and German civil law, and Roman law all agree that it is unethical for lawyers to accept such fees. In 1975 British judges strenuously opposed even a closely regulated version of the fee, in which a contingency suit could go forward so long as leading lawyers verified its reasonableness. They explained that lawyers would no longer make their cases "with scrupulous fairness and integrity."

The American exception on contingency fees developed naturally and inevitably from a wider and more profound American exception on legal fees in general, an exception that is central to understanding the problems of our legal system.

America is the only major country that denies to the winner of a lawsuit the right to collect legal fees from the loser. In other countries, the promise of a fee recoupment from the opponent gives lawyers good reason to take on a solidly meritorious case for even a poor client. Oxford's Patrick Atiyah notes that "the reality is that the accident victim with a reasonable case should be able to find a lawyer with equal ease in England and America."

At first much of America tried a not very promising substitute for the contingency fee: volunteer legal service. Lawyers were supposed to make a reasonable effort to handle a poor person's claim for free when it appeared meritorious. When a suit of this sort was a money claim, and it succeeded, the now not-so-penniless client might offer the lawyer a grateful recompense, but was not obliged to do so. The system was based on two-way altruism, first from the lawyer, then from the beneficiary



UPI/Beckmann

In Britain and most other countries the winner of a lawsuit has the right to collect legal fees from the loser.

Systems that depend too heavily on pure altruism do not tend to chug along forever. Without a legal right to recover fees in case of victory, lawyers did not donate enough time to these *pro bono publico* cases, and some meritorious claims slipped through the cracks. The straightforward solution of shifting fees to the losers of lawsuits was obstinately resisted. So, amid misgivings and reluctance, the contingency fee was admitted state by state; Maine was the last state to legalize it, in 1965.

Restrictions confined the use of the fee to the necessary cases. The arrangement was to be discouraged unless a client was too poor to pay the normal freight. Most important, lawyers could represent only plaintiffs on this basis, and never defendants, either civil or criminal. And although contingencies were permitted in most money claims, they were disallowed in many other kinds of lawsuits, divorces in particular.

A further web of swaddling rules protected lawyers from dealings by which, purposely or not, they might end up obtaining stakes in the cases they pressed. They could not buy up a promissory note to collect at a profit, nor buy businesses or parcels of land to which lawsuits were attached unless their primary aim were to acquire the property rather than the incidental share of its value represented by legal claim. They could not give money to their clients for free for fear of the appearance that they were paying to keep a lawsuit alive (which, as the offense of "maintenance," was punishable at common law by imprisonment). In fact, they were advised not to enter into business dealings with their clients at all to avoid pitfalls of this nature.

The older American legal ethicists emphasized the need for vigilance against the special corrupting dangers of the contingency fee. Lawyers were to recognize that taking a share in the spoils subjected them to a sort of moral vertigo that should be shunned when not necessary and handled with tightrope care when it was. They would have to cultivate a special humility and detach-

ment when they worked on this basis, trying harder than other lawyers to remember that winning wasn't everything, struggling to forget that victory in the case at hand might bring personal riches or that loss might bring a financial blow. In short, the system was asked to run on a new kind of altruism, the self-restraint of lawyers with fortunes at stake.

"My Ads Can Make You Millions"

Just as salesmen paid on commission step forward and make eye contact when the customer walks in the store, so contingency-fee lawyers have a strong incentive to get clients interested in the merchandise. For such reasons the standard American text on legal ethics, by Judge George Sharswood of Pennsylvania, said the fee gave "an undue encouragement to litigation." Street-level views could be much more scathing. By the 1920s one federal prosecutor was calling the fee the "arch tempter to the ambulance chaser" (as well as the fount of "false claims, witness fixing, and perjury").

With their incentive to go for volume, contingency-fee lawyers have long done far more than their share of advertising and solicitation, both lawful and unlawful. "My custom TV ads can make you millions," promises a full-page pitch on page three of the December 1985 *Trial*, the magazine for injury lawyers. "Twenty-seven lawyers have become millionaires while running my custom TV commercials, 9 are multi-millionaires, and 22 are close (net worth between \$450,000 and \$975,000)," claims independent producer Paul Landauer. "Some started with less than nothing! One borrowed \$6,000 to go on the air and took in an off-shore injury case the second week that settled for \$3.8 million." Smart lawyers, he explains, know that attracting clients "in bunches and droves" increases the odds of getting a "big one." "I give you an elegant, 100-percent custom, 'dream lawyer' image the TV audience can't wait to call."

Cultivators of Discontent

The initial step of getting potential clients to dial the operators standing by to receive their call is but the first in the encouragement of litigation. That encouragement naturally extends to every stage of the dispute. The true cultivator of discontent does not sow the seeds of grievance and then retire while the seedlings grow or wither as Nature ordains. He waters and fertilizes the tender shoots to a state of garish bloom.

The popular television show *L.A. Law* has made famous the character of divorce lawyer Arnie Becker. In one episode, a woman comes in who is thinking of splitting up with her husband; they haven't been fighting, but they seem to have drifted apart; maybe it's time to work out a parting of the ways. As Arnie drops a word here and a hint there, her mood subtly changes. She begins to feel annoyed at her hubby, then downright aggrieved; by the next commercial she is howling for his scalp on toast.

This style of consciousness-raising or client education can be applied to virtually any legal problem. Someone walks into the office in a far from combative frame of mind, feeling there is something to be said for both sides, not at all in the right mood for litigation services. The

entrepreneur can artfully lay out the full gravity of the other side's conduct. The client who wants help in rescheduling overdue bills can begin to appreciate how irresponsible the banks were to send him so many credit cards. The frightened tenant behind on the rent can realize, the thought coming as it unbidden, that the landlord's delay in repairing the sink is really little short of depravity.

None of this would have surprised old-time lawyers in the least, and it was one reason for the insistence on detachment and passivity that runs through their writings on the lawyer/client relationship. Yes, lawyers were to apprise clients fully of their rights and options, but it was best done clinically, so as not to inflame any latent feelings of fear, rage, envy, or avarice. If the case did proceed to litigation, the client as "master of his suit" was to provide the impetus not only for the initial filing but for any major escalation of the battle. Given a client of lawful intent, the ideal lawyer did not try to shape even his attitudes, let alone his story.

Client Loses Control

If you hire a contingency-fee lawyer you surely know already about the great advantage of giving him a piece of the action: he gets a powerful incentive to bring in the absolutely biggest cash amount. But the absolutely biggest cash amount may not be what you want.

You may not, for example, be feeling angry enough to fire off every arrow in your quiver of legal rights. Maybe it strikes you as a little rough to sue the nurse as well as the doctor and hospital just to get a few dollars more, or to brand your ex-business partner as a racketeer as part of your action seeking a fairer division of the enterprise property. You may not want to pry into the other side's private life or invite prying into your own. Then, too, litigation can end in many ways. The bitterest marital fallings-out have been known to end in a miraculous reconciliation. (Most states still forbid contingency fees for obtaining divorce decrees because they so clearly give the lawyer a reason to sabotage any such development.) A new management might take over at the workplace where you were fired and offer you a job instead of back-pay settlement. The magazine you sued for libel might print your side of the story. In a University of Iowa study of libel complainants interviewed after their suits were over, by far the majority said they would have been satisfied at least initially with a correction or retraction instead of cash damages.

But, if someone else fronted the money to get you into court, the action is no longer yours alone. You have a new partner in your lawsuit, maybe a senior partner, to whom words of forgiveness butter no parsnips and gestures of mercy pay for no beachfront condos. You will be pushed toward high-ticket strategies, although they may end in hatred or self-reproach.

Timing is a common source of conflict between lawyer and client interests. Most litigants tire of their fights, if not at first, then after a while, and at some point would rather get on with their lives than hold out for a little more. The lawyer with a big war chest has an incentive to make you wait in order to go for the extra money. Every so often the roles are reversed: some clients have

complained, and at least one legal-malpractice suit has charged, that lawyers settled too early for a low figure because they needed help with the office cash flow.

Hiring a lawyer on an hourly fee puts you in control of the direction of your affairs, much as a taxi fare gives you wide discretion to name your own destination and hop off where you want. The contingency fee takes you along for someone else's ride, aboard a high-powered machine typically geared to breaking altitude records. With luck, it might be a ride to riches. But it is best not to complain about the steering. And although you may think you have the right to change lawyers in mid-lawsuit if things get too ugly, just try it.

Costs to Third Parties

There is no denying that contingency fees have certain productivity advantages. Paying people only if their efforts culminate in success definitely coaxes more effort out of them. The question is whether the effort is aimed in the right direction. Much of the economy is run on a fee-for-results basis. Farmers get paid for cabbages based on how many edible cabbages they come up with, not how many hours they spend in the cabbage patch. Realtors and travel agents work on straight commission. So, for that matter, do authors who hope to make royalties past the advance on their books: if the product doesn't sell, they may get no recompense for an extra hundred hours of work.

Not all occupations are like cabbage, house, or book selling. Contingency fees tend to be disfavored in professions to whom the interests of others are helplessly entrusted, where misconduct is hard to monitor. Accountants have long been barred from accepting contingency fees ("I'll pay you twice your normal rate if my taxes go down, the bank stays happy, and I survive the next annual meeting without being voted out"); we hope they will stay independent enough to tell their clients

Doctors have never been allowed to charge contingency fees—to place bets with their patients on the success of their therapies.

unwelcome truths. Salesmen are not always paid on commission in part because the hustle factor in salesmanship can be turned in a destructive direction: commissioned salesmen, although they outperform the hourly variety, are also more tempted to use high-pressure sales techniques and manipulative tactics that "make their numbers look good" to the boss.

Contingency fees are particularly frowned on where the costs of abuse fall on third parties who are not taking part voluntarily. Giving traffic cops contingency fees by

hinging their bonuses on how many tickets they write arouses widespread anger because it so obviously tempts the officer to be unfair to the motorist. The same is true of giving tax collectors contingency fees by hinging their bonuses on how many deductions they disallow or how many assets they seize. Giving soldiers contingency fees for successful attacks, by letting them loot the towns they capture, was long favored as a way of encouraging warlike zeal, but came under gradual ethical control as civilization progressed; we now give out medals and ribbons instead of the contents of civilian homes.

Dangers for Society

Giving lawyers contingency fees encourages similar abuses of both the client and the public. In the classic underworld injury racket, the operator, after pocketing the defendant's tender of settlement, gives the accident victim whatever pocket change it is thought should satisfy him, or just dumps him back on the street with no money at all. (Any back talk from the victim and his original accident will seem minor in relation to the troubles that await him.) Most clients of today's litigation industry fortunately do not get treated that badly. But many are quite surprised to discover at the end of a suit that the lawyer's claimed "expenses"—copying, filing costs, expert witness fees, and so forth—have somehow ballooned to represent a huge share of the settlement on top of the contingency fee itself. Some naive souls never find out how much the defendant paid to settle, but take the lawyer's word for it.

But the dangers of the contingency fee go beyond the exploitation of clients. After all, alert clients can be on guard against being exploited by their own lawyers; as the abuses are more widely publicized, more may learn

The designated opponents are far from the only ones victimized by wrongful or overzealous litigation.

to avoid the lawyers who get too greedy in bill reckonings. The real problem with the contingency fee derives not so much from the conflicts it creates between the interests of lawyer and client, as from the even more dangerous conflicts it creates between their interests and everyone else's.

In truth, many clients are delighted to find a lawyer who is much more ruthlessly committed to winning than the hourly-fee lawyer who represents their opponent. They seek the operator who knows how to turn a worthless or low-value claim into a cash bonanza even if he keeps most of the extra money for himself. If they are made to cooperate in truth-shading or worse, they are not bothered. Some are only too glad to think up new embellishments of their own.

The case against the contingency fee has always rested on the danger it poses not to the one who pays it, but to the opponent and more widely to justice itself. As other nations recognize, it can yoke lawyer and client in a perfectly harmonious and efficient assault on the general public. The designated opponents are far from the only ones victimized by wrongful or overzealous litigation. Every lawsuit sweeps in third parties who are forced to expend time, energy, and money without compensation, and surrender their privacy by answering under oath the probing questions of a hostile lawyer. The cost to taxpayers of running the system are far from trivial; more broadly, lawsuits tend to paralyze productive initiative by keeping rights in a state of suspense. We all pay for needless litigation.

Enthusiastic First Resort

The most common justification for the contingency fee is that it provides the "key to the courthouse" for people of modest means. But injury lawyers tend to oppose the method all other countries use to provide that key: an hourly fee paid by the losing opponent. And it turns out that they happily charge contingency fees to middle- and upper-income clients who could easily afford to pay on an hourly basis.

In fact, mysteriously, the contingency fee has become the *only* way most clients can get a lawyer for injury cases, even if they would rather pay an hourly fee. Some clients suspect that a phone call or two from a lawyer, or a letter on his stationery, may be all they need to get a satisfactory resolution of their problem. They might feel that giving their lawyer a third of the amount won in such a case would be an undeserved windfall. But they are out of luck. A report from the Federal Trade Commission showed that 97 percent of lawyers took injury cases only on contingency, refusing to consider hourly rates, however generous. Lawyers seem to have come to the conclusion that a good injury case is a plum and, damn it, they have a right to a share, as befits a player. They are also loath to undercut the "going rate" fee percentage, even when success in a case seems virtually assured. In some of the rougher towns like Detroit and Kansas City the going rates over the years have been reported to run at 40 and even 50 percent.

As lawyers have discovered how very profitable this kind of practice can be, more of them have gotten over their scruples. The contingency fee is coming to be seen as the basis of an industry boldly and openly run for profit, as an enthusiastic first resort for the general case rather than a troubled last resort for the special. And in a trend that is full of implications for the future, the fee is spreading to litigation over employment matters, child support, will contests, copyrights, taxes, and perhaps most ominously, divorces.

In Texas, where the contingency-fee industry is unusually well developed, it is having a profound effect on commercial litigation. Texas lawyer John O'Quinn may represent a one-man wave of the future. His full-page Yellow Pages ad, as quoted in a *Wall Street Journal* report, says he is dedicated to "helping injured people obtain cash damages" and promises an "attorney on call 24 hours a day." State bar officials have accused him of using

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runners to acquire injury cases. What makes O'Quinn an interesting and apparently a very, very rich man is that he also applies his personal injury case methods—appealing to populist resentment—to otherwise routine disputes between businesses, with astonishing success. His most startling victory came in 1988 when a jury awarded \$600 million to one of his clients, an Ohio natural-gas producer, in a contract dispute with the giant Tenneco Corporation.

A Professional's Obligations

For centuries the practices of law, medicine, accounting, pharmacy, and other professions have been seen as fundamentally different from those of, say, agriculture, metalworking, and clothes-making, not because the former pursuits are more important or difficult, but because they pose special dangers of abuse and unethical conduct. Professionals face distinctive ethical responsibilities that would be unnecessary and indeed wrongheaded to impose on other persons. These responsibilities have gradually crystallized in the form of long-evolved codes of professional ethics.

A typical tenet of these codes is that a professional practice should not be run purely "as a business." Ethical codes commonly require members to charge per-hour fees rather than contingency fees based on a client's satisfaction or success. Even more common are rules restricting the gung-ho "chasing" of business through advertising and more direct promotional methods.

Such rules plainly curb competition, and many free-market supporters have denounced them as advancing a profession's collective interest at the expense of society's. Critics have cheered over the last 15 years as professions have been forced to relax or abandon their former ethical rules, under pressure from antitrust suits and adverse court decisions.

The case *against* untrammelled professional competition is seldom heard at length these days, but should not be dismissed lightly. It proceeds from the observation that competition tends to stimulate output of a service and tailor it more closely to what customers want. These normally fine results can be problematic in a professional context.

Consider first the stimulation of output. Overselling—the hustling of customers to buy things they would probably do better without—is perhaps a venial offense in the selling of home freezers and encyclopedias, but somewhat more ominous when applied to amphetamine pills and divorces. Auto salesmen are free to encourage impulse buying of sports cars, but surgeons may have a duty to discourage unnecessary surgery.

Perhaps, lest we fall into paternalism, it is best to recognize the client's right to be self-destructive. Trouble is, many dubious professional services harm someone other than the one who pays for them. A great deal of medicine is practiced on infants or on feeble or unconscious persons at the (perhaps misguided) behest of family members and others. There is likewise a steady market for faked medical reports, forged prescriptions, and undeserved audit opinions, all of which facilitate



Most states forbid contingency fees for divorces lest they encourage lawyers to sabotage reconciliation.

fraud aimed at third parties. The unethical doctor or accountant, far from being shunned by clients, may be in hot demand—which may be one reason to shield both professions from too strong a financial incentive to give clients what pleases them.

Of course the deliberate insulation of producers from consumer sovereignty is a dangerous thing. It seems likely that many of the old bans—on price advertising by druggists and opticians, for example—were of little importance in curbing abuse and did badly undercut market efficiency. We may also wish on libertarian grounds to uphold an individual's right to offer services to consenting clients even if the consequence is to expose third parties to hard-to-detect abuse. But however strong the case may be for deregulating the practice of medicine and accounting—while, one hopes, allowing outraged colleagues to shun the maverick, which our antitrust laws currently forbid them to do—there is no case at all for extending the principle to the practice of law.

Lawyers are delegated certain quasi-governmental powers to invoke compulsory process. In particular, they can initiate lawsuits that impose huge unrecompensed costs on what frequently turn out to be innocent opponents. As we know from the case of pollution, the opportunity to impose costs on other people is likely to be overused unless it is regulated or priced in some way. In no way does it violate individual rights to demand of those who seek to wield this coercive power that they submit in exchange to certain rules to prevent its over-

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March 26, 1997

Senator Lyda Green
State Capitol, Room 125
Juneau, Alaska 99801-1182

Re: HB 58

Dear Senator Green:

I am writing on behalf of State Farm to give you some examples of cases which justify the need for some of the reforms that are being sought through HB 58. There are two very general kinds of claims that are affected by this legislation: claims for punitive damages and claims for compensatory damage. With respect to punitive damage claims, I have not had personal experience with an award of punitive damages against one of my clients. However, I have defended many of these claims, and I know there have been significant punitive damage awards in most of the major communities in Alaska. We have had two such awards here in Juneau over the last several years. Approximately a year ago, a federal jury assessed punitive damages of over fifteen million dollars against Aetna. Although the federal judge set aside that award, the action he took in doing so is being appealed to the Ninth Circuit Court of Appeals, so the ultimate outcome is uncertain. The second recent punitive damage award here in Juneau was against a local bank and was in excess of five-hundred thousand dollars. The trial court refused to set aside that award, and the case was ultimately settled before appeal. I am sure you are aware of the case of Underwriter's At Lloyd's, London v. Narrows, 846 P2d 118 (Alaska 1993), which involved a punitive damage award by an Anchorage jury of sixty million dollars. This award was reversed by our Supreme Court, and the case was settled for a confidential amount after remand to the trial court.

There are those who say that such awards do not justify the need for the reforms contained in HB 58. These cases are the tip of the iceberg. Although I have never had a punitive damage award against a client I represent, I see punitive damage claims as a matter of course in the cases I defend. In three of the last five cases I have tried to verdict punitive damage claims were made. None were awarded. But those claims were incredibly expensive and time consuming to defend.

We now see punitive damage claims made against almost every institutional defendant we represent. Almost without exception, these claims are time consuming and expensive to defend. They are expensive to defend because the exposure presented, as evidenced by the verdicts I have summarized above, is unlimited. Each and every punitive damage claim must be taken very seriously and defended accordingly because of this unlimited exposure.

LESSMEIER & WINTERS
ATTORNEYS AT LAW

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I have enclosed herewith a recent study entitled The Role of Punitive Damages in Civil Litigation: New Evidence from Lawsuit Filings. This study confirms what our experience has been, as it finds not only that lawsuits involving punitive damage claims take one-third longer to resolve than suits without such claims, but that the "uncertainty posed by the prospect of unlimited punitive damages, combined with the relative probability of a punitive damage award if the case goes to jury trial, provide litigants who demand punitive damages with potent leverage against risk-adverse defendants, and tip the balance in settlement bargains in favor of litigants with weak or even frivolous cases."

Ironically, I just ran across a Continuing Legal Education (CLE) study program entitled, "A Primer on Punitive Damages." This paper begins by telling a lawyer what we all know to be true:

'A solid punitive damage claim is a powerful weapon for a plaintiff. Since the trier of fact does not precisely determine such damages at trial, the claim adds unpredictability to the case. Also, a punitive damage award is difficult to overturn on appeal. Indeed, "[c]ourts have affirmed punitive damage awards with a ratio [to the compensatory award] of as high as 2,000 to 1." Thus, a deep-pocket defendant who has committed an egregious act is at high-risk for a large punitive damage award, regardless of the actual damage caused. Such a defendant may prefer to settle the case for a known sum before trial, rather than risk receiving a large punitive damage award after trial.'

Bert C. Cozart, A Primer on Punitive Damages, California Lawyer, January 1997.

The issue is not necessarily the number of adverse verdicts, but the number of punitive damage claims which are made and the effect of those claims. Each claim has to be defended. Each has the potential of affecting the value of the underlying claim for compensatory damages. Each imposes a significant cost. This reality is ignored by those who chose to focus only on actual verdicts.

The second kinds of claims are those that are frivolous, either in whole or in part. Let me give you just a few examples of the kinds of claims we have defended:

One such claim involved an aggressor in a parking lot fight (he lost the fight) who sued the owner of the parking lot. The claim was successfully defended, but the cost was significant.

A second such claim was made by a convicted rapist who sued the bar that provided alcoholic beverages to him, claiming he committed his crimes because he was under the influence of alcohol. This case was litigated all the way to the Supreme Court. Again, the defense was successful, but not without significant cost.

Another such case involved claims made by two young men who were injured when running from the police. They had been at a party held by a young woman whose parents were not

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home. When the party got too loud, the neighbors called the police. Incredibly these young men sued the owners of the house!

Another case involved an intoxicated man who somehow managed to enter a transformer area at a municipal utility yard. He then climbed up on top of a transformer and was severely injured when he stood up and was shocked. He sued the municipality.

Yet another case involved owners of an unused walkway who were sued because when while out of town, their daughter had a party and a number of the "guests" jumped up and down on the walkway, causing the walkway to collapse. One of the guests was hurt when the walkway collapsed and she of course sued.

We have seen claims made by people who have fallen over while working on ladders, stepped out in front of cars, pulled out in front of oncoming vehicles, fallen on wet walkways, burned themselves with hot water and cut themselves with saws. We frequently see cases against health care providers that are filed without any substantive basis whatsoever. Over and over again we see claims which are legitimate in part, but are exaggerated in an effort to increase the value of the claim.

The list could go on and on, but the point is that our society has adopted a lawsuit mentality, instead of a philosophy of personal responsibility. We hope that this legislation will change that by removing some of the windfalls which currently exist in the system, by placing incentives for early and responsible evaluation of claims, by placing reasonable limits on non-economic and punitive damage claims, and finally by clearly and specifically penalizing those who come to court and make false statements to better their position.

Please let me know if you have further questions or if further information would be of benefit.

Sincerely,

LESSMEIER & WINTERS

By. 
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The Role of Punitive Damages in Civil Litigation: New Evidence from Lawsuit Filings

By Steven Hayward†

HIGHLIGHTS:

- This study offers new data on the frequency and the effects of punitive damages, based on a detailed review of more than 1000 lawsuits filed and concluded in San Francisco County Superior Court.
- Punitive damages are demanded in 27 percent of all cases where they are conceivably recoverable.
- Lawsuit filing data show that business and government defendants are four times as likely as an individual defendant to face a lawsuit that demands punitive damages.
- Lawsuits that include punitive damage demands take one-third longer to resolve than suits without these demands. The average lawsuit in our 1000 case sample took 15 months to resolve; cases with punitive damage demands took an average of 21 months to resolve.

† Steven Hayward is vice president, research for the Pacific Research Institute. William S. Loughman, an attorney and senior fellow in legal studies for the Pacific Research Institute, conducted the research into lawsuit filings.

- Punitive damage demands play a significant role in the out-of-court settlement process, where the vast majority of lawsuits are settled. Punitive damage demands tilt the playing field in favor of demanding parties, and increase out-of-court settlement amounts.

- Studies of punitive damage jury verdicts have been interpreted to suggest that the risk of receiving an adverse punitive damage judgment is remote. Closer scrutiny of the data, we argue, will show that the probability of punitive damage awards is vastly understated by these studies, in part because the data have been improperly qualified.

Introduction

The controversy over punitive damages in civil litigation has centered around the number of punitive damage awards, and the dollar amounts of such awards. Comprehensive data on this issue are scarce because there is no complete statistical database of trial verdicts. However, we believe that the focus of research on the number of punitive damage verdicts is misplaced to some extent. Focusing only on trial verdicts understates the scope and nature of the problem because the overwhelming majority of all lawsuits are resolved out of court. According to surveys of lawsuits, less than 2 percent of all cases go to trial. Looking only at the 2 percent of cases that reach a jury is like looking only at the visible tip of a large iceberg: it ignores the larger unseen part below the water line that may do more harm. Thus, to argue that punitive damage awards are rare is to miss an obvious point: *jury verdicts of any kind are rare*. No one would say, however, that because jury verdicts are rare, lawsuits themselves are insignificant or costless. Yet this is the inference that has been drawn from various punitive damage studies that focus only on trial verdicts.¹

The right question to ask about the civil litigation process is: *what is occurring in the other 98 percent of cases that are resolved out-of-court?* Because 98 percent of cases are resolved out of court, it is important for researchers and for public policy makers to understand what is going on in these cases, and how the legal rules, including the relative probability of punitive damages, affect the outcomes of the negotiation process for out-of-court settlements.

A large proportion of lawsuits today include punitive damage demands. Because 98 percent of lawsuits are resolved out-of-court, an important threshold question to answer is: *Do punitive damage demands in lawsuit filings have a significant effect on the out-of-court settlement process?*

¹ For example, the recent federal Department of Justice estimates of civil suit verdicts in state courts, discussed below, generated numerous newspaper headlines to the effect that "punitive damages are rarely awarded."

In an attempt to shed light on this question, the Pacific Research Institute conducted a detailed examination of more than 1000 lawsuit filings in San Francisco County Superior Court. We conclude that punitive damages are used as a weapon to generate more favorable out-of-court settlements, especially against business and government defendants.

What Lawsuit Filings Data Tell Us

Most punitive damage studies focus on verdicts in the handful of cases that proceed to trial. There are no empirical studies that examine how often, and against whom, punitive damage demands are employed.

In an attempt to shed light on these issues, we have scrutinized a month's worth of lawsuits filed between January 2, 1991 and February 1, 1991 in the Civil Division of the California Superior Court for the County of San Francisco. There were 1,024 lawsuits filed in this venue during this time period. Our analysis seeks to determine what patterns exist with respect to the distribution of claims for punitive damages and statutorily mandated multiple damages. We reviewed each case to determine the type of case, the principal cause of action claimed, whether punitive damages were demanded, how the case was resolved, and how long it took to resolve. We picked cases from 1991 because over 98 percent of cases from this time period had been resolved, either by trial, settlement, or dismissal, so most could be traced out to their conclusion. (A complete description of the methodology used in surveying and classifying these cases is available upon request.)

The highlights of the analysis of these cases include:

- 78 percent of all punitive damage demands were filed against a business defendant. (See Figure 1 below.)
- Government defendants face punitive demands in more than one-third of lawsuits filed against government agencies. (See Table 1 below.)
- Lawsuits that include punitive damage demands take about six months longer to resolve than lawsuits that do not include punitive damage demands.
- The probability of a punitive damage award if a case proceeds to trial is 14 percent or higher. For business defendants, the probability is more than 20 percent.

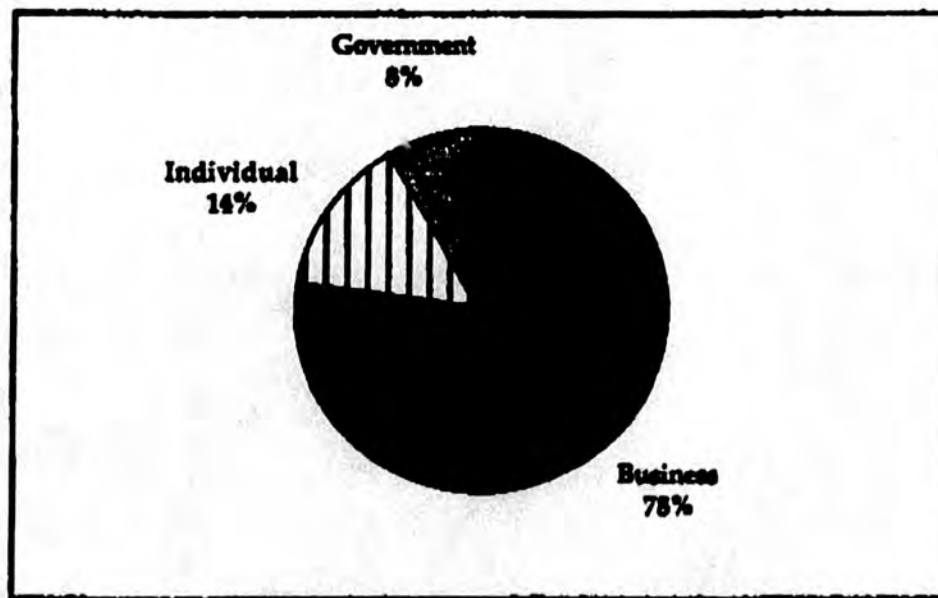
Of the 1,024 cases we examined, nine (9) cases were designated by the court as "sealed" and were unavailable for study. This left a pool of 1,015 lawsuits for study. 537 of these 1,015 cases, or 52.9 percent, were based on one of three principal causes of action where punitive damages are recoverable:

- 1) common law tort;
- 2) statutory tort or other statutory civil action; or
- 3) contract.*

The remaining civil filings within this pool—478 cases—consisted of civil law categories where punitive damages are not available or only very rarely available. These categories include equity causes of action (such as requests for a temporary restraining order); family law matters (chiefly dissolution of marriage proceedings); and civil petitions (such as a name change, to confirm an arbitration award, or to compel an audit entry).

Punitive damage demands were included in 145 of the lawsuits. This represents only 14 percent of the total pool of lawsuits, but 27 percent of the suits in areas where punitive damages are generally available (145 out of 537). Of these 145 filings, 112 or 78 percent were filed against a business defendant. This breakdown is displayed in Figure 1 below.

Figure 1: Distribution of Punitive Damage Demands by Type of Defendant



* Although punitive damages are not normally recoverable in contract lawsuits, many contract suits nowadays include secondary causes of action, such as fraud or "bad faith," which can suffice as a basis for punitive damages. For this reason, contract cases have been included in the pool of cases which can potentially involve a viable claim for punitive or statutory damages.

Of the 1,015 cases reviewed, only 22 went to trial, or 2.1 percent. This is comparable to the trial rate estimated in the Department of Justice study, and is consistent with most studies of lawsuits. Seventeen of these 22 cases were tort, statutory, or contract cases (in which punitive damages may be alleged). Of these 17 cases, seven were court trials (heard by a judge instead of a jury) and 10 were jury trials. Business entities were the primary defendant in 11 of the 17 trials; government entities and individuals were named as the primary defendants in three trials. Six of the 17 cases (two court trials, and four jury trials) included punitive damage demands. Two of the 17 cases settled during trial. Of the remaining 15 cases, plaintiffs won in seven of the trials, while defendants won eight. No punitive damages were awarded in these verdicts.

Table 1 categorizes cases according to the type of primary designated defendant (individual, business entity, government entity, and non-profit organization). Table 2 displays the same data according to type of case instead of type of defendant. The data in these tables demonstrate that punitive damages are overwhelmingly alleged against business entities. Businesses face punitive damage demands roughly four times as often as individuals.

Government Agencies Frequently Targeted

Another remarkable feature is apparent in Table 1: Government entities face punitive damage demands more than one-third of the time (35 percent). While defenders of punitive damages argue that punitive awards are necessary to prevent allegedly gross negligence, malice, or willful harm by businesses, such malicious behavior can hardly be just as frequently alleged in government. But government entities, like businesses, are perceived to have "deep pockets" and make attractive targets for punitive damage demands. Thus, taxpayers, and not just business interests, bear the direct cost of punitive damages. Many of the lawsuits brought against government, and defended at taxpayers' expense, are patently frivolous. For example, in one case from our research, *Buford v. California Department of Real Estate*, the plaintiff demanded \$3 million in punitive damages because the agency had refused to grant him a real estate license. The Department of Real Estate had to answer the suit in court, pointing out that the plaintiff was a convicted felon.

Another notable suit was *Shervin v. California State Police*. Alleging that five state police officers had burst into his home without a warrant but on the direct orders of Governor Deukmejian, Shervin demanded punitive damages based on seven different allegations, including "organized conspiracy, racketeering and/or extortion, to subvert the court and to obstruct justice."

Additional allegations included "torture," and the accusation that the California State Police were engaged in "an extensive, continued and perpetual gigantic organized conspiracy" of an unspecified nature. This was the *fourth* such lawsuit Shervin had brought against various government agencies in recent years, all defended at taxpayer expense.

Table 1: Civil Litigation Filings in Common Law Tort, Statutory Tort, and Contract Cases, and Punitive or Statutory Damage Claims Frequency by Category of Primary-Designated Defendant, 1991

INDIVIDUALS (as primary-designated defendant)		
Category of case:	Total # of cases:	Punitive damages demand included:
Common law tort:	169	16
Statutory tort/actions:	1	0
Contract:	34	5
Totals:	204	21
Frequency of punitive damage claims:		10.29%

BUSINESSES (as primary-designated defendant)		
Category of case:	Total # of cases:	Punitive damages demand included:
Common law tort:	184	74
Statutory tort/actions:	26	19
Contract:	80	20
Totals:	290	113
Frequency of punitive damage claims:		38.97%

GOVERNMENT ENTITIES (as primary-designated defendant)		
Category of case:	Total # of cases:	Punitive damages demand included:
Common law tort:	25	6
Statutory tort/actions:	6	4
Contract:	6	3
Totals:	37	13
Frequency of punitive damage claims:		35.14%

NON-PROFIT ENTITIES (as primary-designated defendant)		
Category of case:	Total # of cases:	Punitive damages demand included:
Common law tort:	5	0
Statutory tort/actions:	0	0
Contract:	1	0
Totals:	6	0
Frequency of punitive damage claims:		0%

Table 2: Distribution of Punitive and Statutory Damages Claims Among Civil Filings by Category of Lawsuit, 1991

Common Law Tort Cases					
	Primary Designated Defendant (Punitive Damage Claims in Parenthesis)				
	Individual	Business	Gov't Entity	Non-Profit	
	Totals P.D.s as %	169 (16) 9.47%	184 (74) 40.22%	25 (6) 24.0%	4 (0) 0%
PDs for all common law tort cases: 24.87% (96/382)					

Statutory Tort Cases					
	Primary Designated Defendant (Punitive Damage Claims in Parenthesis)				
	Individual	Business	Gov't Entity	Non-Profit	
	Totals P.D.s as %	1 (0) 0%	26 (19) 73%	6 (4) 66%	0 (0) 0%
PDs for all statutory tort cases: 66% (23/33)					

Contract Cases					
	Primary Designated Defendant (Punitive Damage Claims in Parenthesis)				
	Individual	Business	Gov't Entity	Non-Profit	
	Totals P.D.s as %	34 (5) 14.71%	80 (20) 25%	6 (3) 50%	1 (0) 0%
PDs for all contract cases: 23.14% (28/121)					

Duration: Punitive Cases Take Longer to Resolve

Another significant finding of this sample of lawsuit filings concerns the average duration of the cases. We assigned a duration value to each case in the sample. The purpose of this analysis was to gauge the length of time until each case was resolved, and to see whether lawsuits that included punitive damage demands were concluded more quickly or less quickly than lawsuits that did not demand punitive damages. Our analysis of the duration of cases showed that lawsuits that did not include a punitive damage demand were concluded in an average of 15 months, while punitive damage lawsuits required an average of 21 months to conclude—a six month difference.

It is difficult to know whether this distribution of case filings, punitive damage demands, and average duration to resolution holds constant in the

case filings in other jurisdictions. But for *purposes of illustration only*, if this distribution were roughly similar in all the jurisdictions covered in the Department of Justice estimates, it would suggest that a business defendant facing a punitive damage demand would have about a 14 percent probability of receiving an adverse punitive damage judgment at trial—substantially higher than the 5.9 percent of trials that resulted in punitive damages in all of the trial verdicts considered as a whole in the DoJ study.² It should be emphasized here that many of the 75 counties included in the DoJ study, such as Washington state counties, do not allow or severely restrict punitive damages, so the overall probability in areas allowing punitive damages is certainly much higher than 14 percent.

Asking the Right Questions: The Dynamics of Lawsuit Settlement

To appreciate fully the significance of the findings of our analysis of lawsuit filings, it is necessary to understand how punitive damage demands may affect the calculus of out-of-court settlement demands. A review of the scholarship about this subject will establish the following conclusions:

1. The *unpredictability* of a prospective punitive damage award contributes significantly to the *uncertainty* (and therefore the *risk*) of a court trial outcome.
2. Both the uncertainty posed by the prospect of unlimited punitive damages, combined with the relative probability of a punitive damage award if a case goes to jury trial, provide litigants who demand punitive damages with potent leverage against risk-averse defendants, and tip the balance in settlement bargains in favor of litigants with weak or even frivolous cases.

As mentioned previously, concentrating on trial verdicts overlooks "where the action is" in civil litigation: out-of-court settlements. We are not suggesting that verdicts are unimportant. To the contrary, punitive damage verdicts are like the tip of the proverbial iceberg. The small number of trials affect decisions in the vast majority of lawsuits that do not proceed to trial. Verdicts are "information signals" for litigants. Even Stephen Daniels and

² The calculation for this figure is as follows: In our case sample, 38.5 percent of business cases include a punitive damage demand. The Department of Justice report estimated that there were 5,240 tort cases against a business defendant in its sample of cases from 75 counties. Holding constant from our sample, this would suggest that 2,017 of these cases included punitive damage demands (38.5% of 5,240 cases). If we assume that the proportion of punitive verdicts is in parity with the distribution of punitive demands (i.e., 78 percent against business), then 284 of the 364 punitive verdicts in the DoJ study were against business defendants. These 284 verdicts represent 14 percent of the 2,107 cases.

Joanne Martin, who are strong proponents of punitive damage awards, note that "jury verdicts in the minority of matters actually adjudicated play an important role in determining the worth, or settlement value, of civil matters filed but not tried."³

To get a proper perspective on how this process works requires a consideration of the basic dynamics of a lawsuit. There is growing scholarly literature that offers several models of decision-making in the litigation process, especially in cases involving doubtful or even frivolous legal claims. "Situations involving litigation are a paradigmatic case of bargaining conflict," Kip Viscusi has written, and hence susceptible to illumination through game-theory and decision-tree models.⁴ As professors Robert Cooter and Daniel Rubinfeld of U.C. Berkeley have noted, "The attributes of litigation bargaining—rivalry, communication, side payments, interdependency, and uncertainty—characterize bargaining games as analyzed in microeconomics."⁵ This approach can help clarify the role of punitive damages in changing the calculus of settlement between litigating parties.

The first thing to understand about lawsuits under American law is that the plaintiff has the opening strategic advantage: even a plaintiff with a weak case places the defendant in the position of having to defend himself (and therefore incurring legal costs), or else the defendant will be liable for the full claim on a default judgment. Hence, even a defendant facing a suit without merit is often willing to pay an amount that is less than his prospective defense costs to settle the case and "make it go away." According to various studies, the cost of defense in an *average* tort lawsuit ranges from \$6000 to \$10,000, depending on the kind of suit.⁶ A litigant with even a mildly plausible basis for an average suit can often expect a nuisance settlement value within this range. Professors David Rosenberg and Stephen Shavell of Harvard Law School comment: "By filing a claim, any plaintiff, and thus the plaintiff with a weak case, places the defendant in a position where he will be held liable for the full judgment demanded unless he defends himself. Hence, the defendant should be willing to pay a positive amount in settlement to the plaintiff with the weak case—despite the defendant's knowledge that were he to defend himself, such a plaintiff would withdraw."⁷ University of Michigan economist Avery Katz adds that in

³ Stephen Daniels and Joanne Martin, "Myth and Reality in Punitive Damages," 75 *Minnesota Law Review* 1-64 (October 1990), p. 28.

⁴ W. Kip Viscusi, "Product Liability Litigation with Risk Aversion," *Journal of Legal Studies*, Vol. XVII (January 1988) p. 120.

⁵ Robert D. Cooter and Daniel L. Rubinfeld, "Economic Analysis of Legal Disputes and Their Resolution," *Journal of Economic Literature*, Vol. XXVII (September 1989), p. 1069.

⁶ J. Kakalik and N. Pace, *Costs and Compensation Paid in Tort Litigation* (Santa Monica: RAND Corporation Institute for Civil Justice, 1986).

⁷ D. Rosenberg & S. Shavell, "A Model in Which Suits Are Brought for Their Nuisance Value," 5 *International Review of Law and Economics* (1983), p. 3.

many cases "the defendant is willing to pay a settlement up to the amount of his defense costs in order to avoid having to respond to the plaintiff's complaint."⁸

The main determining factor of whether a filed lawsuit will yield a settlement to the plaintiff is the "threat credibility" of the suit, i.e., what is the probability of a verdict favorable to the plaintiff if the case goes to trial, and what is the likely amount of damages that the plaintiff could win? The scholarly models of the out-of-court negotiation process suggest that an increase in the prospective amount of a jury verdict increases the likelihood of a settlement offer by the defendant, and tends to increase the amount of such settlements. Professors Kathleen Engelmann and Bradford Cornell argue that "it is almost invariably the case that increasing the cost of litigation increases the probability of settlement."⁹ Professor Barry Nalebuff of Princeton University concurs, noting that "an increase in the court award . . . raises the probability of settlement."¹⁰

This can be true even in frivolous or marginal lawsuits, or lawsuits with a doubtful chance of success at a trial. Professor Katz comments: "The main reason that frivolous suits are not always met with a blanket denial and refusal to negotiate, of course, is that the defendant rarely knows the merits of the claim with certainty. Since refusing to take a valid claim seriously can be quite costly, a frivolous plaintiff may be able to take advantage of the defendant's uncertainty regarding the claim's validity to extract a substantial settlement." Moreover, Katz adds, "higher trial costs raise the defendant's benefit from settling with valid claimants and makes him more willing to tolerate the cost of settling with strike suitors."¹¹

The point is: punitive damage demands will often tip the balance of power in bargaining to the plaintiff, even one with a weak or frivolous case. It does so in two ways: by increasing the size of a prospective jury award (by an unpredictable and potentially enormous amount) if the case is taken to trial, and by increasing the legal costs that a defendant will have to incur to fight the suit at trial. First, to use a hypothetical example: while a \$50,000 lawsuit with arguable merit might have a settlement value of \$20,000 or \$30,000, a \$50,000 lawsuit that also demands \$200,000 in punitive damages is no longer a

⁸ Avery Katz, "The Effect of Frivolous Lawsuits on the Settlement of Litigation," *International Review of Law and Economics*, Vol. 10 (1990), p. 4.

⁹ Kathleen Engelmann and Bradford Cornell, "Measuring the Cost of Corporate Litigation: Five Case Studies," *Journal of Legal Studies*, Vol. XVII (June 1988), p. 397. For a general discussion of this point, see John P. Gould, "The Economics of Legal Conflicts," *Journal of Legal Studies*, Vol. 2, No. 2 (June 1973), pp. 279-300; Lucian Arye Bebchuk, "Suing Solely to Extract a Settlement Offer," *Journal of Legal Studies*, Vol. XVII (June 1988), pp. 437-450; Cooter and Rubinfeld, *op cit.*

¹⁰ Barry Nalebuff, "Credible Pretrial Negotiation," *RAND Journal of Economics*, Vol. 18, No. 2 (Summer 1987), p. 208.

¹¹ Katz, *op cit.*, p. 4, 5.

\$50,000 lawsuit for purposes of settlement. The presence of a punitive damage demand provides leverage for the plaintiff to force a higher settlement value from the suit. Second, the presence of a punitive damage demand often requires a more extensive, more costly, and more time-consuming defense by the defendants. Most punitive damage demands are based on claims of intentional wrongdoing or "conscious disregard" of the rights of the litigant. Defending against such extraordinary claims usually requires a more expensive discovery process than ordinary damage claims. In addition to a discovery process about the basic facts of the injury or fraud involved in the tort allegation, determining the malicious intent of the defendant will involve more extensive, and therefore more expensive, document searches and depositions.

The key dynamic of the out-of-court settlement process is *uncertainty*. Obviously if the outcome of jury trials were highly predictable, few if any cases would ever go to trial. The parties would always settle. It is the uncertainty of trial outcomes that has led to a thriving market for jury verdict data services, which are intended to provide at least some guidance to litigating parties to help estimate the risks of trial and the parameters of a reasonable settlement. Punitive damage demands add dramatically to the uncertainty of out-of-court settlement deliberations. The inclusion of a punitive damage demand increases the potential amount of an adverse jury award by an unpredictable degree, since punitive damages are unlimited.

To judge how serious a factor this is, it is necessary to consider the probability of receiving a punitive damage verdict if a case is taken to trial. The plaintiff's leverage is only effective if the threat of extracting punitive damages from a trial is credible. What makes a punitive damage demand credible in the eyes of a defendant? The studies that minimize the number of punitive damage awards are highly misleading on this point.

For example, the recent Department of Justice study's estimates on civil lawsuits seems to suggest that because so few cases result in punitive damages (364 out of 762,000 cases filed, or .0004 percent), the threat of a punitive damage demand in a lawsuit pleading is not very credible.¹² But this is to miss something rather obvious in the DoJ statistics: because only 1.5 percent of the lawsuits actually went to trial, the relevant question to ask is: *what is*

¹² "Civil Jury Cases and Verdicts in Large Counties," U.S. Department of Justice, Bureau of Justice Statistics, Special Report NCJ-154346, July 1995. It is important to take note of the methodological difficulties with this study. While the study purports to represent a review of 762,000 case filings and 12,000 jury verdicts, in fact the Department of Justice only scrutinized a sample of these cases. It is from these samples that extrapolations are made in the various tables in the study. The sample size is not divulged. This is why we have consistently referred to the DoJ's figures as "estimates." Finally, the Department of Justice study does not provide a state-by-state breakdown, so it is impossible to offer observations specific to California based on their estimates.

the risk of receiving a punitive damage judgment if a case is brought to trial? The 364 punitive damage verdicts in the DoJ estimates take on a new significance if pondered in this fashion: they amount to 3 percent of the 12,000 cases tried, or 5.9 percent of verdicts in which the plaintiff was the winner. Three percent, or even 5.9 percent, still may not seem very substantial to outside observers who do not bear the risk themselves, but it is crucial to remember, however, that many if not a majority of these cases that went to trial *did not include a punitive damage demand as a part of their pleading*. Secondly, the DoJ statistics do not tell how many of the suits that included punitive damage demands, or how many of the verdicts that included punitive damages, were suits brought against *businesses* as opposed to *individuals*. (The Department of Justice has the data to make this breakdown, but chose not to report it in its study.)

The disaggregated figures in Table 3 below, taken from the Department of Justice estimates, tell the story more clearly.¹³ Although the DoJ estimates are severely limited because they do not tell us whether the defendant in these verdicts is an individual or a business, and does not tell us what proportion of the cases that went to trial sought punitive damages, they do confirm that the probability of receiving a punitive damage award is significant.¹⁴ For example, in employment law cases (nearly all of which were brought against business defendants), we see that 26.8 percent of all verdicts included punitive damages, with a hefty median punitive award of \$179,000.

¹³ These data appear as Table 8 on page 8 in the Department of Justice study.

¹⁴ As pointed out above, the DoJ did not actually analyze 762,000 cases on a case-by-case basis. It would take years to conduct such an analysis. But unless a substantial sample of cases is analyzed closely, it is impossible to answer some key questions about what is happening. The DoJ does not estimate how many of the 762,000 suits requested punitive damages as a part of their filing, or how many of the 12,000 that went to trial included punitive damage demands. But without knowing this, it is difficult to judge the significance of some of the DoJ findings. For example, while the DoJ study notes that only 13 out of 403 medical malpractice verdicts included punitive damages, the study does not say—because the DoJ does not know—how many of those 403 cases demanded punitive damages as a part of their case filing. Although the DoJ estimates do break down suits filed against individuals and filed against business, it does not reveal how many of the suits against business that went to trial included punitive damage demands. Again, the DoJ cannot know this without actually examining each and every case filing. Because the DoJ study is based on estimates instead of a hard count of actual cases, it cannot tell us much that is meaningful about the relative risk posed to defendants who face punitive damage demands.

Table 3: Punitive Damage Awards for Plaintiff Winners in Civil Jury Cases in State Courts in the Nation's 75 Largest Counties, 1992

	Plaintiff winner cases		Amount of punitive damages awarded to plaintiff winners			% of plaintiff winner cases with punitive damages	
	No. awarded punitive damages	% of cases receiving punitive damages	Total	Median	Mean	Over \$250K	Over \$1 mill.
Case type:							
All jury cases	364	5.9	\$267,879,000	\$50,000	\$735,000	23.7	11.6
Tort cases	190	4.0	91,477,000	36,000	481,000	22.7	10.1
Automobile	55	2.4	35,535,000	25,000	641,000	19.9	7.3
Premises liability	15	1.7	1,272,000	40,000	87,000	0	0
Product liability	3	2.2	40,000	9,000	12,000	0	0
Intentional tort	38	18.5	10,926,000	25,000	286,000	13.8	8.5
Medical malpractice	13	3.1	3,120,000	199,000	245,000	31.8	0
Profsnl malpractice	15	15.7	6,077,000	250,000	412,000	44.0	8.5
Slander/libel	8	29.8	1,341,000	47,000	164,000	34.2	0
Toxic substance	13	6.2	26,420,000	1,692,000	1,994,000	54.7	54.7
Other tort	30	7.2	6,746,000	100,000	226,000	20.9	10.9
Contract cases	169	12.2	169,528,000	52,000	1,003,000	24.4	12.6
Fraud	38	21.2	7,339,000	45,000	191,000	18.9	10.4
Seller plaintiff	24	5.6	1,221,000	22,000	51,000	0	0
Buyer plaintiff	47	12.4	27,446,000	27,000	581,000	28.6	11.1
Employment	46	26.8	132,759,000	179,000	2,875,000	42.1	26.1
Rental/lease	11	11.3	399,000	50,000	37,000	0	0
Other contract	2	1.8	365,000	145,000	162,000	44.4	0
Real property cases	5	11.7	6,873,000	85,000	1,375,000	40.0	40.0

Another point should be made from the DoJ estimates. While defenders of unlimited punitive damages prefer to use *median* punitive award figures because a few large awards can skew *average* award figures, this point can be turned on its head. The large disparity between median punitive award amounts and average award amounts (\$50,000 and \$735,000 respectively in the DoJ estimates) highlights the unpredictability of punitive awards. As our previous report on punitive damages in California showed, there was a huge range in punitive damages awarded between 1990 and 1994, demonstrating that punitive damages are unpredictable and arbitrary.¹⁵ In California cases during this period, the range of punitive awards runs from 710 times compensatory damages to .0001 times compensatory damages. (In one case, a defendant who was not assessed any compensatory damages was nevertheless

¹⁵ *Punitive Damages in California: A Preliminary Report* (San Francisco: Pacific Research Institute, 1995).

hit with \$62,000 in punitive damages.) It is precisely this uncertainty that provides the plaintiff with additional leverage in the settlement process.

Conclusions

The California statutes governing punitive damages use exceptionally strong language to prescribe when punitive damages are appropriate. Punitive damages should be awarded where there is "clear and convincing evidence" that a defendant has behaved with "malice," or has engaged in "despicable conduct which is carried on by the defendant with a willful and conscious disregard of the rights or safety of others." Other descriptions include "oppression, intentional misrepresentation, deceit, or concealment of a material fact. . ." Unless it is implausibly assumed that such extraordinary behavior is rampant and pervasive in California, the frequent appearance of punitive damage demands in lawsuit filings is evidence that they have become simply a regular litigation tactic.

It is not persuasive to say that the frequency of punitive damage demands have little or no effect on the cost and outcomes of litigation. The uncertainty and risk posed by potential punitive damage awards magnifies the leverage of such demands in out-of-court settlements. The prospect of "runaway juries" is far from fanciful. Even judges have felt compelled to speak out about this phenomena. In a recent California trial involving an employment dispute that resulted in an \$80 million punitive damage award, the trial judge set aside the verdict, noting:

"This award is so disproportionate to the injuries, damages and conduct, and so unsupported by the evidence it shocks the conscience of this court to the point that the court cannot countenance such a result and feels compelled, despite its respect for the jury process, to grant a new trial . . . Punitive damages award is excessive and clearly motivated by passion and prejudice [of the jury]. The award does not bear a reasonable relationship to the nature of defendant's action and the extent of plaintiffs' injuries."¹⁶

Despite the admonitions of California statutes that there be "clear and convincing evidence" of extraordinarily deliberate malicious behavior, it is clear that new guidelines and limitations on punitive damages are needed.

¹⁶ *Lane v. Hughes Aircraft Company*, Los Angeles County Superior Court Case No. BC 075 519 (December 15, 1994).

THE ROLE OF PUNITIVE DAMAGES IN CIVIL LITIGATION: NEW EVIDENCE FROM LAWSUIT FILINGS



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April 4, 1997

Senator Jerry Mackie
Senator John Torgerson
Alaska State Legislature
Juneau, Alaska 99801

Re: Tort Reform Bill -- CSSSHB 58(FIN) am

Dear Senators:

The current tort reform bill is once again being subjected to the criticism that it could threaten the \$5 billion Exxon Valdez punitive damage verdict, which is currently on appeal to the U. S. Court of Appeals for the Ninth Circuit. The lawyers who have agreed to accept "only" 20% of that award are encouraging the Exxon claimants to send public opinion messages in opposition to the bill.

I served on the commission Governor Knowles appointed last year to make recommendations for changes to Alaska's civil liability laws. The commission recommended a limit on punitive damages in order to relieve Alaska business from the threat of unreasonable exposure, which multiplies litigation and which can be used to extract excessive and unjustified settlements. The Governor's commission was composed of members from all sides of the issue, including some of the lawyers who urge the rejection of HB 58. As I recall, the commission adopted its recommendations for a cap on punitive damages with only two dissenting votes, one of which came from the member of the legislature and one from an advocate of reform who thought the proposal insufficient.

The recommendations of the commission with respect to punitive damages are not identical to the language of HB 158, but the basic cap of three times compensatory damages appears in both measures, and therefore should be regarded as acceptable to most of the interest groups concerned with civil liability. By definition, punitive damages are awarded over and above the amount necessary to fully compensate the injured party for all actual losses, including intangible losses like "emotional distress." Awarding a plaintiff three or four times actual losses should hardly be seen as restricting justice for Alaskans. But the modest restrictions of HB 58 are needed to prevent extreme results with which I am personally familiar including one case in which a plaintiff with no physical injuries or medical expenses was awarded punitive damages more than 200 times the amount of actual loss.

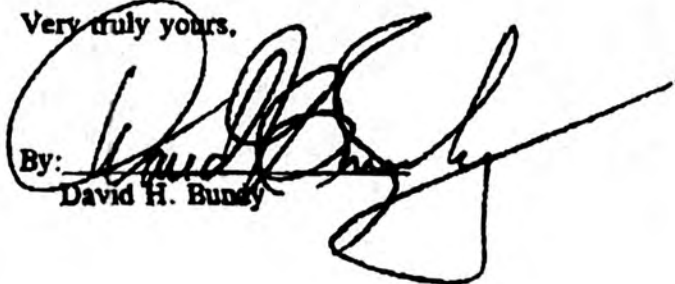
As far as the Exxon Valdez punitive damage verdict is concerned, there is no basis for belief that limiting punitive damages in Alaska state courts will undercut that result. The Exxon case was tried in federal court under federal admiralty law, and is on appeal to another federal court. While Exxon will certainly argue the verdict is excessive, the

Senators Mackie and Torgerson
April 4, 1997
Page 2

compensatory verdict plus the amount Exxon paid in settlements, when multiplied by three or four, is not materially lower than the punitive award which would have been allowed under HB 58. So HB 58 will not offer Exxon any new arguments on appeal.

Opponents of tort reform know that the prospect of a \$5 billion cash payoff is anticipated in parts of the State. They think if they can convince legislators that this payment is jeopardized, the Legislature will turn away from reform. But this is a red herring. Alaskans deserve protection from the threat of excessive and unjustified punitive damages. Small businesses, including owners of fishing vessels, are frequent targets of litigation, and face high insurance premiums as a result. A big verdict can drive a defendant into bankruptcy and the exposure to this risk, plus ongoing legal fees, encourages marginal cases and compels settlements even where liability is very doubtful. Nothing in HB 158 takes away a dollar of justified compensation from a plaintiff who files a claim in a timely manner and pursues it reasonably. The Legislature should not be reluctant to enact the bill.

Very truly yours,

By: 

David H. Boney

DHB:mw
H:\B2\TORTREF\TORTREF.LTR



April 2, 1997

The Honorable Brian S. Porter
House Judiciary Committee
Alaska House of Representatives
Capitol Building, Room 216
Juneau AK 99801-1182

Dear Representative *Brian* Porter:

On behalf of USAA and more than 11,000 USAA members in Alaska, I am writing you to express strong opposition to House Bill 95 and ask your assistance in preventing the bill from becoming law. USAA is a member-owned company providing insurance and financial services to military families worldwide. Preserving the confidentiality of membership data is an essential part of USAA's relationship with its members.

USAA insures over 90 percent of the active duty military officers in all branches of the U. S. armed forces, as well as a large portion of the nation's foreign service officers and many other federal government officials. It provides coverage in fifty-two (52) jurisdictions within the United States and other locations throughout the world. Consequently, its records routinely reflect the current stationing addresses of military and foreign officers who rely upon USAA to maintain the confidentiality of the identities, addresses, drivers license information, vehicles and related information pertaining to them and their dependents. Any breach of that confidentiality would adversely affect USAA's fiduciary relationship with their members. We believe House Bill 95 (hereafter referred to as "the Act") will force USAA to violate the members' expectations of confidentiality and privacy of the information they have entrusted to the company.

I believe the Act violates Alaska's trade secret laws and the U. S. Constitutional prohibition on a taking as it relates to trade secrets. Specifically, the bill requires insurers to periodically divulge customer lists, which have been developed at considerable expense, to a private vendor designated agent of the State. The agent receives a windfall in that it is able to establish a commercially valuable database from the confidential and proprietary customer information exacted from insurers. Insurers receive no compensation from the agent or the state for the information or the costs incurred in providing the information. To the contrary, insurers will have to bear the substantial expense of providing the data.

Beyond question, the Act will impose a disparate burden on USAA members and others who are active duty members of the U. S. Armed Forces. Such persons are permitted by federal statute to maintain certain privileges of their home of record without regard to where they may be stationed. This includes registering their automobiles in the home of record state. The insurance policy, however, is issued to satisfy the laws of the state where the automobile is

The Honorable Brian S. Porter
April 2, 1997
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garaged, not where it is registered and will not appear in the Alaska database. The many Alaska service men and women who keep their cars registered there but are stationed elsewhere will frequently be identified by the designated agent as not having insurance. This is an unfair burden to add to those who have already made the sacrifices inherent in choosing to serve in the Armed Forces of their country.

The public policy that would be created by the Act is morally flawed. Essentially, it proposes that a private vendor knowingly create an incomplete list of persons within the state who have automobile insurance. The State of Alaska will then operate from the premise that, until that person can prove their innocence, anyone whose name does not appear on that list is in violation of the state's financial responsibility laws. This is a radical departure from the traditional presumption of innocence.

Database verification programs have been enacted by numerous states throughout the nation, but only Utah mandates a designated vendor agent to operate the program. In January, 1993, the state of Connecticut examined eighteen (18) such programs nationwide. In reviewing the results of that study, it is clear that one common aspect for all programs is that effectiveness in reduction of the uninsured motorist rate is directly related to the human resources devoted to enforcement of the program. For example, North Carolina, with a population of approximately six million vehicles, achieved an uninsured motorist rate of 3% with a full-time staff of 177 to handle letters and sanctions. Pennsylvania achieved a 2.5% UM rate with a full time staff of 59. In those states which have achieved very low uninsured motorist rates, there have generally been well-defined and well-staffed enforcement programs to utilize the information developed from the database verification program. Any efforts to create a verification program within a state should be accompanied by a review of the enforcement provisions for that state's mandatory insurance/ financial responsibility laws. If, as in the case of Utah, there is no mechanism for enhanced enforcement, the result is a creation of a database with nothing to follow.

Since the Act proposes a program that is modeled on the Utah program, I believe this Legislature should take a closer look at the total experience there instead of accepting at face value unsubstantiated claims of program success. Rising uninsured motorists claims in Utah belie the assertions of a declining uninsured motorist population. The Utah Governor recently signed into law a bill which opens the way for a legislative audit of the program following complaints by citizens erroneously accused of being uninsured. Last year, USAA's strong concerns with the confidentiality of its data were underscored when the agent, instead of returning our data tapes, returned those of a competitor to us.

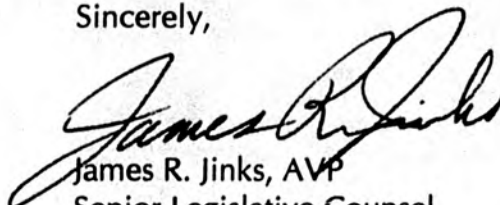
For your consideration, I am enclosing an analysis of why we believe the Act violates Alaska's Trade Secret laws and the U. S. Constitutional Fifth Amendment protection of property rights. While USAA recognizes Alaska's interest in dealing with the uninsured motorist

The Honorable Brian S. Porter
April 2, 1997
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problem, we believe House Bill 95 would force upon USAA the unwelcome role of becoming a part of the law enforcement process while imposing a substantial financial burden as well. While reversing the long-standing presumption of innocence, it would also have a disparate impact on our members and those similarly situated.

For the reasons expressed above and in the attached analysis, I am respectfully asking for your assistance in defeating legislation which burdens so many and benefits only the designated agent.

Sincerely,



James R. Jinks, AVP
Senior Legislative Counsel

JRJ:djn
Attachment

THE ACT CONSTITUTES A TAKING UNDER STATE AND FEDERAL LAW

I. STATE CLAIM TAKING

The Act Would Constitute A Taking Of Property Protected Under The Uniform Trade Secretes Act

Alaska is among the 35 states and other jurisdictions which have adopted the Uniform Trade Secrets Act. Generally, a trade secret is:

"information including a formula, pattern, compilation, program, device, method, technique, or process, that (emphasis added):

- (a) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use; and
- (b) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy."

The membership data which the Act requires USAA to disclose to a third party agent is confidential, proprietary, and a valuable trade secret. The data reflecting the identities, addresses, driver's license information, birth dates, vehicles, policies and policy expiration dates of USAA's members has substantial economic value. That information derives independent economic value from not being generally known to, and not being readily ascertainable by proper means by competitors, direct mailers and other persons who could obtain economic value from its disclosure or use.

USAA has always closely guarded their membership data and has never used sales agents for sold customer information as other insurers do. To the contrary, it has established specific written corporate policies and rigorous security procedures to maintain the secrecy of membership information. USAA's rigorous internal policies, procedures, confidentiality agreements and database security certainly constitute "efforts that are reasonable under the circumstances to maintain (the) secrecy" of their membership data.

Essentially, the Act seizes the USAA's membership data without reasonable provisions to maintain its secrecy and authorizes the designated agent to establish a commercially valuable database from confidential and proprietary customer information exacted from USAA and other insurers without compensation. The very purpose of the Act is to disclose the USAA's membership information through the state computer system to all law enforcement personnel and numerous state and local government employees. Although it limits release or disclosure of information in the database for unauthorized purposes or persons, the Act fails to establish any security procedures to prevent unauthorized releases and disclosures. In fact, it appears to provide statutory immunity for the state and the designated agent, and does not even require the return of insurers' customer data.

II. FEDERAL CLAIM TAKING.

The United States Supreme Court has established that trade secrets are protected by the taking clause of the Fifth Amendment [*Monsanto*, 467 U. S. at 1002-03, 103 S. Ct. at 2872. See also *Noranda Exploration*, 335 N. W. 2d at 603 (holding that proprietary information is entitled to protection as property under the Federal and Wisconsin taking clauses)]. The threatened appropriation of USAA's trade secret clearly constitutes an uncompensated taking in violation of the Fifth Amendment.

The Appropriation Is A Categorical Violation of the Fifth Amendment

The United States Supreme Court has established two categories of *per se* takings: physical appropriations and deprivations of all beneficial use of property. Plaintiffs can establish a *per se* violation under both of those categories.

In *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U. S. 419, 434 - 35, 102 S. Ct. 3164, 3175 (1982), the Supreme Court reiterated the well-established rule that any governmental action that effects a permanent physical occupation of property is a compensable taking, regardless of its purpose or economic impact. This *per se* rule is based on the recognition that a physical taking deprives a property owner of the essential right to exclusive possession, use and control over its property (*Loretto*, 485 U.S. at 433, 102 S. Ct. at 3175). Whenever the government deliberately causes its agents or the public at large to regularly use or permanently occupy something which was previously under private ownership, there is an incontestable case for compensation under the Federal takings clause [Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 Harv. L. Rev. 1165, 1184 (1967)].

The Act requires USAA to surrender physical possession of their trade secret membership data to the designated agent on magnetic tape. It authorizes the designated agent to invade USAA's database electronically and use it continuously in the operation of the agent's business. The designated agent's physical possession, electronic invasion and continual use of USAA membership data will deprive it of exclusive possession and control over its property the same way the physical installation of cable television equipment deprived apartment owners of exclusive possession and control over their buildings in *Loretto*. In both cases, the physical appropriation allows third parties continuing access and use of private property on an indefinite basis. Under these circumstances, the appropriation is a *per se* violation of the Fifth Amendment.

The Act Also Constitutes A Fifth Amendment Taking Under The Traditional Three-Prong Test.

The traditional three-prong test for a violation of the Federal taking clause involves three factors: (a) the character of the governmental action, (b) its interference with reasonable, investment-backed expectations, and (c) its economic impact. Any one of those factors can be determinative in a particular case.

Alaska Has No Valid Governmental Interest In Appropriating USAA Trade Secrets

It is settled that there must be an "essential nexus" between a "legitimate state interest" and the challenged condition; that is, between the legislative end and the legislative means. In addition, there must be a reasonable relationship between the challenged requirement and the property owner's proposed development; that is, between the burden and the benefit to the property owner. The burden is on the government to establish that the challenged requirement is reasonably related or "roughly proportional" in nature and extent to the benefit conferred on the property owner.

The taking provision of the Act cannot meet this strict constitutional standard. There is no essential nexus between Alaska's interest in identifying uninsured motorists and the appropriation of USAA's trade secret membership data for the benefit of a third party who will reap substantial commercial benefit from it.

Alaska's interest in identifying uninsured motorists can be addressed by less confiscatory means than the appropriation of USAA's trade secrets to a designated agent without compensation. In fact, many other states have adopted measures to identify uninsured motorists, but only one state, Utah, has appropriated insurers' proprietary data for the benefit of a third party without compensation.

USAA Has A Reasonable, Investment-Backed Expectation That Their Trade Secret Will Not Be Stripped Away To Benefit A Third Party

USAA has a reasonable, investment-backed expectation that they will maintain exclusive use and control of their trade secret membership data. The Association has never released that membership information without extensive safeguards to preserve its secrecy.

In *Monsanto*, the Supreme Court held that Monsanto had a reasonable investment backed expectation that data it submitted to the EPA under statutory guarantees preserving its trade secret protection would not be disclosed under subsequent statutory amendments (*Monsanto*, 467 U.S. at 1012, 104 S. Ct. at 2877). The Court held that Monsanto was entitled to compensation for the disclosure of that data under the Fifth Amendment. USAA's reasonable, investment-backed expectation in their property interest is similarly protected (*Monsanto*, 467 U.S. at 1001-03, 104 S. Ct. at 2872-73).

The Threatened Taking Has A Substantial Economic Impact

The Act gives the state's designated agent a valuable capital asset at the expense of USAA and other insurers. USAA's membership data has substantial monetary value not only for the agent's current business operations, but also for USAA's competitors, direct mailers, and others who might obtain it from the agent. The mere preparation of the initial records required by the Act will impose a significant economic burden on USAA's members.

The threatened injury to USAA is, however, much greater than the benefit to the designated agent and the state. The potential loss of its trade secret protection and damage to its customer relations is incalculable.

The Taking Is Clearly For A Public Use And Without Compensation

The "public use" requirement of the Federal Taking Clause is "coterminous" in scope with the police power (*Monsanto* 467 U.S. at 1012-13, 104 S. Ct. at 2878). As long as taking has a conceivable public character, it meets the "public use" requirement (*Monsanto*, 467 U.S. at 1014-15, 104 S. Ct. at 2879). Under this broad standard, the taking effected by the Act is clearly a taking for a public use.

Nor can there be any dispute that the Act does not adequately provide for just compensation. It provides no compensation at all. This is not a case where a nominal or inadequate compensation is provided in the statutory scheme (Compare *Monsanto*, 467 U.S. at 994, 104 S. Ct. at 2868-69; *Loretto*, 458, 102 S. Ct. at 3169)). This is a case in which USAA's private property is being appropriated for public use at great expense to the Association with no compensation whatsoever.

Although Alaska may have a legitimate interest in identifying uninsured motorists, the legislative end of identifying uninsured motorists and the legislative means of forcing USAA to surrender their trade secret membership data to Alaska's designated agent without compensation do not constitute an "essential nexus." Moreover, the state's end and its means are not reasonably related. The taking does not insure effective identification of uninsured motorists. Certainly, it does not constitute the least intrusive means of identifying uninsured motorists. Therefore, the Act's taking provision is a violation of due process.

MEMORANDUM

TO: Paul Richards
FROM: David H. Bundy
DATE: April 14, 1997
SUBJECT: Comments on draft S CS for CS for SS HB 58

In reference to the work draft received this afternoon (paragraphs refer to section numbers in the draft):

5. Statute of repose changed from 8 years to 10. Looks OK
8. Six years changed to 8. Looks OK
9. Non-economic goes to \$500,000 or \$1,500,000 for severe case. This may be OK but represents a big jump as compared to the \$300/\$500 limit in original bill.
10. New standard for punitive damages, slightly easier to meet than prior standard of malice; new limit of 3 times or \$500, as opposed to \$300 may be OK; Enhanced limit of 4 times or \$3 million is a much higher than prior limit of 4 times or \$600. Would be better, if we have to raise limit, to keep it at \$1 million or less. Maybe alternative might be 4 times or \$2 million, whichever is less. We do want to avoid a limit tied to net income if possible. New subsection (h) is good; need to keep that.

I see future tax provision, collateral source and periodic payments sections have been deleted. That's OK if needed to keep the punitive limits and allocation of fault sections.

- 16 Reduced percentages to prevailing party looks OK; they're still high enough to have an impact.

I'll try to send more comments by the end of the day.

**ALASKA OIL AND GAS ASSOCIATION
POSITION ON
TORT REFORM LEGISLATION
April, 1997**

The Alaska Oil and Gas Association (AOGA) is a trade association whose 19 member companies account for the majority of oil and gas exploration, production, transportation, refining and marketing activities in Alaska.

The Alaska Oil and Gas Association believes Alaska should adopt reforms to its civil justice system:

- The Alaska civil justice system gives juries and judges discretion to impose unlimited punitive damages awards, without adequate guidelines or criteria necessary to insure the constitutional protection of due process.

- Alaska's civil justice system discourages investment in the state. Firms assessing whether to invest or to conduct business in Alaska rather than in another state or country must take into account the legal risks that Alaskan law allows, and the substantial legal risks that can be incurred even in defending against frivolous civil actions.

A variety of reforms have been suggested to address these problems. The Alaska Oil and Gas Association believes the most important are:

- Limitations on punitive damages. This reform would make it clear that awards beyond those necessary to compensate plaintiffs for real damages would need to be justified by clear and convincing evidence of malice or conscious acts showing deliberate disregard of another person's rights and would be capped - as are sentences in criminal law - so that juries and judges could not impose financially ruinous or unlimited awards. Punitive damages which are tied to a defendant's earnings and bear no relationship to compensatory damages are unacceptable.

- Judgments should be proportionate to fault. It is fundamentally unfair to require a defendant to pay a much larger share of damages than the defendant's share of fault.

Other legitimate and important reforms are appropriate. However, the two reform areas above are particularly significant to companies who are sensitive to the large risks they face from disproportionate awards and unlimited punitive judgements. Reform of these two areas would reduce business risks, establish a greater degree of fairness, and bring Alaskan law into line with that found in progressive states interested in fairness and a competitive business climate.

Adopted by the AOGA Board of Directors, February 10, 1997. Amended by the State Legislative Committee March 19, 1997 and April 1, 1997.

Alaska State Legislature



Official Business
Fax: (907) 465-3472

State Capitol
Juneau, AK 99801
(907) 465-3720
(907) 465-2689

Speaker of the House of Representatives

Tamara Brandt Cook
Director, Legal and Research Services Division
Legislative Affairs Agency
April 11, 1997

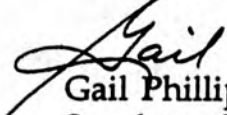
Dear Tam:

Please be advised that we will require that Mike Ford and his team to be standing by at 2:00 pm this Sunday afternoon to deal with an important bill that will require their immediate attention. It may be that Mike and his team of typists, proofers, etc. will not be required, in which case they will be notified and released.

Due to the sensitive nature of the subject matter of the bill, I can give you no more details at this time. You will know who will be my designee for this matter when the original of this letter is presented to Mike Ford on Sunday at 2:00 pm in my office. My designee is hereby delegated authority to take whatever steps, and to give whatever direction is required to Mike Ford and his staff, in order to achieve a satisfactory result.

Thank you and your fine staff for the outstanding job you are doing.

Sincerely yours,


Gail Phillips
Speaker of the House of Representatives


Thanks!

LESSMEIER & WINTERS

LAWYERS - LLC

ONE SEALASKA PLAZA
SUITE 303
JUNEAU, ALASKA 99801-1249

TELEPHONE: (907) 586-5912
FACSIMILE: (907) 463-3020

MICHAEL L. LESSMEIER
GREGORY W. LESSMEIER
SHELDON E. WINTERS
BETH LEIBOWITZ
*MICHIGAN

April 16, 1997

Senators

Dear Senator:

I am writing on behalf of State Farm to respond to Jeff Friedman's letter of April 15, 1997. In that letter Mr. Friedman states that the most recent version of HB58 is a bill that was written primarily by State Farm Insurance Company. This is simply not true. A simple comparison between the Senate Rules Committee Substitute and the Senate Finance Committee Substitute shows that the bills are the same in most respects. The changes that do appear in almost every instance were made by the sponsor of this legislation in an effort to reach compromise. For example, the statute of repose was increased from 8 years to 10 years. The non-economic damages limits were raised from three hundred to five hundred thousand dollars for the lower limit, and from five hundred thousand to 1.5 million for the upper limit. The punitive damage limit was raised. Provisions regarding collateral benefits, periodic payments and reduction of awards by the amount one would pay for federal income taxes were deleted. The allocation of fault provision was modified again in an effort to respond to the critics of this legislation. The vast majority of these changes were either suggested by the administration, the trial lawyers or were made in an effort to respond to other concerns. It is neither fair nor accurate to say this bill contains significant new language that either was not part of the Senate Finance Committee Substitute or contained in one of the other related bills before the legislature.

Sincerely,

LESSMEIER & WINTERS

By: 
Michael L. Lessmeier

MLL/blw

**

OPINION SECTION:

*

POSTER CHILD

ANTI-TORT REFORM AD MISLEADS ALASKANS

By Daily News editorial staff

In recent weeks, lawyers fighting state tort reform proposals have trotted out a poster child named Sara. A newspaper ad features this forlorn young girl sitting in a wheelchair, staring sadly at readers.

"Sara and many of her friends were severely injured when the roof collapsed over their school cafeteria," reads the text. "It collapsed because a greedy contractor cut corners when the school was built."

The ad goes on to assail "the Tort Reform bill, HB 58," because it "denies Sara, other injured children and their parents the right to sue the contractor."

As your blood begins to boil because of this rank injustice, you stop for a second. Hmm ... I don't remember hearing about such a horrible accident; did I miss something?

Actually, no.

In their rush to inflame passions against tort reform, a group called Citizens For Civil Justice has taken considerable liberties with reality. Sara has no more substance than the spaceship the Heavens Gate cultthought was trailing the Hale-Bopp comet.

Let's check in with the mastermind of the ad, prominent Alaska trial attorney Ames Luce.

"It's hypothetical, not an actual situation," Mr. Luce said.

"We were trying to dramatize an event that would occur if in fact your child or mine or the hypothetical Sara were injured. ... If the impression is that Sara is an actual person, we didn't mean to imply that."

Gee, could have fooled us.

The girl is shown in a wheelchair and identified by name. The text says she and friends "were injured." The text says that thanks to tort reform, Sara "will never get her day in court."

Granted, Mr. Luce quickly agreed the ad "probably was poorly worded. ... We probably will change it if we run it again." But this dose of slippery ad rhetoric calls his group's whole case against tort reform into question.

Measured tort reform can bring more certainty to the legal process without unduly harming the rights of victims. On the other hand, it's possible for reformers to overreach, pushing overhyped, ill-considered ideas that will do little to reduce insurance

rates.

The challenge for Alaskans and their elected officials is to find the right balance. Attacking tort reform with tear-jerk ads about made-up accidents has no place in this important debate.

*



Poster child

Anti-tort reform ad misleads Alaskans

In recent weeks, lawyers fighting state tort reform proposals have trotted out a poster child named Sara. A newspaper ad features this fictional young girl sitting in a wheelchair, staring sadly at readers.

"Sara and many of her friends were severely injured when the roof collapsed over their school cafeteria," reads the text. "It collapsed because a greedy contractor cut corners when the school was built."

The ad goes on to assail "the Tort Reform bill, HB 36," because it "denies Sara, other injured children and their parents the right to sue the contractor."

As your blood begins to boil because of this rank injustice, you stop for a second. Hmm ... I don't remember hearing about such a horrible accident, did I miss something?

Actually, no.

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Let's check in with the manufacturer of the ad, president Alaska trial attorney Ames Lutz.

"It's hypothetical, not an actual situation," Mr. Lutz said. "We were trying to dramatize an event that would occur if in fact your child or mine or the hypothetical Sara were injured. ... If the impression is that Sara is an actual person, we didn't mean to imply that."

Gas, could have fooled us.

The girl is shown in a wheelchair and identified by name. The text says she and friends "were injured." The text says that thanks to tort reform, Sara "will never get her day in court."

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Measured tort reform can bring more certainty to the legal process without unduly harming the rights of victims. On the other hand, it's possible for reformers to overreach, pushing overtyped, ill-considered ideas that will do little to reduce insurance rates.

The challenge for Alaskans and their elected officials is to find the right balance. Attacking tort reform with tear-jerk ads about made-up accidents has no place in this important debate.

APR-16-97 WED 8:49

LESSMEIER & WINTERS

FAX NO. 9074633020

P.01

APR-16-97 WED 7:59 AM

From Friedman/Porterfield to 19074633020

at 04/15/97 08:40P

P. 1

Jeffrey Friedman
P.O. Box 111841
Anchorage, AK 99511-1841

jeffj@alaska.net

April 15, 1997

Dear Senator:

The most recent substitute version for House Bill 58 being considered by the Senate is a hastily and poorly written bill. It is being offered as a compromise bill. It is not. It is a bill written primarily by State Farm Insurance Company, and its hired agent Michael Lessmeier. I think it fair to say State Farm did not have the best interests of Alaskans in mind when it proposed this bill.

There have been several attempts to draft a reasonable compromise on tort reform. The Governor's task force had representatives from the insurance, medical, and business communities. It was created to propose a reasonable tort reform bill. Trial lawyers participated in that process even though they did not believe any reform was needed. This compromise was rejected by Representative Porter when he originally submitted HB 58.

Since then, there have been other attempts to negotiate and reach a compromise. Each time, the good faith efforts to reach agreement were rejected without any consideration. As recently as this last weekend, Roger Holmes who has been supporting major tort reform efforts for years, proposed a reasonable solution. Again, reason was ignored.

The current version of HB 58 is bad for many reasons. Essentially, it will harm children and middle class Alaskans who can least afford to pay this price. It will also drastically increase litigation.

- **Section 5.** Many injuries to children do not manifest themselves until they reach certain developmental stages. This change would prevent children from ever making a claim for these sorts of injuries since you can not sue before the injury occurs. It would also preclude any state cause of action if the Alyeska Pipeline ever leaked, since it is more than 10 years old.

- **Section 9.** This section is unconstitutional since it makes arbitrary distinctions between different sorts of injuries. There is no reason to treat loss of an arm different than loss of several internal organs.
- **Section 10.** An arbitrary cap on punitive damages makes no sense. It means average people of modest means can be financially ruined while large corporations, like State Farm, pay less than one day's worth of profit.
- **Limiting discovery on punitive issues** until after trial means increased costs for the court system. Most judges won't keep a jury waiting for a week or two while the parties conduct discovery. In most punitive cases, it will take that long just to read the documents even if they are immediately produced. Accordingly, a second jury will be selected, and much of the same evidence will be presented twice.
- **Sections 11 - 13.** A similar provision was held to be unconstitutional in Montana. It will be held unconstitutional here. When fault can be attributed to non-parties, you increase the risk of fraud. It is easy to find someone to accept the blame when they are not a party and any fault attributed against them can not be used against them in future litigation. Under current law, a defendant can name additional defendants if it thinks someone else caused the harm. That way, all parties potentially at fault are before the court and can be questioned before the jury.
- **Section 15.** Plumbers and electricians are licensed professionals in Alaska, but there is no board certification. Under this provision, you could not use an expert to testify that an electrician acted negligently. Similarly, lawyers are licensed, but there is no board certification. That means no expert witnesses in a legal malpractice case.
- **Section 16.** This dramatically increases the penalty for failing to accept an offer of judgment. The State of Alaska, and other large organizations, will often pay this penalty. People with no money, won't care because you can't get blood from a stone. The average Alaskan with a retirement fund or other savings will not be able to take this risk, however. They will be forced to settle valid claims because they can not afford to risk everything even if they are 90% sure of winning. This provision will affect all claims equally. Since less than 1% of all claims are frivolous, this means that 99% of the claims dropped because of this threat will be valid claims. Defendants will be blackmailed into settling claims rather than risk paying full attorney fees to the plaintiff.
- **Section 30.** \$500,000 in malpractice insurance is not enough. Given the high cost of medical care needed by victims of

NO
TF?

we
Feb - T.

APR-16-97 WED 8:50

LESSMEIER & WINTERS

FAX NO. 9074633020

P.03

APR-16-97 WED 8:00 AM

From Friedman/Porterfield to 19074663805

at 09/16/97 08:00 AM

P. 3

medical malpractice, at least \$1 million should be required. This level of insurance is available to any doctor anywhere in Alaska.

- **Section 44.** This will turn every trial into a lengthy circus. There will be numerous "mini-trials" on whether false statements were made. A trial that otherwise would be completed in a week would take two weeks to complete. In other words, you will need to double the number of civil judges and courtrooms if this passes.

Sincerely,

Jeff Friedman



USAA
STATE LEGISLATIVE AFFAIRS

915 "L" Street, Suite 1100
Sacramento, CA 95814

FAX

Date: 4/10/97

Number of pages to follow: 1

To:

Jim Scurrant

Phone:

Fax:

CC:

From:

**James R. Jinks, AVP
Senior Legislative
Counsel**

Phone: **916/552-6715**

Fax: **916/442-1328**

REMARKS:



Urgent



FYI/Review



As Requested



Please comment

Here's what Donley's amendment
will result in for Auto insurance.
Similar results in other lines.
Also, the specter of a 3d Party
bad Faith lawsuit and award places
a big obstacle in efforts to combat
insurance fraud!

CONFIDENTIALITY NOTICE

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Capitol Fax Alert

**Your Involvement Is Needed
Please Contact Your Legislator**
State Office: 907/463-5118 Fax: 907/463-5128

Alaska

To: NFIB/Alaska Fax network
From: Thyes Shaub, State Director
RE: HB 58 Tort Reform
Date: April 1, 1997

Senate Contact Needed on Tort Reform

HB 58, tort reform legislation, sponsored by Representative Brian Porter passed the House of Representatives after 3 days of floor debate. The bill was referred directly to the Senate Finance Committee. The Senate Judiciary Committee was by-passed because Senator Taylor's tort reform legislation (SB15) had already been heard and moved to the Senate Finance Committee. SB 15 does not contain the legislative language needed to cap non-economic and punitive damages. SB 15 does put a cap of \$500,000 on punitive damages but exempts conduct that was motivated by financial gain, thus eliminating business interests.

HB 58 is scheduled for hearing in the Senate Finance Committee on Thursday April 3rd at 9:00 am. Letters of support are needed now. The bill is essentially the same as the version passed by the House in the last legislature. It makes important changes to Alaska's tort laws to make the civil justice system more fair, more efficient and less costly.

HB 58 allows for appropriate compensation for persons injured through the fault of others. There is no limit on economic damages such as medical costs and lost wages. It does limit non-economic damages such as pain and suffering to \$300,000 and for specified injuries to \$500,000. Punitive damages are prohibited unless malice or conscious acts show deliberate disregard for another person. Then damages, of up to \$300,000 or three times the amount of compensatory damages awarded, whichever is greater, is allowed. Extreme cases may qualify for a cap of \$600,000 or four times compensatory damages.

NFIB/Alaska strongly supports putting reasonable limits on non-economic and punitive damages. When there are no limits on damages, any business may be just one lawsuit away from being put out of business.

Fax letters of support to members of the Senate Finance Committee listed below. **Please fax a copy of your letter to the NFIB office in Juneau at 907-463-5128.**

Senator Drue Pearce, Co-chair 465-3872; Senator Bert Sharp, Co-chair, 465-2070; Senator Dave Donley, 465-6595; Senator Sean Parnell, 465-6592; Senator Randy Phillips, 465-4979
Senator John Torgerson, 465-4779; Senator Al Adams, 465-4821

H & H CONSTRUCTION CO., INC.
HC 34 BOX 2070
WASILLA, ALASKA 99654

April 1, 1997

Senate Finance Committee
Juneau, Alaska

Attention: Senator Al Adams

Dear Senator:

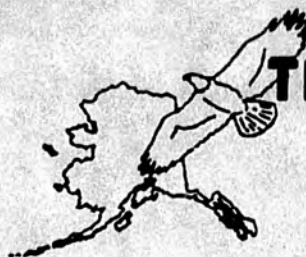
I am a building contractor in the Mat-Su Valley and strongly support IIB 58. I support putting reasonable limits on non-economic and punitive damages and feel its time to make changes to Alaska's tort laws to make the civil justice system more fair, more efficient and less costly.

Sincerely,

Ronald R. Hull

cc: National Federation of Independent Business

Flight Safety Alaska, Inc. dba



**TAKE FLIGHT
ALASKA**

1740 E. Fifth Avenue
Anchorage, Alaska 99501
Phone ... : (907) 274-9943
Fax : (907) 272-3486

FAX COVER SHEET

COMPANY NAME.. : ALASKA STATE SENATE

FAX NUMBER : 907-465-3872

ATTENTION : SENATOR DRUE PEARCE

DATE SENT : 4/1/97

FROM : EDDIE PARROTT

PAGES INCLUDING COVER : 1

Message

Please support the passage of HB 58 on tort reform. We support this bill rather than SB15.

COPY
TO
NFIB



UNITED
INSURANCE

P.O. Box 33519
JUNEAU, ALASKA 99803
(907) 789-5208
FAX: (907) 789-1856

April 1, 1997

Senator Drue Pearce
Legislative Office Building
Juneau, Alaska 99811

Re: HB 58: Tort Reform

Dear Senator Pearce:

I understand that HB 58, Tort Reform legislation is up for consideration again this year and is scheduled to come before the Senate Finance Committee on Thursday, April 3rd.

The ever increasing cost of personal injury cases and the unpredictability of juries in awarding damages has had a huge impact on small business in Alaska. I see it in my business, especially when insurance companies are reluctant to quote on liability insurance where there is any product liability involved. If they do quote, the premium is high, and in many cases they refuse to quote. This makes it difficult for the small business person.

I understand this bill does not limit economic damages such as medical costs and lost wages, but it does put a reasonable cap on additional awards for damages such as pain and suffering. I think this bill will make the civil justice system more fair, efficient and less costly.

The bill may not lower the cost of insurance in all cases, but I do think it will help with the availability of insurance, especially product liability coverage.

Sincerely,

Dave Moe



UNITED
INSURANCE

P.O. Box 33519
JUNEAU, ALASKA 99803
(907) 789-5208
FAX: (907) 789-1856

April 1, 1997

Senator Bert Sharp
Legislative Office Building
Juneau, Alaska 99811

Re: HB 58: Tort Reform

Dear Senator Sharp:

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Sincerely,

Dave Moe



UNITED
INSURANCE

P.O. BOX 33519
JUNEAU, ALASKA 99803
(907) 789-5208
FAX: (907) 789-1856

April 1, 1997

Senator Dave Donley
Legislative Office Building
Juneau, Alaska 99811

Re: HB 58: Tort Reform

Dear Senator Donley:

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Sincerely,

Dave Moe



UNITED
INSURANCE

P.O. Box 33519
JUNEAU, ALASKA 99803
(907) 789-5208
FAX: (907) 789-1856

April 1, 1997

Senator Sean Parnell
Legislative Office Building
Juneau, Alaska 99811

Re: HB 58: Tort Reform

Dear Senator Parnell:

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Sincerely,

Dave Moe



UNITED
INSURANCE

P.O. Box 33519
JUNEAU, ALASKA 99803
(907) 789-5208
FAX: (907) 789-1856

April 1, 1997

Senator Randy Phillips
Legislative Office Building
Juneau, Alaska 99811

Re: HB 58: Tort Reform

Dear Senator Phillips:

I understand that HB 58, Tort Reform legislation is up for consideration again this year and is scheduled to come before the Senate Finance Committee on Thursday, April 3rd.

The ever increasing cost of personal injury cases and the unpredictability of juries in awarding damages has had a huge impact on small business in Alaska. I see it in my business, especially when insurance companies are reluctant to quote on liability insurance where there is any product liability involved. If they do quote, the premium is high, and in many cases they refuse to quote. This makes it difficult for the small business person.

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Dave Moe



UNITED
INSURANCE

P.O. Box 33519
JUNEAU, ALASKA 99803
(907) 789-5208
FAX: (907) 789-1856

April 1, 1997

Senator John Torgerson
Legislative Office Building
Juneau, Alaska 99811

Re: HB 58: Tort Reform

Dear Senator Torgerson:

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The ever increasing cost of personal injury cases and the unpredictability of juries in awarding damages has had a huge impact on small business in Alaska. I see it in my business, especially when insurance companies are reluctant to quote on liability insurance where there is any product liability involved. If they do quote, the premium is high, and in many cases they refuse to quote. This makes it difficult for the small business person.

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Dave Moe



UNITED
INSURANCE

P.O. BOX 33519
JUNEAU, ALASKA 99803
(907) 789-5208
FAX: (907) 789-1856

April 1, 1997

Senator Al Adams
Legislative Office Building
Juneau, Alaska 99811

Re: HB 58: Tort Reform

Dear Senator Adams:

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The ever increasing cost of personal injury cases and the unpredictability of juries in awarding damages has had a huge impact on small business in Alaska. I see it in my business, especially when insurance companies are reluctant to quote on liability insurance where there is any product liability involved. If they do quote, the premium is high, and in many cases they refuse to quote. This makes it difficult for the small business person.

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Sincerely,

Dave Moe



Fax Cover Sheet

DATE: *April 1, 1997*

TIME:

TO: *NFJB*

PHONE:

FAX: *(907) 4163-5128*

FROM: *Dick Davis*

PHONE: (907) 581-1276

FAX: (907) 581-1496

RE: *Tort Reform*

CC:

Number of pages including cover sheet: *4*

Message



April 1, 1997

Senator Drue Pearce, Co-Chair
Senate Finance Committee
Alaska State Legislature
State Capital, Room 513
Juneau, AK 99801-1182

Re: Tort Reform

Dear Senator Pearce:

As a small Alaskan business, truly Alaskan owned by Aleut shareholders we support HB 58 which limits non-economic damages such as pain and suffering to \$300,000.00 and for specified injuries to \$500,000.00.

I urge you to pass a bill with reasonable limits on non-economic and punitive damages. When there are no limits on damages, a small business may be just one lawsuit away from being put out of business.

Sincerely,

Richard D. Davis, Jr.
Chief Executive Officer



April 1, 1997

Senator Albert Adams
Senate Finance Committee
Alaska State Legislature
State Capital, Room 417
Juneau, AK 99801-1182

Re: Tort Reform

Dear Senator Adams:

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Sincerely,

Richard L. Davis, Jr.
Chief Executive Officer



April 1, 1997

Senator Bert Sharp, Co-Chair
Senate Finance Committee
Alaska State Legislature
State Capital, Room 514
Juneau, AK 99801-1182

Re: Tort Reform

Dear Senator Sharp:

As a small Alaskan business, truly Alaskan owned by Aleut shareholders we support HB 58 which limits non-economic damages such as pain and suffering to \$300,000.00 and for specified injuries to \$500,000.00.

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Sincerely,

Richard L. Davis, Jr.
Chief Executive Officer

C P Accounting

Post Office Box 872508
Wasilla, AK 99687
376-5376

TELECOPIER COVER SHEET

FAX NUMBER 376-2812

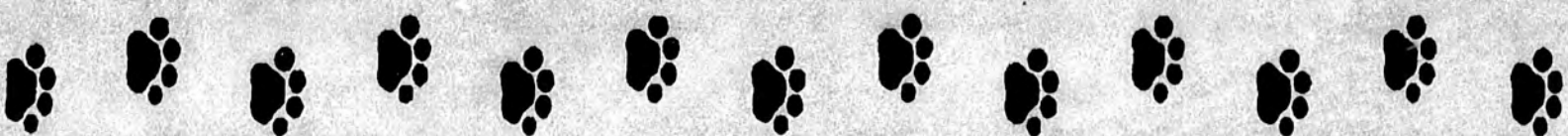
DATE: 4/1/97NAME: Druse PearceFIRM: Senate CollierFAX NO.: 465-3872NUMBER OF PAGES (including this sheet): 1

OTHER INSTRUCTIONS OR NOTES:

High costs of settlements are putting the
insurance rates so high - small business
cannot operate with current rates - this
must stop - please support HB58 being heard
April 3 -

Carol Palmer

NOTE: If any of the fax copies are illegible, or you do not receive the same number as stated, please contact us immediately at number above.



From: Alaska Backpacker Shuttle
P.O. Box 232493
Anchorage, Alaska 99523-2493

To: Shawn Parnell

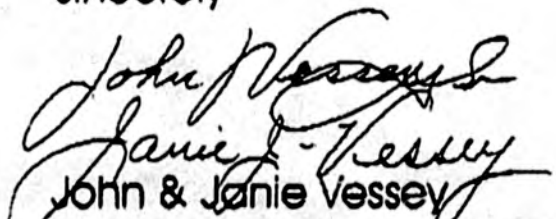
Dear Shawn

I am writing you in support of HB58. I support putting reasonable limits on non-economic and punitive damages. The lack of limits puts any small business like ours subject to going out of business if only one law suit is brought against it.

Please support HB58 on Thursday April 3rd.

Thank you for your support of those who need your help.

Sincerely



John & Janie Vessey
Alaska Backpacker Shuttle



Alaska State Medical Association

4107 Laurel Street • Anchorage, Alaska 99508 • (907) 562-2662 • (907) 561-2063 (fax)

April 3, 1997

The Honorable Drue Pearce, Co-Chair
The Honorable Bert Sharp, Co-Chair
Finance Committee
Alaska Senate
State Capitol (MS3100)
Juneau, AK 99801

Post-It® Fax Note	7671	Date	3.31.97	# of pages	11
To	Rep. Porter	From	Jim Jordan		
Co./Dept.		Co.	ASMA		
Phone #		Phone #	562-2662		
Fax #		Fax #			

Subject: CSSH B 58(FIN)am

Dear Senators Pearce and Sharp:

The Alaska State Medical Association (ASMA) is comprised of nearly 500 physicians located throughout Alaska. The ASMA House of Delegates and Board of Trustees would like to thank you for providing the opportunity for ASMA to testify on its recommendations for modifications to the civil justice system.

Physicians in Alaska practice in unique and challenging circumstances. Our goal is to provide the most appropriate and best medical care possible to our patients. Our profession is facing increasingly complex issues involving new technology, moral and ethical situations, and fiscal pressures from all fronts.

The practice of medicine in Alaska is typified by the sole practitioner or small clinic practices which are essentially small businesses. But this too is changing with managed care appearing throughout Alaska which brings its own special considerations. Questions arise as to quality of care in a managed care setting that is driven perhaps more by fiscal considerations than by the medical condition of the patient. These fiscal considerations are being driven by others than the treating physicians. Such circumstances provide for further complications and uncertainties in the applications of the civil justice system to the practice of medicine.

ASMA has been on record for many years supporting changes in the civil justice system that provide for less uncertainties in the system while not keeping any person from the courthouse. Those changes are as follows:

1. Ceiling on Non-economic Damages

No limit is suggested on proven economic damages such as loss of earnings and medical expenses. ASMA recommends a ceiling of \$250,000 on recovery from non-economic damages which are those intangibles such as pain and suffering.

No caps or extremely high ceilings for non-economic damages provides for a system along the lines of a lottery. Uncertain, extremely high potential awards lead to high professional liability insurance rates which in turn leads to more physicians going without such coverage. An uninsured doctor may not have the assets to satisfy a judgment for loss of earnings and future medical expenses let alone an award for non-economic damages.

2. Limits on Attorney Fees

A sliding attorney's contingency fee schedule is recommended as follows:

- 40% of the first \$50,000
- 33 1/3% of the next \$50,000
- 25% of the next \$500,000
- 15% of any amounts in excess of \$600,000

Sufficient, appropriate net compensation to the injured party is the goal of the recommendation while providing for just compensation to the injured party's attorney. More compensation to the patient is the result.

3. Collateral Source Evidence

Allow a defendant (e.g., physician) to introduce evidence pertaining to amounts of other proceeds received by a plaintiff due to the situation that resulted in the lawsuit. Examples of those proceeds are insurance proceeds and workers compensation payments. This prevents duplicate payments for the same loss.

4. Periodic Payment of Future Damages

When an award for future damages exceeds \$50,000, allow either party to require the court to provide that the judgment be paid in installments over the term of the plaintiff's disability.

This allows for the purchase of an annuity to make future payments as and when they arise - a significant savings over an immediate lump-sum payment of an entire award.

5. Arbitration

Allow physicians to contract with patients for mandatory arbitration of malpractice claims.

6. Statute of Limitation

Maintain a statute of limitation that requires an action for injury or death against a physician to be filed within 2 years of when the person knows or should have known of the injury. However, for children under age six, require that action be brought before age eight or within two years, whichever is longer. But, the clock stops if there is fraud, intentional concealment of facts, or if there exists an undiscovered foreign body (of no therapeutic or diagnostic purpose) in the body of the injured child and the action is based on the presence of the foreign body.

7. Statute of Repose

Incorporate a general statute of repose that prevents suits from being brought after eight years measured from the date of the act that caused the injury or death. The statute of repose applies without regard to the statute of limitation. However, any statute of repose should not apply in cases involving intentional acts or if intentional concealment of facts occurred that resulted in a delay of more than eight years before the basis for the legal action was known.

8. Panel System

ASMA recommends the continuation of the panel system. Although, complete and credible empirical data which would indicate the impact of the panel system is impossible to develop, anecdotally many ASMA member physicians feel it is important and worthwhile for the panel system to remain in place. ASMA would consider a change in the method of selection of the panel to allow each side to choose a physician member with then those two members selecting a third physician. However, the physicians chosen should be physicians both licensed and actively practicing medicine in Alaska.

ASMA would also recommend that the "bias" questionnaire be changed so as to ferret out only real conflicts of interests as opposed to perceived conflicts. It would also appear that the existing questionnaire may be easily "gamed" by physicians not wanting to serve.

ASMA's experience is that it is not unusual for 40 suits involving medical malpractice to be filed each year which tend to take approximately two years to be adjudicated. Therefore, at any given point in time approximately 240 Alaska physicians are impaneled. This is over 20% of all physicians in Alaska, a significant contribution to the system for which, in most cases, the service is done pro bono.

The above are outlines of the features of civil justice reform that ASMA member physicians feel should be adopted. Many of the above are incorporated in CSSH B 58(FIN)am. For those that aren't, ASMA recommends amending CSSH B 58(FIN)am to include them. Specifically, the absolute cap of \$250,000 on non-economic damages is recommended to be incorporated. The general concepts underlying CSSH B 58(FIN)am are supported by ASMA.

The underlying purpose in the above is to provide some certainty where little certainty currently exists. Imposition of certainty provides for greater predictability and should result in reduced premium rates for professional liability coverage. Similar measures were adopted in California over 20 years ago with one result being that overall medical malpractice insurance premiums in California are half of what they are here in Alaska. Attached is a copy of an article that appeared in January/February 1997 issue of Contingencies the bi-monthly journal of the American Academy of Actuaries. Also, included is the "Issue Brief" cited in the article. As you can see, the impact of the MICRA has been significant in California; The Academy work group concludes that a

package of reforms is more effective than individual reforms, and key among the reforms are a cap on non-economic damages and a mandatory collateral-source offset rule.

Lower rates should result in more physicians having professional liability insurance coverage with sufficiently high limits. This result should provide for added peace of mind to patients. We believe it can be expected that lower costs for professional liability will have a marginally greater impact on the likelihood of private practice physicians practicing in rural communities having coverage with sufficient limits than those physicians practicing in urban areas.

Should you have any questions or comments you may direct them to any of the following people:

ASMA Board of Trustees

Paul Raymond MD, President,
235-7000, fax 235-4050

John J. Smith MD,
276-5222, fax 278-9044

Kevin M. Tomera MD,
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563-8588, fax 563-6903

Patrick Brady MD,
261-3102, fax 261-4882

Douglas G. Smith MD,
272-2571, fax 272-6751

David E. Johnson MD,
225-5144, fax 247-0920

Thank you again for opportunity to provide testimony.

Sincerely,



James J. Jordan
Executive Director

cc: Representative Brian Porter
Alaska House of Representatives
State Capitol, Mail Stop 3100
Room 216
Juneau, AK 99801-1182



A Surgical Fix for Medical Malpractice

Reforms Work Best as a Package, Study Shows

By Jeffrey Speicher

Almost everyone agrees: The medical malpractice system in the United States serves no one well. Although a few multimillion dollar settlements draw public attention, most individuals who suffer real injury at the hands of their physician or hospital accept less than the full value of their claim—and endure long delays before receiving compensation. Those most harmed—people left with lifelong medical needs or permanent loss of income—are most likely to be underpaid.

Physicians, who in the 1950s faced a 1-in-7 chance of being sued over the course of a career, now see the odds reduced to 1-in-7 *per year*. As a result malpractice insurance premiums have skyrocketed, causing many practitioners to abandon their specialties or adopt costly defensive-medicine procedures. Many insurers, buffeted since the early '70s by recurrent cycles of higher claims frequency and larger jury awards, have withdrawn from the market, which has reduced availability of coverage and further driven up costs. And as for attorneys . . . well, even some thoughtful legal scholars believe the system is out of whack.

According to Randall Bovbjerg of Washington's Urban Institute, author of numerous studies on medical malpractice, many of the system's problems arise from a basic difference between doctors and lawyers: Physicians think about healing injuries, attorneys about resolving disputes. Says Bovbjerg, "Doctors see medical malpractice as a way to make injured patients whole—financially as well as physically. Lawyers come into the process after a conflict arises, and their focus is on justice for their client."

Jeffrey Speicher is manager of member communications for the Academy and an editor for Contingencies.

This difference in worldview intertwines medical malpractice with the legal system. Malpractice must balance the need to compensate deserving claimants, deter future violations by making doctors more careful, and obtain justice for both patients and medical providers. All this from what Bovbjerg defines as "mainly an insurance system run by experts."

A group of those insurance experts, members of the American Academy of Actuaries, recently suggested an approach to make the system less costly. According to the Academy report, "Medical Malpractice Tort Reform: Lessons from the States," the mixed results of reform attempts by the states point the way to effective federal action.

"Congress should adopt a comprehensive approach to tort reform by adopting a package of measures," says Jim Hurley, an actuary with Tillinghast/Towers Perrin and leader of the Academy group. "Our report provides a synthesis of measures that have been effective at the state level."

A Package Deal

The California Medical Injury Compensation Reform Act (MICRA) of 1975 shows the success of the package approach. Before MICRA's adoption, the state's percentage of total U.S. loss payments was significantly higher than its proportion of the nation's physicians. By 1981, California's loss payments had dropped and were about even with its percentage of physicians. Costs continue to fall, even as California's share of physicians remains stable. Writes the Academy group: "The relationship of decreased relative costs to the timing of reform provides strong evidence for the effectiveness of the MICRA package." [See Figure 1.]

At the head of the Academy's list for lawmakers is a nationwide cap on jury awards for noneconomic damages such as pain and suffering. As evidence, Hurley points to Ohio where malpractice costs fell after a 1975 cap on damages, only to rise dramatically after court challenges led to a 1985

FIGURE 1

Malpractice Loss Payments in California as a Percentage of the U.S. Total, 1975-94

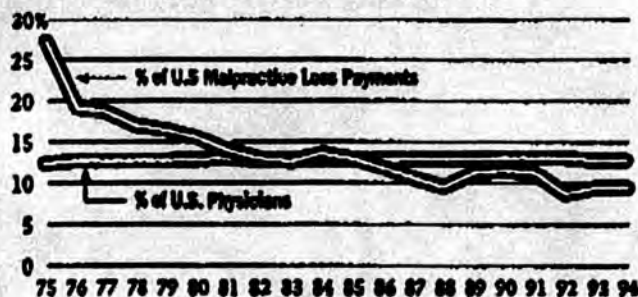


FIGURE 2

Malpractice Loss Payments in Ohio as a Percentage of the U.S. Total, 1975-94



ruling that overturned the cap. [See Figure 2.]

Such a cap should be established on a per-medical-injury basis at a level low enough to have an impact—at \$250,000, for example. In addition, a mandatory collateral-source offset rule is needed to ensure that double and triple indemnification cannot be collected through multiple suits. Under this rule, a jury or judge would have to consider compensation paid from other sources.

Above all, the Academy report warns against piecemeal or faulty changes. Loss experience in New York shows that the individual tort reform measures adopted in that state over the past two decades did not improve costs relative to the U.S. total. "Poorly crafted malpractice reform—either

Above all, the Academy report warns against piecemeal or faulty changes. "Poorly crafted malpractice reform—either individual measures that are too limited or broad transformations that are too far-reaching—can have unintended consequences that drive up costs."

individual measures that are too limited or broad transformations that are too far-reaching—can have unintended consequences that drive up costs," says Hurley.

The Academy's suggested approach involves what medical malpractice experts call "takeaway" reforms—preserving the current reliance on the tort system, but eliminating some of the costliest and most abused features.

Other voices in the debate, including representatives of the medical community, call for a back-to-the-drawing-board approach. Unfortunately, the design that comes back often relies on a no-fault model. While no-fault medical malpractice insurance would largely untangle the process from the legal system, no-fault often rewards individuals whose claims would otherwise be denied. Says Hurley, "No-fault would drive frequency of claims through the roof—some argue by a factor of at least two and perhaps by a factor of

eight or more. It's scary how many things can be compensated under the typical no-fault system."

Frequency of claims, according to Hurley, is the key driver of costs. "Over the past two decades, the plateaus and surges of claims frequency have been difficult to anticipate and measure, but the long-term trend has been up," says Hurley. Size of claims also is an important cost factor, but dollar amounts in settlements have been increasing in a more predictable fashion over time.

No-fault also would take most cases out of court and make malpractice a transaction between insurer and claimant. Advocates claim that this would cut legal costs—which are enormous. For example, according to the Insurance Services Office, legal defense costs for insurers alone accounted for 14 percent of total tort costs in 1992.

However, experience in Florida and Virginia, where no-fault for obstetric cases is already in place, does not show substantially reduced costs or less need for legal counsel. Says Bovberg, "Everyone who uses the no-fault system in Florida and Virginia consults a lawyer."

Other options exist. A proposal by Jeffrey O'Connell, professor at the University of Virginia School of Law, seeks a middle way between no-fault and status quo. He would shorten the process and lower costs through an early offer of payment of noneconomic damages.

O'Connell is blunt about his disgust with the current state of affairs. "Medical malpractice is a nightmare of useless circularity," he says. However, according to O'Connell, the system is not consistently biased against defendants. Most proposed changes, on the other hand, invariably favor the defendant. Justice—as well as political reality—requires benefits for the plaintiff as well.

"Reform requires a quid pro quo," says O'Connell. "While the Academy has described quite lucidly the options for takeaway reform, such measures could not get through Congress without being so watered down as to be meaningless," says O'Connell. "True reform should involve a fair trade: making it easier for claimants to be paid, but paying them less, as under workers compensation laws."

An Offer You Can't Refuse

O'Connell's ideas have found sponsorship on Capitol Hill. A bill introduced in the 104th Congress by Sen. Mitch Mc-

Connell (R-Ky.) would create an early-offer plan for all tort claims, including medical malpractice. Under the proposal, a defendant in a personal injury claim is given the option of offering payment to the injured party within 180 days of the claim. The defendant purchases for the claimant a comprehensive major medical insurance policy that covers medical expenses, rehabilitation, and lost wages beyond monies received from collateral sources. In addition, reasonable hourly fees for the claimant's attorney would be paid.

Claimants who are offered such a settlement within 180 days of the claim would be obliged to accept. This won't get egregious medical offenders off the hook, however. A normal tort claim could be pursued for noneconomic damages, but with a higher-than-current standard of evidence.

Medical malpractice is a nightmare of useless circularity.

The plaintiff must prove that the medical provider's misconduct was wanton or intentional.

Because the defendant would not be forced to offer a settlement, physicians and their insurers could take their chances in court in the case of bogus claims. However, the risk might be too great. O'Connell cites a prominent medical malpractice defense lawyer who estimates that he'd make an early offer in 200 of the his firm's 250 current cases. So the balance is tipped toward the defendant, but not without providing a substantial benefit to the plaintiff: Timely resolution and quick settlement.

The limit on legal fees would discourage what O'Connell calls "the unconscionable abuse of the system by some members of my profession." Among other criticisms, the Virginia professor points out that contingent fees are often not truly contingent on risk. Attorneys take the same settlement percentage from open-and-shut cases as from complex cases, a practice that subsidizes work on failed litigation and which O'Connell denounces as an illegal tax on deserving claimants.

Hurley gives O'Connell's proposal a mixed review. "To its credit, the early-offer plan is not mandatory for defendants, which leaves the tort system in place to challenge claims perceived as nonmeritorious," says Hurley. He also notes that periodic insurance payment to claimants allows compensation to be made as costs are incurred, eliminating the burden of large lump-sum payouts. Also, O'Connell's plan emphasizes two fundamentals that the Academy report identified: mandatory recognition of collateral benefits and controlling noneconomic damage costs. In fact, the O'Connell plan eliminates consideration of noneconomic damages altogether unless the case goes to court.

However, Hurley notes, the periodic payment plan theoretically would have to remain in force for decades. Will claimants be out in the cold after the disability policy limits are reached, or will the insurer face unlimited exposure? Another concern: Like no-fault, the early-offer plan could give incentives for unmerited claims. Insurers may pay a doubtful claim rather than incur expensive litigation costs

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and risk a large judgment award. In addition to increased costs, Hurley worries about a basic question: "Is it the right message to send to individuals who think doctors and insurers have deep pockets? The system may have practical advantages, but in terms of equity, it is hardly fair."

No matter which remedy is tried, no action will slash premium costs immediately, Hurley cautions. "Tying tort reform to premium reductions, as has been done in some states, is unrealistic," he says. "There is little evidence that the cost savings can be translated directly into lower costs for health care providers. More likely, reform will slow the rate of premium cost increases."

The course of reform will be determined by elected officials at the state and federal levels. The debate will be long, no matter which option—if any—is approved. In the meantime, the cost of inaction continues to be passed on to the public in the form of increased medical fees and reduced services.

By working together in recent years, insurers and health-care providers have begun to bring medical spending under control. Effective medical malpractice reform is one way to keep the momentum going. □

Answer to Brain Drain, page 13:
The house number is 76.

Fall
1996

ISSUE BRIEF

AMERICAN ACADEMY OF ACTUARIES

Medical Malpractice Tort Reform: Lessons from the States

The cost of insuring physicians against medical malpractice claims has increased dramatically in recent years. Skyrocketing premium costs and a string of highly publicized lawsuits have led many physicians to curtail certain high-risk procedures. By reducing the availability of important medical services, this practice of defensive medicine could have serious public-health consequences. In addition, increased malpractice insurance expenses are passed on to patients and health plans, thus fueling medical inflation.

To combat these ill effects, several states have adopted reforms designed to reduce the cost of medical malpractice insurance. More recently, Congress has attempted to follow the initiative of the states but has been unable to enact comprehensive medical malpractice tort reforms into law.

To date, state efforts have enjoyed varying degrees of success in reducing medical malpractice insurance rates. What can be learned from the experience of the states? How can these conclusions be applied at the federal level? The American Academy of Actuaries Work Group on Medical Malpractice Reform has studied the impact of state reforms and offers its comments to state and federal officials who are considering national tort reform.

Findings

Any federal medical malpractice tort reform effort should be based on a package of measures that have exhibited some success in stabilizing medical malpractice costs. The most effective elements of such a package are a cap on noneconomic damages and an

offset for collateral payments from other sources. These reforms would limit the financial exposure of health-care providers to lawsuits and would ensure that damages could not be collected through multiple suits. While there are significant limitations on data used to study specific tort reforms, persuasive results can be observed by looking at medical malpractice costs in certain states over time and relating that experience to the timing of particular tort reform measures.

In the following comparison of cost levels in three states that have enacted tort reform measures, paid losses of the individual states as a percentage of the U.S. total are used as the measure of costs. The percentage of physicians in each state as a total of U.S. physicians is used as a reasonable benchmark. The degree to which the percentage of paid losses differs from the percentage of physicians measures the effectiveness of the reforms. All else being equal, the relative cost percentages of paid medical malpractice claims should remain constant over time. Any observed changes in a state's relative cost levels provide an indication of the effectiveness of tort reform. The three states studied are California, New York, and Ohio.

The American Academy of Actuaries is the public policy organization for the actuarial profession, providing unbiased actuarial information to elected officials and regulators.

Members of the Work Group on Medical Malpractice Reform: James D. Hurley, ACAS, MAAA; William E. Burns, ACAS, MAAA; Linda A. Dombier, PCAS, MAAA; Allen C. Lyle, PCAS, MAAA; and Edward M. Wrobel Jr., PCAS, MAAA.



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• **California.** Since the Medical Injury Compensation Reform Act (MICRA) package of reforms was enacted in 1975, medical malpractice costs have fallen substantially as a percentage of the U.S. total.

• **New York.** Individual reform measures were adopted in 1975, 1981, 1985, and 1986. No observable improvement in the state's relative costs has resulted. The New York reforms did not include a cap on damages.

• **Ohio.** Reforms enacted in 1975 included a cap on damages. The cap was overturned in 1985, after which costs rose dramatically and have remained high.

California

The California loss data (Exhibit 1) illustrate that while the state's proportion of the U.S. physician population has remained relatively stable, its per-

Exhibit 1

Malpractice Loss Payments in California as a Percentage of the U.S. Total, 1975-94

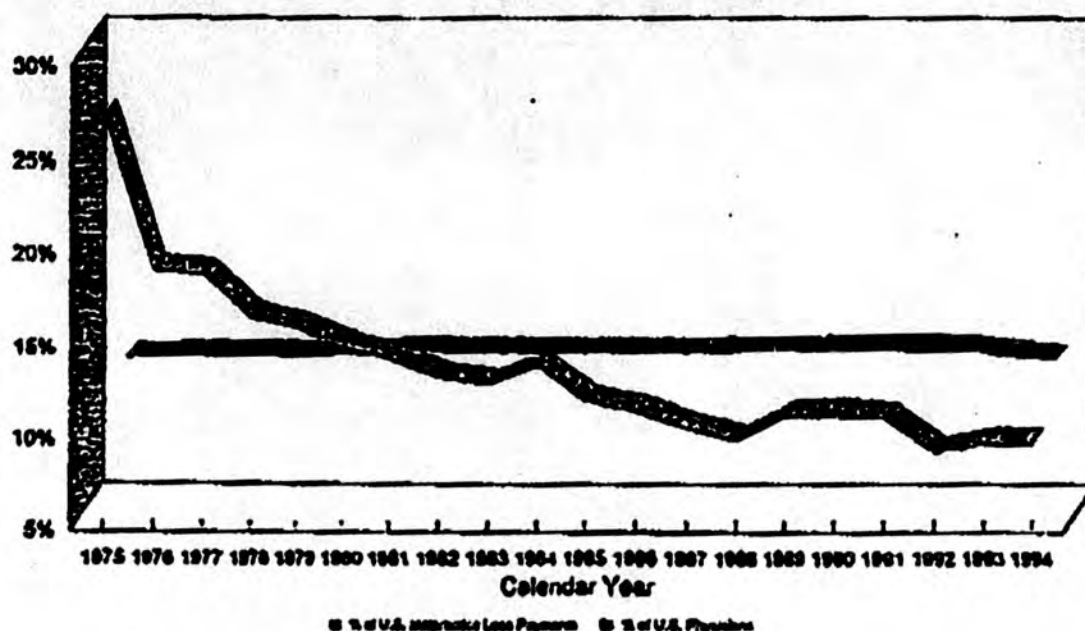
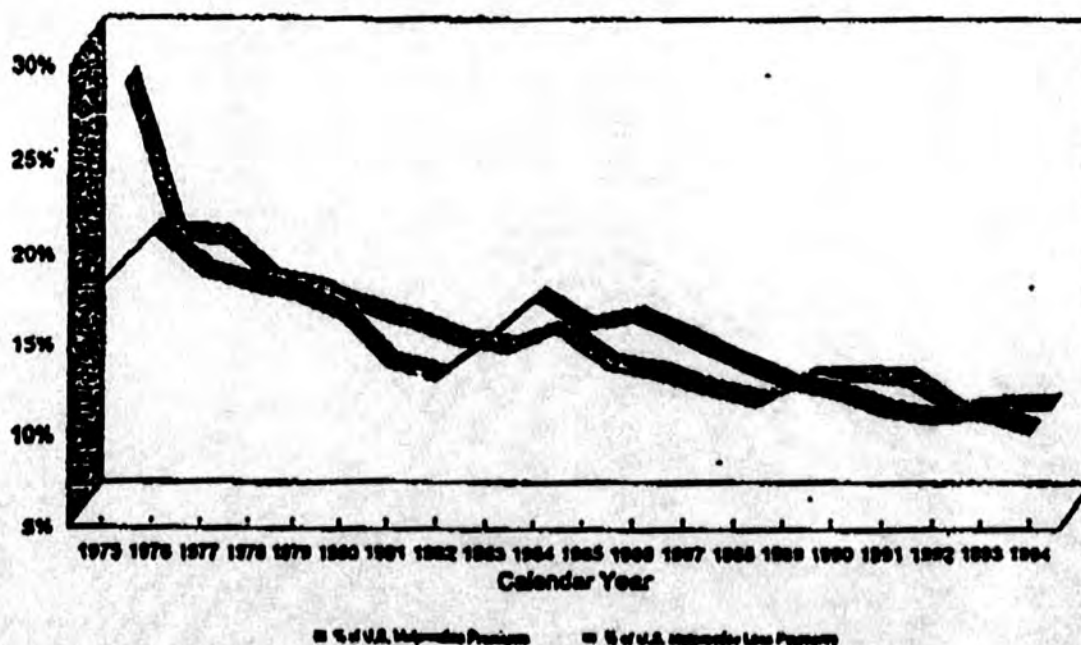


Exhibit 2

Malpractice Premiums and Malpractice Loss Payments in California as a Percentage of the U.S. Total,



... reform provides strong evidence for the effectiveness of the MICRA package.

Many opponents of tort reform argue that insurance premiums do not drop after medical malpractice reform. Indeed, costs and premiums normally rise with inflation, and tort reform may only slow the increases. However, the California data show that premiums declined as losses declined. Exhibit 2 compares the paid loss data from Exhibit 1 with California premiums as a percentage of the total U.S.

... that the individual tort reform measures implemented in New York did not improve New York's experience relative to that of other states. New York's loss payment percentage does not show any observable pattern of decline or improvement over the 19-year period, despite the various tort reform measures adopted. The New York reforms did not include a cap on damages and were enacted in piecemeal fashion. Therefore, this result supports the merits of a cap on damages and the concept of a package of reforms.

Exhibit 3
Malpractice Loss Payments in New York as a Percentage of the U.S. Total, 1975-94



Ohio

The final example is Ohio, with data presented in Exhibit 4. The data show a gradual decline in costs following tort reform in 1975. The Ohio cap on damages came under court challenge in 1982, result-

ing in sharp increases that reached a peak in 1985 when the cap was finally overturned. Since 1985, costs in Ohio have remained high, with no signs of decreasing. Again, the data appear to support a tort reform package and the specific benefit of a cap on noneconomic damages.

Exhibit 4

Malpractice Loss Payments in Ohio as a Percentage of the U.S. Total, 1975-94



Conclusions

California's experience indicates that properly implemented medical malpractice tort reform can reduce the cost of medical malpractice insurance. After reviewing several states' experience with medical malpractice tort reform and examining studies on the issue, the Academy work group has concluded the following:

- a package of reforms is more likely than individual reforms to achieve savings in malpractice losses and insurance premiums, and
- key among the reforms in the package are a cap on noneconomic awards and a mandatory collateral-source offset rule.

For reform to be effective in reducing costs, the cap on noneconomic awards should be established on a

per-medical-injury basis at a level low enough to have an impact (e.g., \$250,000). In addition, a mandatory collateral-source offset rule is needed to ensure that double and triple damages cannot be collected through multiple suits. Under this rule, each suit would have to consider damages already paid from other sources.

Although these reforms have been successful in reducing the cost of medical malpractice insurance, elected officials and regulators must still consider the effects of medical malpractice reform on physicians, consumers, health plans, and other interested parties. When considering medical malpractice reform, state and federal officials should weigh the impact on society as a whole and strive for a balanced, comprehensive solution.