A Comprehensive Market Strategy For Tort Reform

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This Article outlines the basic features of a market for selling, purchasing, and trading tort claims. It argues that, in contrast to other tort reform proposals, a market approach will benefit tort victims with quicker, higher, and certain damage awards; offer defendants numerous ways to hedge their liability; reduce crowded court dockets and induce faster, fairer settlements; and help society by retaining appropriate safety incentives and allocating the costs of accidents to those most able to bear them. In short, a tort claims market will create a new kind of insurance after accidents occur.

The Article begins by briefly identifying which features of the current tort regime are most problematic. It then evaluates four tort reform proposals intended to address these problems. After reviewing the medieval roots of laws which prohibit a claims market, the Article argues that such laws are obsolete. It considers current practices which partially permit the sale of tort claims and advocates expanding them into a full-blown market. Finally, the Article explains how such a market will work. It describes the dynamics of a primary market between tort victims and claims purchasers, and then applies this model to mass torts. It describes a secondary market for reselling and trading claims and the advantages of a claims market during bankruptcy proceedings resulting from tort liability. Throughout, the Article identifies many competitive advantages of claims purchasers over contingency-fee attorneys, and the development of information necessary for a tort claims market to function. The Article concludes by suggesting new issues and empirical work to develop this proposal further.

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Introduction

A. *A Tort Crisis?*

Rendered more complex by both technological innovation and a greater understanding of the human body, tort law in America has changed rapidly over the past thirty years. From mechanical risks posed by dangerous products to genetic dangers introduced by toxic waste, from a single patient harmed by medical malpractice to the 2.4 million allegedly injured by Agent Orange, the variety and number of tort claims have expanded dramatically. Traditional tort concepts such as causation, risk, negligence, and even injury have been challenged and at times


5. See, e.g., Peter Huber, *Liability: The Legal Revolution and Its Consequences* 178 (1988) (explaining that genetic vulnerability to certain potentially dangerous toxic chemicals is unequally shared by different ethnic and racial groups); see also UAW v. Johnson Controls, Inc., 499 U.S. 187 (1991) (holding potential dangers presented by exposure to lead insufficient reason to exclude women able to conceive children from employment).

6. See, e.g., Tarasoff v. Regents of Univ. of Cal., 551 P.2d 334 (Cal. 1976) (holding psychologist informed by murderer of his intent to kill liable for not warning victim directly).


In addition to fear of developing an injury, plaintiffs sometimes seek compensation for enhanced risk of injury. See Glen O. Robinson, *Probabilistic Causation and Compensation*
redefined or discarded\textsuperscript{8} in an effort to cope with the increasing number and novelty of tort injuries.

Despite creative responses by the courts, criticism of tort law in America continues to mount, often applying the term "crisis" to a host of supposed systemic failings.\textsuperscript{9} Commonly cited problems include a shortage of available insurance,\textsuperscript{10} huge jury awards that provide windfalls to plaintiffs,\textsuperscript{11} a stifling of technological innovation,\textsuperscript{12} and a decrease in


8. \textit{See, e.g.,} Mark A. Peterson, \textit{Giving Away Money: Comparative Comments on Claims Resolutions Facilities}, 53 LAW & CONTEMP. PROBS., 113, 117 n.8 (1990) ["Under Option 1 of the compensation procedure,\textsuperscript{a} a claimant who states that she used the Dalkon Shield can receive $725 without having to provide any information about a possible injury. Processing of Option 1 claims involves no discovery, no issue of liability, causation or even injury, and automatic, minimal payment."] \textit{See also} STEPHEN D. SUGARMAN, \textit{DOING AWAY WITH PERSONAL INJURY LAW: NEW COMPENSATION MECHANISMS FOR VICTIMS, CONSUMERS, AND BUSINESS} 52 n.32 (1989) ["I have serious doubts about whether this case should have been brought at all \ldots you have shown no factual connection of any substance between the diseases and the alleged cause." (quoting AMICUS J., Fall 1984, at 46 (quoting statement of Judge Jack B. Weinstein to the Agent Orange Plaintiffs' Management Committee))].

9. \textit{See, e.g.,} HUBER, \textit{supra} note 5 (bewailing most developments in tort law during last thirty years and advocating neocontractual solutions); WALTER K. OLSON, \textit{THE LITIGATION EXPLOSION: WHAT HAPPENED WHEN AMERICA UNLEASHED THE LAWSUIT} (1991) (criticizing procedural developments such as contingency fees and liberal discovery as well as "moral failure" such as litigiousness and avarice of lawyers, and advocating fee-shifting so that losing party pays legal costs); SUGARMAN, \textit{supra} note 8, at 1-72 (disputing ability of tort law to achieve safety, compensatory, and justice goals, and proposing comprehensive health and income insurance funded by both public and private means).

10. \textit{See, e.g.,} HUBER, \textit{supra} note 5, at 134-42, 146-49 (explaining that joint and several liability of tortfeasors and expansion of litigation contributed to insurance crisis); George L. Priest, \textit{The Current Insurance Crisis and Modern Tort Law}, 96 YALE L.J. 1521 (1987); Richard K. Willard, \textit{The Litigation Explosion and the Need for Tort Reform, in 3 THE LEGAL SYSTEM ASSAULT ON THE ECONOMY: THE INSURANCE CRISIS, TORT REFORM, AND ALTERNATIVE SOLUTIONS} 3 (Peter Huber et al. eds., 1986) [hereinafter LEGAL SYSTEM ASSAULT] ["The underlying cause of [increased insurance premiums] is a substantial, long-term expansion of tort liability which has predictably contributed to the increased cost of liability insurance."]

11. \textit{See, e.g.,} HUBER, \textit{supra} note 5; OLSON, \textit{supra} note 9.

America's economic competitiveness. 13

Recent scholarship, however, has cast doubt on assertions of a general tort crisis, 14 and has begun to examine the role of special interests in promoting the idea of such a crisis. 15 A number of specific problems in the tort system may have also recently abated. For example, prohibitively high insurance rates and unavailability of coverage have become less serious problems. 16 Similarly, the number of lawsuits filed, the size of

13. President's Council on Competitiveness, Agenda for Civil Justice Reform 1-6 (1991) [hereinafter Council on Competitiveness] (committee chaired by Vice President Quayle reporting that American businesses and government spend $80 billion annually on direct litigation costs to detriment of United States economy); see Contract with America 143 (Ed Gillespie & Bob Schellhas eds., 1994) (reporting an undocumented claim that "Americans spend an estimated $300 billion a year in needlessly higher prices for products and services as a result of excessive legal costs.").


16. 1 American Law Inst., Reporter's Study on Enterprise Responsibility for Personal Injury 82 (1991) [hereinafter American Law Inst.] (reporting on Consumer Federation of America study arguing rise in liability insurance reflected economic factors such as increases in inflation, real per capita income, and real health care costs); W. Kip Viscusi, The Dimensions of the Product Liability Crisis, 20 J. Legal Stud. 147, 176-77 (1991) (explaining that while crisis in availability of insurance existed in early 1980s, insurance became generally available by end of decade although at much higher premiums); Tim Smart, Down So Long, Looks like a Sea Change for Insurers, Bus. Wk., Jan. 16, 1995, at 68 (reporting that during past decade, surplus available for paying claims and other expenses increased by more than 10% per year versus average premium growth of only 8%, insurers exceeded demand in some parts of country, and there were improvements from sharp decline in payments for losses in formerly depressed insurance lines).

Indeed, some have questioned the thesis that the tort system caused an insurance crisis, arguing that there is not enough data to support this claim. See Judith P. Swazey, Prescription Drug Safety and Product Liability, in Liability Maze, supra note 12, at 291, 295-96; Eliot M. Blake, Comment, Rumors of Crisis: Considering the Insurance Crisis and Tort Reform in an Information Vacuum, 37 Emory L.J. 401, 425-28 (1988). For two brief, but helpful, surveys of the issue, see 1 American Law Inst., supra, at ch. 2; Scott E. Harrington, Liability Insurance: Volatility in Prices and in the Availability of Coverage, in Tort Law and the Public Interest: Competition, Innovation, and Consumer Welfare 47 (Peter H. Schuck ed., 1991) [hereinafter Tort Law and the Public Interest].
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damage awards to successful plaintiffs, and the frequency of plaintiff victories have declined in recent years.\(^7\) Other alleged problems may never have existed. For instance, far from stifling technological innovation, tort liability likely has induced improved safety design, manufacturing techniques, warning labels, and use instructions.\(^8\) Many also doubt that tort liability has rendered America less economically

Furthermore, some have charged that speculation by insurance companies during a period of especially high interest rates during the late 1970s and early 1980s may have contributed to the sharp rise in insurance rates. See Schwartz, \textit{supra} note 15, at 1164-66; Tamar Lewin, \textit{The Liability Insurance Spiral}, \textit{N.Y. TIMES}, Mar. 8, 1986, at 35 (reporting allegations of National Insurance Consumer Organization). \textit{But see Priest, supra} note 10, at 1529-31. Others have accused the insurance industry of antitrust violations resulting in higher insurance costs and limited availability of some kinds of insurance. See Hartford Fire Ins. Co. \textit{v.} California, 113 S. Ct. 2891 (1993).

\(^{17}\) Kevin M. Clermont \& Theodore Eisenberg, \textit{Trial by Jury or Judge: Transcending Empiricism}, 77 \textit{CORNELL L. REV.} 1124, 1134 (1992) (proposing modified case selection effect theory to account for finding that "plaintiffs enjoy greater success before judges than before juries in three major tort categories—product liability (personal injury), medical malpractice, and motor vehicle. In only two large personal injury categories—Federal Employers' Liability Act (FELA) and marine—is there a significantly higher win rate before juries than before judges."); Eisenberg \& Henderson, \textit{supra} note 15; Valerie P. Hans \& William S. Lofquist, \textit{Jurors' Judgments of Business Liability in Tort Cases: Implications for the Litigation Explosion Debate}, 26 \textit{LAW \& SOC'Y REV.} 85, 93 (1992) ("Rather than revealing jurors willing or eager to impose on business the costs of plaintiffs' injuries, our findings show that jurors were suspicious of the legitimacy of plaintiffs' claims and concerned about the personal and social costs of large jury awards."); James A. Henderson, Jr. \& Theodore Eisenberg, \textit{The Quiet Revolution in Products Liability: An Empirical Study of Legal Change}, 37 \textit{UCLA L. REV.} 479 (1990); Edward Felsenthal, \textit{Juries Display Less Sympathy in Injury Claims}, \textit{WALL ST. J.}, Mar. 21, 1994, at B1; Linda Himelstein, \textit{Should Business Be Afraid of Juries?}, \textit{BUS. WK.}, Nov. 8, 1993, at 100 (reporting recent studies show decline in number of product liability cases filed, in number of plaintiffs' victories in product liability cases brought by individuals, and in size of awards received by prevailing plaintiffs); Robert Pear, \textit{Medical Malpractice Study Finds Unjust Payments Are Rare}, \textit{N.Y. TIMES}, Nov. 1, 1992, at 42 (reporting conclusion of study's chief author: "The current system often comes to the right decision about whether a payment should be made in medical malpractice cases. And the amount of payment correlated closely with the severity of injury.").

competitive. Nonetheless, numerous serious problems do exist in the current tort system, problems with grave consequences for tort victims, tort defendants, and society in general. These problems include delay in compensation, uncertainty of recovery, inequity when a small number of victims collect huge awards while the majority of victims are undercompensated, incentives to litigate, huge attorneys' fees, and related transaction costs. Mass tort litigation introduces a new set of difficulties. Standard problems of delay and inadequacy of recovery are compounded when tortfeasors become bankrupt, and yet another set


22. See HUBER, supra note 5, at 150-51 (citing studies of inequities and uncertainties in tort awards as well as large legal and administrative costs of tort system); O'CONNELL, supra note 21, at 62-83; SUGARMAN, supra note 8, at 36-39.

23. OLSON, supra note 9, at 1-11 (blaming contingency fees, class actions, permissive discovery, and other developments for increased litigation).

24. See Willard, supra note 10, at 5 ("According to the Rand Corporation study of liability cases from asbestos . . . , attorneys' fees consumed 63 percent of all damage awards. A typical court case . . . [cost] $380,000. Of this, $125,000 would be for [plaintiff's] legal fees . . . and $141,000 ultimately in net compensation to the plaintiff."). But cf. SCHUCK, supra note 3, at 202 ("[T]he total amount awarded to plaintiffs' lawyers [in the Agent Orange litigation] was $10.7 million, still a very low award by conventional standards.").

25. See SUGARMAN, supra note 8, at 40-41.

26. See infra Section III.D.
of problems is introduced when trust funds that were established to ensure future payments become insolvent.\textsuperscript{27}

B. \textit{A Market Solution}

To address these and other problems, this Article offers a new approach: a market for the sale and exchange of tort claims.\textsuperscript{28} Instead of hiring an attorney on an hourly or contingency-fee basis, tort victims will sell their claims to purchasers in exchange for immediate and riskless compensation. Because tort purchasers will have a lower cost of capital than plaintiffs’ attorneys, such purchasers will be able to offer potentially greater compensation to victims. Numerous incentives will ensure future cooperation from the victim, even after she has sold her claim, including possible additional payments based upon future contingencies. And to help a victim market her claim and receive the highest payment on the most favorable terms possible, agents—possibly plaintiffs’ attorneys—will help package and market her claim to buyers.

For their part, buyers will purchase a broad range of tort claims in a significant number of lawsuits in order to diversify the risks associated with litigation. In the mass tort context, certain accidents will yield very similar claims in terms of causes of action, proof of liability, and other features. Such mass tort claims resemble an aggregate of simple, individual tort claims, and tort claims purchasers will treat them similarly. Other mass torts are complex, varying in the value of the claims, applicable legal theories, and other features. Tort purchasers will buy a mix of such diverse claims arising from a common mass tort, and will invest in additional mass torts as well. By investing in a variety of claims and lawsuits, tort claims buyers will diversify their claims portfolios, reduce their risk, and lower their cost of capital.

Tort investors will require significant amounts of capital in order to


\textsuperscript{28} This Article’s main concern is a market solution to deal with some of the particularly intractable issues related to mass tort litigation. Although other kinds of torts are discussed for purposes of illustration, this Article focuses primarily on personal injury torts. However, there is no reason why the proposal of litigation as an investment opportunity need be limited to torts, of whatever kind, or to class actions. Indeed, as the analysis in Part III will show, it would be far less complicated to arrange a market to invest in other kinds of litigation, such as securities litigation, that do not involve large numbers of diverse plaintiffs or causes of action, nor threaten defendants with insolvency.
diversify their portfolio of claims, as well as sophistication to evaluate and prosecute a wide variety of tort claims. Although tort investors will be able to organize themselves in a variety of ways, a likely vehicle will be investment firms, publicly or privately held, whose assets consist of different kinds of tort claims in a diversity of lawsuits.

In order to bring liquidity to their investments and thus further lower their risk and cost of capital, investors will want to exchange tort claims in a secondary market. The method of exchange will vary according to the value of the claim and the level of information costs associated with the exchange. To the extent that low value claims can be standardized, they will be exchanged in bulk in a clearinghouse fashion, much as automobile claims are settled in no-fault regimes. High value claims will be traded on their own. Alternatively, claims of varying values and types may be bundled and securitized. The largest claims, such as corporate claims, can be securitized themselves.

Derivative instruments—based upon the claims themselves or upon the stock or bonds of a company whose assets consist of claims—will allow for a further reduction of risk. Claims holders will be able to hedge the risk associated with owning and prosecuting claims, again reducing their cost of capital, while defendants will be able to moderate their exposure to damages to a much greater extent than currently possible.

When defendants face insolvency from potential mass tort liability, as in the asbestos cases, a tort claims market will not solve the basic problem of the aggregate amount of tort victims' claims exceeding the tortfeasor's assets. Nonetheless, by developing information quickly, such a market will signal the need for bankruptcy proceedings early on, and will provide the court with more accurate information regarding current and future tort liabilities. In some cases, a claims market may also permit a quick and efficient takeover and reorganization of a corporate defendant by claims purchasers, using the unliquidated debt of tort claims to bring about a kind of leveraged buyout of the corporation.

C. Advantages of a Market Solution

The economic efficiencies resulting from a tort claims market will benefit nearly every participant in the tort process.

Tort victims will be able to receive immediate, certain, and often greater payments from claims purchasers. Inequity in recoveries will also be reduced, because a tort victim will receive an average award, based upon typical jury behavior, instead of an idiosyncratic award made in a particular case. Due to the expanded number of bidders competing for a victim's claim, this average award will also be larger than the award most
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victims would receive under the current regime, regardless of whether the victim retained an attorney on an hourly or contingency-fee basis or even settled the claim herself. Only the lucky few plaintiffs who win significantly above average awards under the current tort regime will receive less than they do now.

Of course, participating in a tort claims market will be optional; victims will retain the right to proceed as they would under the current system. A tort claims market will simply expand the options available to victims by allowing them to adjust the level of risk they wish to bear, the amount and timing of the recovery they seek, and other variables to a far greater degree than they are presently able to do.

Because investors will possess a lower cost of capital and be able to outbid plaintiffs' attorneys for claims, a market will foster meritorious lawsuits while discouraging less worthy claims. Deprived of cases with high expected returns, plaintiffs' attorneys will not be able to afford to bring more speculative cases. And since the plaintiffs' bar will no longer have an oligopsony on bringing tort claims, plaintiffs' attorneys will have to lower their fees in an effort to compete with claims purchasers, thereby allowing victims to receive more money—whether they sell their claims or not.

Settlements will also be more common. Such a market will develop information about tort claims more quickly than plaintiffs' attorneys now can. And tort claims buyers will have greater resources and bargaining power than tort victims and plaintiffs' lawyers. As a result, a tort claims market will promote fairer, faster, and more efficient settlements, thereby reducing litigation costs and relieving court dockets.

On a procedural level, a tort claims market will eliminate many difficulties currently associated with class actions. Such a market will avoid the inter-class rivalries which currently beset mass tort litigation. And when tortfeasors become insolvent due to tort liability, a tort claims market will streamline protracted and expensive bankruptcy procedures. A tort claims market will also be far more efficient than the current system of establishing claims resolution facilities and trusts to settle and administer claims payments.

By providing liquidity for tort claims, a market will also cure another defect of the current tort system which promotes inefficiency by prohibiting certain kinds of assets (tort claims) from being freely exchanged. And although a tort claims market will not improve the availability of insurance or lower premiums, it will act as a kind of post-facto insurance by allowing the costs of accidents and the risk of recovery to be redistributed to those most willing to bear them.

A claims market will bring benefits to tortfeasors as well, by enabling
tortfeasors and their insurers to hedge their exposure to damages. Currently, tortfeasors must choose between either contesting a lawsuit, thereby exposing themselves to uncertainty as to liability and damages, or settling the lawsuit, thereby eliminating uncertainty but surrendering the chance to prevail and possibly encouraging similar suits. Permitting tortfeasors to invest in the very claims holders bringing suit against them will enable tortfeasors to moderate their level of exposure to damages while still opposing the suit by pursuing a variety of new hedging strategies made possible by a tort claims market. Indeed, an options market will enable defendants to "put" the claims and recover their defense costs if they win, without adopting the draconian English rule requiring the losing party to pay the winning party's litigation costs.

Part I reviews some current proposals for tort reform. It begins with a brief account of one of the earliest tort reforms, strict liability, and the increasingly limited ways courts apply the doctrine. Next it considers a social welfare proposal which would largely bypass the tort system when compensating accident victims. Part I then outlines how, despite free market rhetoric during the last fifteen years, the Reagan and Bush Administrations, many in Congress, and numerous states have adopted a distinctly non-market approach, opting for caps on damages and other means of shifting the cost of accidents to victims. Finally, Part I criticizes from an economic perspective a proposed market for surrendering the right to recover for future tort claims in exchange for guaranteed health care and income support. In doing so, it identifies some of the relevant actors and dynamics which this proposal for a tort claims market must address.

Part II briefly examines present legal prohibitions against a market for tort claims, including bans against trading, encouraging, and financially supporting litigation. It argues that such bans are relics of medieval times and have no value in modern society. Part II concludes by describing how principles and practices in the current tort system may be altered and expanded to create a market for tort claims.

Part III explains how such a market would work and how it can address some of the shortcomings of the current tort regime. It begins by describing the economics of a primary tort market—a market in which original tort victims sell their claims to investors. Next, it considers the particular problems and opportunities of investing in mass tort litigation. Part III then outlines how a secondary market—in which tort buyers trade or resell their claims—would function. It explains how such a market would provide liquidity and expand opportunities to hedge risks for both defendants and plaintiffs. In doing so, it addresses the costs of developing and trading information about tort claims for exchange in a secondary
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market. Finally, Part III addresses problems associated with potentially insolvent defendants, and shows how a tort claims market will reduce the costs and delays incurred during bankruptcy proceedings.

The Conclusion suggests further areas of inquiry to develop and refine this proposal for a tort claims market.

I. Four Proposals for Tort Reform: A Review and Critique

Tort reform proposals have followed a variety of approaches, from bypassing the tort system to limiting particular variables such as contributory negligence or damages. The following approaches represent four distinct theoretical and political perspectives: strict liability, comprehensive social insurance, damage ceilings, and a market for potential tort claims. Although these reforms have many variations, an example of each will illustrate their basic features.

A. A Review of Tort Reform Proposals

1. Strict Liability: A Stalled Revolution

Although it appeared in some forms in the nineteenth century, strict liability, especially as applied to consumer products, was a departure from the traditional, early twentieth-century tort regime. Strict liability pre-assigns most or all of the cost of accidents to those who perform ultrahazardous activities or produce hazardous products. Under strict


30. See, e.g., Comprehensive Environmental Response, Compensation and Liability Act of 1980 (“Superfund Act” or “CERCLA”), 42 U.S.C. §§ 9601-75 (1988) (requiring that generators and transporters of hazardous waste and owners and operators of hazardous waste sites be held strictly liable for costs of cleaning up sites, subject only to expressly enumerated defenses).
liability, traditional tort inquiries, such as product defect or the tortfeasor's negligence, either presumptively attach to the tortfeasor or are discarded altogether. Although affirmative defenses may exist, such as assumption of risk or contributory negligence, the defendant clearly has the burden of overcoming the presumption of liability.

Yet, despite the doctrine's simplicity, its promise of reduced transaction costs, and its significant academic support, strict liability seems to have reached its limit. Since the end of the 1980s, courts and state legislatures have begun to curb, and at times retreat from, permitting liability without a showing of defect. Furthermore, the doctrine has been restricted almost exclusively to product manufacturing and not to other sectors of the economy, such as service industries.

Some of this retrenchment stems from a desire to provide product users with incentives to exercise safety; some of it stems from the belief that pre-assigning liability to manufacturers is too costly for American industry. Whatever the cause, the diminished application of strict liability suggests that significant development or expansion of the doctrine is unlikely any time soon.

31. See, e.g., Barker v. Lull Eng'g Co., 573 P.2d 443, 445-53 (Cal. 1978) (rejecting Restatement's "unreasonably dangerous" language and making clear purpose of strict product liability is to "shift[] the burden of proof to the manufacturer to demonstrate that an injury-producing product is not defective in design"). But see Hayes v. Ariens Co., 462 N.E.2d 273, 278 (Mass. 1984) (rejecting Lull and retaining burden on plaintiff to prove injury resulted from defendant's conduct).


35. Id. at 1281 n.69 and sources cited therein.
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2. The Expansion of Social Welfare in Exchange for Reduced Rights to Sue

A second kind of reform, sometimes linked with no-fault schemes, would bypass most, if not all, of the tort system and replace it with a needs-based compensatory system. Under a broad social insurance system, the facts surrounding the injury—damages, negligence, the identity and financial resources of the tortfeasor, and so forth—would be irrelevant. Injury alone would warrant compensation for medical costs and lost wages. The tort system could be retained to varying degrees in order to punish particularly dangerous activity or to deter future hazardous activity, but the reason or nature of the accident would not matter for purposes of compensation to the victim.

Social welfare programs in this country predate the New Deal. Professor Stephen Sugarman has proposed using such programs to replace or reduce America’s current reliance on the tort system as a means of compensating victims for injuries. Professor Sugarman advocates a “Comprehensive Compensation Strategy” which would consolidate and expand upon a variety of social insurance programs currently available in the United States, such as workers’ compensation, unemployment insurance, and social security. All people in need of income and health care would be eligible for support, whether due to accident, illness, youth, old age, layoffs, or any other reason. Employers would pay for temporary income and medical needs of their employees and families, whereas long

36. Sugarman, supra note 8, at 127-65.
term needs would be met by an expanded social security system. In exchange for these benefits, and to reduce the costs associated with the tort system, tort damages would be limited, but recovery made easier.

Although theoretically provocative, Professor Sugarman's proposal does not provide any data by which to assess the costs and benefits to taxpayers, tortfeasors, or tort victims. Without knowing who benefits and at what cost, it is difficult to determine whether the sacrifice of tort recovery rights for greater social welfare benefits makes sense. In addition, his proposal seems unlikely to gain much political support, since the costs in the tort system are indirect for the vast majority of Americans, whereas the taxes necessary to pay for health and income support would be quite obvious. Furthermore, as the next reform illustrates, the federal government and numerous state governments have already been reducing tort rights without the political necessity of compensating victims with additional government support.

3. Damage Ceilings: Adding Injury to Injury

A third type of reform advocates a ceiling or "cap" on damages. The Reagan and Bush Administrations actively promoted such

40. But see Willard, supra note 10, at 5 (arguing that the United States already possesses such a social safety net).

41. SUGARMAN, supra note 8, at 167-200.

42. For comprehensive health care alone, the current cost would likely be $700 billion over five years. Dana Priest, Health Care Financing Questioned, WASH. POST, Sept. 20, 1993, at A1, A9.

43. See infra note 70 (discussing costs of national health care versus costs of tort system).

44. Of a number of neocontractual reforms advanced, the damage ceilings proposal has gained the most acceptance by legislatures. See Mark Geistfeld, The Political Economy of Neocontractual Proposals for Products Liability Reform, 72 TEX. L. REV. 803, 817-19 (1994).

45. See TORT POLICY WORKING GROUP, REPORT ON THE CAUSES, EXTENT AND POLICY IMPLICATIONS OF THE CURRENT CRISIS IN INSURANCE AVAILABILITY AND AFFORDABILITY (1986); TORT POLICY WORKING GROUP, AN UPDATE ON THE LIABILITY CRISIS (1987). Appointed by U.S. Attorney General Edwin Meese in 1986 to investigate the "insurance crisis," the Group recommended capping non-economic damages at $100,000, limiting contingent fees, turning large damage awards into periodic payments instead of lump sums, eliminating joint and several liability, stimulating alternative dispute resolution, and eliminating the collateral source rule. For a critique, see SUGARMAN, supra note 8, at 78-81 (arguing that the report's "package of victims' rights cutbacks is best seen as seeking to turn the tort law clock back to the 1950s").

46. See Philip J. Hilts, Bush Enters Malpractice Debate with Plan to Limit Court Awards, N.Y. TIMES, May 13, 1991, at A1 (reporting Bush Administration's proposal to withhold federal Medicare and Medicaid funds from states if they do not adopt limits on malpractice victims' awards for pain and suffering, replace lump sums with periodic
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reforms, the Clinton Administration has considered them, and the House of Representatives of the 104th Congress, pursuant to the Contract with America, has approved such damage caps; many states have already implemented them.

Damage caps are intended to reduce the number and duration of lawsuits by limiting their profitability, especially for contingency-fee attorneys. By limiting exposure to damage claims, caps retain the tort system while limiting the risk to the tortfeasor of engaging in hazardous activity. Beyond a specified level of damages faced by a tortfeasor, proposals of this type assign any excess costs of accidents to tort victims. In contrast to strict liability, which permits tortfeasors to spread the cost of accidents broadly onto consumers, damage caps force tort victims to bear much of these costs by themselves. Furthermore, whereas in a judicially-created strict liability regime the presumptions behind assigning payments for medical malpractice damages, and strengthen medical licensing boards); see also COUNCIL ON COMPETITIVENESS, supra note 13 (proposing model state code to reduce tort liability by means of procedural reforms and caps for punitive damage awards). Many of the Council's proposals were included in legislation before the 102d Congress, see Rhonda McMillion, Civil Justice Reform, A.B.A. J., Apr. 1992, at 103, but were defeated in the Senate, see Barry Meier, Bill to Curb Consumer Lawsuits Falls Short, N.Y. TIMES, Sept. 13, 1992, at E3. But see infra note 48.

47. Robert Pear, Clinton May Seek Lid on Doctor Fees and Liability Suits, N.Y. TIMES, Mar. 9, 1993, at Al ("[While no] decisions have been made . . . the Administration is seriously considering many proposals to limit lawsuits and payments for injuries caused by doctors' negligence."); David Rogers, Initial Clinton Medical Malpractice Reform Plan Pulled After Resistance by Entrenched Interests, WALL ST. J., June 15, 1993, at A20.

48. See H.R. 956, 104th Cong., 1st Sess. § 201 (1995) (proposing punitive damage cap of greater of $250,000 or three times plaintiff's economic losses in any civil action for harm in any federal or state court); id. at § 203 (proposing limitation of noneconomic damages in any health care liability action to $250,000).


50. An early federal statute embodying this principle is the Price-Anderson Act, originally passed in 1957, which limits total liability for a nuclear-related accident to $560 million. 42 U.S.C. § 2210 (1988 & Supp. III 1991). A serious accident has never tested the liability limit. It seems highly dubious, however, that if a significant nuclear disaster affecting even a relatively small population center of 100,000 did occur, public sentiment would countenance limiting compensation to a few thousand dollars per victim. In fact, the statute contemplates further appropriation of public funds in the event a nuclear incident involves damages in excess of the liability limits. 42 U.S.C. § 2210(e)(2). Perhaps more appropriate for statutory damage caps are those situations in which total liability can be predicted with some certainty, as in epidemiological estimates of adverse reactions to vaccines. See National Vaccine Injury Compensation Program, 42 U.S.C. §§ 300aa-10 to 300aa-33 (1988 & Supp. II 1990) (establishing "scheduled" or fixed levels of recovery for certain types of damages).
the costs of accidents to tortfeasors may be rebutted or mitigated, damage ceilings imposed by legislatures are more rigid. Not only can this be unfair and even cruel, but it also results in numerous market distortions.

Moreover, damage caps represent a distinctly non-market approach to tort reform. For example, in the case of products liability, consumers and manufacturers will not be able to bargain fully and freely for the price consumers are willing to pay in exchange for the hazard they are willing to bear when using the product. Although the price will no doubt reflect the demand by some consumers for additional safety, the manufacturer’s cost of production also includes potential tort liability. With damage caps, manufacturers do not bear the full costs of defective products. The result is that the price of the product will not clearly and directly reflect the degree of its safety.

Other dislocations will result. Faced with limited potential damage payments, producers will have less incentive to sell safer products or even to invest in research to develop them. Moreover, competitors who are able to produce safer products at higher costs will not be able to recover as much of the savings from reduced damage liability that normally result from greater safety. Damage ceilings thus deprive these manufacturers of an important competitive advantage, and are a direct subsidy or “tax” in favor of producers of more dangerous products paid by potential tort victims and by manufacturers of safer products. These are curious reform proposals by two Administrations and a Congress ostensibly committed

51. See Frank Cornelius, Crushed by My Own Reform, N.Y. TIMES, Oct. 7, 1994, at A31. Mr. Cornelius’s op-ed describes how, as an Indiana lobbyist, he successfully pushed for a $500,000 cap on damages and the elimination of pain and suffering awards for medical malpractice. Later he became a victim of a series of excruciating and life-threatening incidents of malpractice by hospitals and doctors. Able to recover only a fraction of his actual damages, he notes that the damage cap reform had no effect on rising health care costs in Indiana.

52. See 1 AMERICAN LAW INST., supra note 16, at 208-12 and sources cited therein; GUIDO CALABRESI, THE COSTS OF ACCIDENTS (1970); STEVEN SHAVELL, AN ECONOMIC ANALYSIS OF ACCIDENT LAW chs. 6, 8, & 9 (1987); W. Kip Viscusi, Toward a Diminished Role for Tort Liability: Social Insurance, Government Regulation, and Contemporary Risks to Health and Safety, 6 YALE J. ON REG. 65, 79-93 (1989) (arguing market imperfections result in imperfect risk-reduction incentives); Note, supra note 32, at 877-87. See also STEPHEN J. CARROLL, ASSESSING THE EFFECTS OF TORT REFORMS (1987) (observing that it is not yet possible to assess recent legislative reforms due to insufficient data and lag time between reforms and behavior).


54. Cf. Barker v. Lull Eng’g Co., 573 P.2d 443, 456 (Cal. 1978) (finding once plaintiff proves product’s design proximately caused injury, defendant must prove on balance that benefits of challenged design outweigh risk or danger inherent in such design in order to evade strict liability).

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possibly by a third Administration ostensibly committed to improved health care and consumer protection.

4. **I'd Give My Right Arm: A Market for Pre-Injury Tort Claims**

Professor Sugarman apparently senses that his proposal for expanded social programs in place of rights to sue in tort might not be feasible in the current political climate. As an alternative, he offers a fourth tort reform proposal which is far more innovative and radical: a pre-accident market. Building on the work of Professor Jeffrey O'Connell and others and based upon a previous article with Robert Cooter,

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55. He does, however, cite California laws and statutes, Florida statutes, and case law from numerous states supporting his tort reform proposals. SUGARMAN, supra note 8, at 176-80 and sources cited therein. However, the recent trend among the states has been to limit victims' tort rights without compensatory social programs. See supra note 49.


In essence, O'Connell suggests broad insurance coverage with insurers receiving subrogation rights in order to achieve some of the traditional aims of a tort system, such as deterring unsafe behavior by particular actors. This Article will outline the limitations of this approach in the discussion on subrogation. See infra Section II.B.3.


Professor Sugarman proposes that people sell their right to recover future damages in the tort system in exchange for a guarantee of future medical and income support.

Professor Sugarman identifies three deficiencies in the current tort system which would form the basis of mutually beneficial exchanges sufficient to establish a market in potential tort claims. He initially observes that many people obtain first-party protection through their employers or private insurers to "be assured of compensation whether or not their injurer is liable in tort and solvent." Since tort law would be "largely superfluous" in paying for such a victim's out-of-pocket expenses, Professor Sugarman concludes that "many potential victims with adequate first-party protection ought to be happy to sell their tort rights to redundant awards for less than injurers now spend to [settle]."

Second, he claims that since most people do not get first-party insurance for pain and suffering, "it is reasonable to assume that potential injurers also place a higher value on being rid of such claims than most potential accident victims place on their rights to sue for such losses (at least in less-serious injury cases)." Third, he simply observes that since legal fees comprise "a high proportion" of the tort system's total costs, both victims and injurers would save if legal fees were reduced or eliminated.

Professor Sugarman proposes that because of their stronger bargaining power and other competitive advantages, employers would act as agents for their employees and sell their employees' potential tort claims to the insurers of potential tortfeasors. In effect, tort claims would be "presettled" by contract. In exchange, employees would receive greater benefits in the form of wages, lower health plan deductibles, and additional health care coverage. The interests of employees would be protected, Professor Sugarman maintains, because sale of potential tort rights would not be a condition of employment, and a competitive market coupled with the employer's bargaining power should "ensure that employees' rights fetch their full market value when sold."

With adequate insurance for serious, long-term care, "people would probably not," he believes, "insist on an individualized, after-the-fact determination" as in the present tort regime. Instead, most would

59. SUGARMAN, supra note 8, at 202.
60. Id.
61. Id.
62. Id.
63. Id.
64. Id. at 203.
65. Id. at 206.
likely be content" with a "generous but not extravagant" set of benefits such as those offered in death or dismemberment policies.\textsuperscript{66}

B. \textit{A Critique of Sugarman's Pre-Injury Tort Market}

Professor Sugarman might be accused of excessive optimism and even naivete about the willingness of injured plaintiffs to be content with surrendering their right to sue when seriously harmed.\textsuperscript{67} But his analysis of the sale of both non-serious and serious pre-tort claims suffers from even greater flaws than a particularized understanding of human behavior. The following discussion not only presents four defects in his proposal, but also outlines some of the interests, actors, and dynamics involved in any tort claims market. In doing so, it attempts to identify some of the problems this proposal must address.

1. \textit{The Impossibility of Predicting the Value of a Universe of Potential Torts}

Professor Sugarman acknowledges the problem of a lack of information for people trying to evaluate whether to waive tort rights. "A market organized through employers, however," he argues, "would largely avoid these problems. Employees have a much better chance to sit down and rationally look over a single plan for injury coverage and better understand what they are gaining and forfeiting by the sale of their potential tort claims."\textsuperscript{68}

But the value that a potential victim would surrender in exchange for health and income support is not simply the value of the injury, but rather the pre-settlement value of the tort suit. This value is determined by the degree of injury (economic, pain and suffering), the tortfeasor's ability

\textsuperscript{66} \textit{Id.}

\textsuperscript{67} For example, as part of his proposal, Professor Sugarman suggests that "people might agree . . . not to seek pain and suffering damages of more than $150,000 . . . ." \textit{Id.} at 206.

\textsuperscript{68} SUGARMAN, \textit{supra} note 8, at 207.
Insurers and potential victims face not one but a host of uncertainties about what is being sold for medical and income support and other benefits. It is difficult to see how employees and insurers alike will be able to predict the sum value of numerous variables, each of which has a considerable range, even with actuarial data.

And ironically, the more successful such a contractual scheme becomes, the more unconscionable it might be. If a truly large number of people agreed to sell their tort rights, insurers could only afford to offer in exchange a slight increase in health, income, or other type of benefits. For, even if insurers saved billions in averted tort suits (from litigation costs saved and damage payments avoided), the savings divided among millions of Americans in the form of improved benefits would still be fairly small. Even if the benefits included full income and health maintenance, this might represent a value of only a few hundred, or perhaps a few thousand, dollars in additional benefits to the majority of potential tort victims who already have some form of coverage—hardly an amount worth the surrender of the right to sue in tort.

2. Adverse Selection and Free-Rider Problems

By suggesting that people do by contract what they are apparently unwilling to do by voting, Professor Sugarman’s proposal allows citizens, now consumer-employees and their families, as well as employers, to opt out. As a result, those who participate in the system might be the least

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69. For example, even if one driver of a car involved in an accident was injured in the exact same manner, to the exact same degree, due to the exact same level of tortfeasor negligence, as observed by the exact same witnesses, in the same jurisdiction as the driver of a second car involved in an accident, if the tortfeasor in the first accident was uninsured and the tortfeasor in the second accident was driving a truck for Exxon, the difference in both the size and likelihood of recovery for the two victims could be huge, thereby making the present value of the victims’ claims differ enormously as well.

70. The most aggressive estimate of the cost of all civil litigation, not just tort suits, is $80 billion annually. See COUNCIL ON COMPETITIVENESS, supra note 13. Yet the estimated cost of the Clinton Administration’s proposed health care system alone, not including lost wages and other benefits proposed by Professor Sugarman, was $700 billion over five years. Supra note 42.

71. Most Americans already have access to some kind of health and income benefits, whether private—in which case the additional benefits may be quite marginal indeed—or public, such as Social Security and Medicaid. See Willard, supra note 10, at 5 (“Our society has a vast need-based compensation system already in place.”). Nonetheless, 37 million Americans have no health insurance. These include poor and working poor who are unemployed or whose employers may not be able to afford to participate in such a scheme. See Erik Eckholm, The Uninsured: 37 Million and Growing, N.Y. TIMES, July 11, 1993, at E5; see also Abraham & Liebman, supra note 38.

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desirable, from an insurance perspective, and those who do not participate might enjoy many of the benefits without surrendering any of their rights.

This problem of adverse selection applies to all possible participants in a potential tort claims market. Some employers—those engaging in hazardous activities or producing dangerous products—would seek to pre-settle claims in order to avoid exposure to large damage payments for their employees' or consumers' serious personal injuries. Other employers—those in non-hazardous industries—would have little incentive to offer such health and income coverage. Conversely, employees in hazardous occupations would retain their right to sue unless offered a significant amount of coverage. Those white-collar workers with low benefits would surrender their tort rights readily, but those with good benefits would likely not. Professor Sugarman recognizes this, but concludes that "this problem of adverse selection seems no more severe here than in other insurance markets."\(^72\) This may or may not be true. But it is difficult to see why a company would accept the expense of establishing and maintaining such a compensation system if it was only able to purchase the least valuable tort rights of its employees.

This would present less of a problem if Professor Sugarman's proposal were merely a contract-based workers' compensation scheme. But he aspires to complete coverage, including harm caused by third-party injurers.\(^73\) Unless a large majority of firms are willing to behave as agents for their employees—and Professor Sugarman never addresses the significant transaction costs, especially for small businesses, of setting up such a clearinghouse within each firm—coverage would be limited to work-related injuries between employers and their employees. As noted above, workers' compensation, Social Security, and generous benefit packages already exist for many workers. It is difficult to imagine why these workers would want to surrender their right to bring future tort claims. And without employee demand, there would be no reason for employers to offer such a plan.

There is a further problem with employers bringing their injured employees' claims against a third-party tortfeasor. Each claim would have to be vigorously pursued in order for it to be settled at its full value. Even assuming that employers would be willing to assume the transaction costs of attempting to settle all kinds of injuries for their workers and families, what incentive would a victim have to participate vigorously in her claim

\(^72\) SUGARMAN, supra note 8, at 207.

\(^73\) Id. at 202 ("Employers, as agents, would sell potential tort claims of their employees to the insurers of potential injurers. Such a sale would effectively cause tort claims to be presettled.").
after pre-selling it? Keeping her job? Fulfilling her tort-sale contractual obligation with her employer? A desire for revenge against the tortfeasor?

Along with Robert Cooter, Professor Sugarman suggests that the purchase of claims from employees “might be made contingent on resale,” i.e., contingent upon the ability of the employer to settle the claim with the injurer’s insurer. But an employee would likely lack incentive to participate without a stake in the outcome. If the resale value significantly exceeded the contingent benefits offered to the employee, she would have a strong incentive not to assist vigorously in the prosecution of the claim, in effect rescinding the sales agreement with her employer. Without her assistance, the employer would be forced not to purchase the claim, thereby enabling the injured employee to pursue the claim on her own.

Furthermore, even if only a portion of the firm’s industrial workforce opted in, those who did not would benefit as free-riders from the improved workplace safety. Assuming that the workplace would be safer, all workers would benefit, although only a portion would have surrendered their right to sue. A response might be that the right to sue has been devalued by improved safety, which has diminished the likelihood of injury. Even if this were true, workers who opt out of the plan would receive the same benefit of increased safety with only a marginal decrease in the value of their potential suit.

Employers will either have to bear the cost of improving safety or they will try to pass on this cost to those in the program by offering less generous benefits. Either way, employers and employees will have less incentive to participate in the proposal because holdouts will benefit from increased safety but will pose nearly the same tort liability as before.

3. Misplaced Incentives for Safety

Rather than improved safety, an economic analysis of Professor Sugarman’s proposal would actually predict increased risks, at least in the short term. Professor Sugarman states:

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74. Cooter & Sugarman, supra note 58, at 176.
75. While SUGARMAN begins his book expressly denying the effectiveness of such incentives on safety, SUGARMAN, supra note 8, at 1-34, he nonetheless argues that employers and their insurers will want to improve safety in order to reduce the likelihood that they will have to pay benefits, id. at 207. Presumably they will also want to improve safety in order to reduce the value, and thus purchase price, of potential tort claims. If Professor Sugarman doubts the safety incentives posed by tort liability, it is difficult to understand why insurance companies would be more vigilant in monitoring potential work hazards because of the risk posed by having to provide medical and income support for someone who is injured than insurers are now for having to pay personal injury damages. In fact, it may be that Professor Sugarman’s proposal actually discourages safety. See infra Section I.B.3.
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If a manufacturer relaxed its quality control in response to the presettlement of its tort claims, so that more hazardous products found their way into the marketplace, it would soon find that the value of potential tort claims against it would increase. To presettle those claims, insurers would then have to pay more, and in turn could demand higher premiums . . . .

Any increase in the value of potential tort claims would be a windfall for employers, despite higher insurance premiums. This is so because employers would be able to recover higher settlement awards for their employee-consumer's injuries, while their employees would receive the same benefits having sold their right to sue at a previous, lower price. The same incentives apply to the workplace, after a significant portion of the employees have sold their potential claims. Of course, manufacturers are not always so calculating when it comes to their consumers' health and safety. But, under certain circumstances, Professor Sugarman's proposal provides incentives for corporations to undertake and retain risks, not to reduce them.

4. Moral Hazards—Proving and Settling Claims

Selling potential tort claims will not eliminate problems of proof which arise in litigation. Guaranteed an income and health support, people would have an incentive to bring false injury claims. Even if actually injured, people would naturally try to maximize the apparent degree of their injury. Employers may or may not try to minimize the value of such claims, for while their premiums might rise, employers might also fear discouraging future sales by their employees. But insurance companies, as ultimate bearers of the cost of accidents, would have an interest in reducing the number and size of injury claims.

As a result, conflict as to the validity and extent of injury would arise. It may be that an administrative hearing, similar to a workers' compensation board, would settle disputes. This problem, which Professor Sugarman does not address, cannot be ignored. It may not be

76. Sugarman, supra note 8, at 207.
77. In the products liability context, see Grimshaw v. Ford Motor Co., 174 Cal. Rptr. 348, 361 (Cal. Ct. App. 1981) ("[T]he highest level of Ford's management made the decision to go forward with the production of the Pinto, knowing that the gas tank was vulnerable . . . [thereby] creating a significant risk of death or injury from fire and knowing that 'fixes' were feasible at nominal cost.").

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cost-effective for insurers to underwrite the purchase of the right to sue in tort if the cost of resolving disputes regarding injuries becomes too high. Similarly, employees may not be willing to sell their right to sue if they still encounter significant transaction costs in bringing claims for their injuries.

II. Abolishing the Legal Obstacles to Establishing a Tort Claims Market

A. Maintenance, Champerty, and Barratry: Ancient Doctrines and Modern Limits

Changes in legal and regulatory regimes can be one of the chief engines of financial innovation. Conversely, the law can stop otherwise viable markets from forming. Such is the case with a market in tort claims, which the common law and/or statutes in most jurisdictions expressly prohibit. For despite the ascension of free market principles in political discourse and in public policy for more than a decade, and despite the continued prominence of the Law and Economics movement in academia, the main obstacles to constructing a market for tort claims are the legal prohibitions against maintenance, champerty, and barratry.

Blackstone defines the offense of barratry, from the French barrateur, a cheat, as “frequently exciting and stirring up suits and quarrels.” Closely related is maintenance, “an officious intermeddling in a suit that no way belongs to one, by maintaining or assisting either party with money or otherwise, to prosecute or defend it.” Champerty, from the French cambi partia or campi partitio, a sharing of the spoil, is a form


79. 4 WILLIAM BLACKSTONE, COMMENTARIES *133.

80. Id. at *134-35; see also Alexander v. Unification Church of Am., 634 F.2d 673, 677 n.5 (2d Cir. 1980).
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of maintenance in which a stranger and a party to a lawsuit agree that the stranger will pursue the claim in consideration of receiving part of any judgment proceeds. In short, barratry refers to stirring up a lawsuit, maintenance involves supporting a lawsuit, and champerty means doing so in hopes of profiting. Presumably barred by all three prohibitions, a market in tort claims is most precisely champertous.

These prohibitions are ancient in origin. And although the philosophical and social rationales for the bans lost significance long ago, many courts continue trying to reformulate their original public policy justifications in an effort to make them relevant today. Other courts invoke them with little or no inquiry as to their appropriateness.

1. Conceptual and Societal Origins

In Rome, a tort victim could sell his claim to another. But in 506 A.D., the Emperor Anastasius removed the financial incentive for such a sale. Because victims were selling their claims for much less than their value, Anastasius only permitted the buyer to recover the purchase price of the claim plus interest.

In the late 13th and early 14th centuries, Edward I promulgated a series of statutes outlawing champerty, maintenance, barratry, and the related offense of conspiracy—an agreement to incite or maintain causes of action falsely and maliciously. These statutes sought to prevent what was in effect a form of legalized warfare in which the powerful tried to “undertake to bear or maintain quarrels, pleas, or debates that concern other people,” especially for profit, in which case they were subject to imprisonment for three years and a “fine at the king’s pleasure.”

More than two hundred years later, Henry VIII continued these laws and added a forfeiture penalty to discourage speculators from purchasing titles or rights in lands of uncertain ownership because such rights or titles were likely to be subjects of future legal disputes. So deep and enduring was the censure against speculating in rights which might

81. 4 BLACKSTONE, supra note 79, at *134-35; see also Unification Church, 634 F.2d at 677 n.5.
83. See Max Radin, Maintenance by Champerty, 24 CAL. L. REV. 48, 55 (1935); see also 7 W.S. HOLDSWORTH, A HISTORY OF ENGLISH LAW 524 (1926).
84. See EDWARD JENKS, A SHORT HISTORY OF ENGLISH LAW 142-43 (1st ed. 1912); 2 JOHN REEVES, HISTORY OF THE ENGLISH LAW 242-43 (photo. reprint 1969) (Dublin, Luke White 1787); see also id. at 457 (similar statutes of Edward III).
85. 2 REEVES, supra note 84, at 242, 243.
86. Id. at 291.
generate future lawsuits that at one time three American states—New York, Virginia, and North Carolina—reenacted Henry VIII’s statute in its entirety.  

As important as these statutes were, they mainly codified the common law’s prohibition against assigning tort claims and other causes of action, a ban which had existed for centuries. To understand the common law’s prohibition of champerty and maintenance, one must understand the ancient concept of “chose in action.” But to understand the vehemence of this prohibition, one must understand the danger and uncertainty of medieval English society which made such prohibitions necessary.

A chose in action, according to Holdsworth, includes “all personal rights of property which can only be claimed or enforced by action, and not by taking physical possession.” In the medieval legal mind, a personal right of action, arising out of contract or tort, arose from an obligatio between two persons and those persons alone. For a third party to assume the right of action would have been unthinkable, since the obligatio and thus the right of action could only exist between the original two parties. In other words, the assignee would lack privity with the remaining party to the obligation. Furthermore, a personal right of action is intangible and only corporeal things—things in which the transferee could have seisin—could be transferred. Moreover, the Roman law’s concern that rights of action were of uncertain value and therefore not appropriate for assignment persisted in medieval times.

Although proscriptions against assigning rights of action may have originated in legal conceptions of the nature of such rights, the multitude of exceptions to these prohibitions which eventually developed illustrates the capacity of English courts to reconceive the notion of a chose in action when necessary. More than legal concepts, then, the ability of powerful lords and their minions to manipulate the judicial process accounts for the enduring ban against assigning many kinds of rights of action. Reflecting

88. 7 HOLDSWORTH, supra note 83, at 516.
89. Id. at 520.
90. Id.
91. 3 THOMAS ATKINS STREET, THE FOUNDATIONS OF LEGAL LIABILITY 77 (1906).
92. Id. Such was probably true early on, although many exceptions developed. See generally 7 HOLDSWORTH, supra note 83, at 515-44.
93. See 7 HOLDSWORTH, supra note 83, at 537-38.
94. See generally id. at 515-44. For an excellent short history, emphasizing the jurisprudential rather than societal sources of the English and American proscriptions against assigning tort claims, see Harold R. Weinberg, Tort Claims as Intangible Property: An Exploration from an Assignee’s Perspective, 64 KY. L.J. 49 (1975).
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on the experience of England and the dangers of assigning rights of action, Holdsworth warned:

the rights may be assigned to persons who, by their power or influence, may be in a position to put a great, and perhaps an illegitimate, pressure on the possessor, or on the person who owes the duty; and that very dubious rights may be assigned to persons in such a position merely because they are dubious . . . .

In England, in the later medieval period, the disorderly state of the country, the technicality of the common law procedure, the expense of legal proceedings, and the ease with which jurors, sheriffs, and other ministers of justice, could be corrupted or intimidated, made maintenance and kindred offenses so crying an evil, that it was necessary to prohibit sternly anything which could in the smallest degree foster them. Therefore the courts in the Middle Ages stretched the offence of maintenance to its utmost limits; and statutes repeatedly prohibited all practices which could favor it.95

Well after the Middle Ages, Lord Coke in Lampet's Case, in dictum identified this danger—that assigning rights of action to “strangers” would lead to the “multiplying of contentions and suits, of great oppression of the people, . . . and the subversion of the due and equal execution of justice” by powerful lords—as the rationale for barring maintenance and champerty.96

In short, both the common law and statutes banned outright the assignment of rights of action not because the practice itself was bad, but out of fear of evil practices which might result—practices which medieval English legal procedure and society were powerless to stop in any other way.

Of course, a total ban on champerty and maintenance might prevent meritorious, as well as dubious, claims from being brought. And such a ban could not prevent the exact same corrupt practices from distorting the judicial process when the powerful sought to enforce a right of action they claimed as their own. Nonetheless, the threat of constant turmoil in the courts and affecting all of society was so great that medieval jurists and monarchs alike determined that the dangers of permitting champerty and

95. 7 HOLDsworth, supra note 83, at 524.
96. 10 Coke's Rep. 46, 48 (1613); see 3 STREET, supra note 91, at 82-83; 7 HOLDsworth, supra note 83, at 525.
maintenance far outweighed any benefits. Despite the evolution of our laws and society, the bans endure.

2. The Modern Status of Maintenance and Champerty

Today, the effects on society of bringing lawsuits are not nearly so calamitous\(^\text{97}\) and may at times be beneficial.\(^\text{98}\) It is doubtful that the tort of champerty is available as a separate cause of action in any state,\(^\text{99}\) while prosecution of champerty as a criminal misdemeanor ended long ago.\(^\text{100}\)

Nonetheless, numerous states prohibit assigning rights of action generally\(^\text{101}\) and personal injury claims specifically.\(^\text{102}\) At least sixteen states directly prohibit champerty, barratry, or maintenance. Numerous others discourage champertous personal injury actions by prohibiting such practices as soliciting legal claims\(^\text{103}\) or furnishing, selling, or buying patient information.\(^\text{104}\)

Most of these laws were enacted long ago. And although those concerning barratry are often criminal and not commonly enforced,\(^\text{105}\) courts continue to apply champerty and maintenance statutes, albeit

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\(^{97}\) But see George Bush, Acceptance Speech at the Republican National Convention (1992), reprinted in CNN Transcripts (Aug. 20, 1992) ("And I see something happening in our towns and in our neighborhoods—sharp lawyers are running wild, doctors are afraid to practice medicine, and some moms and pops won't even coach Little League anymore . . . . I am fighting to reform our legal system, to put an end to crazy lawsuits . . . .").

\(^{98}\) See Owen Fiss, Against Settlement, 93 YALE L.J. 1073 (1984) (discussing private attorney general function of tort law); supra note 18 and accompanying text (discussing incentives for product safety innovation promoted by potential tort liability).

\(^{99}\) See Alexander v. Unification Church of Am., 634 F.2d 673, 677 n.6 (2d Cir. 1980); cf. Burns v. Scott, 117 U.S. 582 (1885) (ruling champertous enforcement agreement between plaintiff and his attorney did not bar underlying suit).

\(^{100}\) See 14 AM. JUR. 2D, supra note 82, at §18 and cases cited therein.

\(^{101}\) See, e.g., N.Y. JUD. LAW § 489 (McKinney 1993) ("[N]o corporation or association . . . shall solicit, buy or take an assignment of, or be in any manner interested in buying or taking an assignment of a bond, promissory note, bill of exchange, book debt, or other thing in action, or any claim or demand, with the intent and for the purpose of bringing an action or proceeding thereon . . . .").

\(^{102}\) See, e.g., N.Y. GEN. OBLIG. LAW § 13-101 (McKinney 1993) (permitting transfer of claims except "[w]here it is to recover damages for a personal injury"). See also 40 A.L.R.2d 500 (1955) (surveying state laws regarding assignment of personal injury claims).

\(^{103}\) See, e.g., MINN. STAT. ANN. § 481 (West 1993).

\(^{104}\) See, e.g., MICH. COMP. LAWS ANN. § 750.410 (West 1993).

\(^{105}\) A recent Westlaw search of all states listed thirty prosecutions for champerty and maintenance since 1949—almost all charged barratry for allegedly bringing harassment lawsuits.
selectively and inconsistently. The reasons commonly offered for enforcing such laws echo those of yore: assigning causes of action will foster vexatious lawsuits and, in the case of torts, personal injury claims are inappropriate for assignment.

As for the first criticism, it does not distinguish between quantity and quality. As already noted, an increase in litigation is not necessarily detrimental since a variety of worthwhile social objectives may be pursued by means of litigation. Furthermore, to the extent that meritorious lawsuits which would not have been brought otherwise can be brought as a result of assignment, more people can pursue and achieve justice. And unlike medieval English law, modern American law currently affords numerous means to discourage and punish malicious lawsuits, including sanctions and countersuits. As will be developed below, a tort claims market would actually discourage spurious lawsuits because

106. Compare Sygma Photo News, Inc. v. Globe Int'l, Inc., 616 F. Supp. 1153, 1155, 1157 (S.D.N.Y. 1985) (construing New York law as permitting assignment of copyrights "for the sole and exclusive purpose of prosecuting" infringement claims where the assignment was "not for mercenary reasons" but to vindicate the rights of one who relied on his agent to police infringement of his work) with Refac Int'l, Ltd. v. Lotus Dev. Corp., 131 F.R.D. 56, 58 (S.D.N.Y. 1990) (finding same law voids agreement granting 5% ownership of patent "simply for the purpose of pursuing litigation" on another's behalf). See also MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 5-103B (1980) (prohibiting lawyers from advancing money for litigation subject to a few exceptions).

For an example in the mass tort context, see In re Agent Orange Prod. Liab. Litig., 818 F.2d 216, 218 (2d Cir. 1987) (striking down contingency-fee agreement in which some plaintiffs' lawyers were remunerated for financial contribution and not for legal services; holding that such arrangement violated equitable fund principles and created potential for conflicts of interest between attorneys and clients).

107. See, e.g., Fairchild Hiller Corp. v. McDonnell Douglas Corp., 321 N.Y.S.2d 857, 860 (N.Y. 1971) (finding legislative intent of New York law is "[t]o prevent the resulting strife, discord and harassment which could result from permitting attorneys and corporations to purchase claims for the bringing of actions thereon . . . .").

108. See, e.g., In re Schmelzer, 350 F. Supp. 429, 437 (S.D. Ohio 1972) (holding personal injury claim may not be assigned in bankruptcy proceeding since that would encourage "a market in the pain and suffering of unfortunate persons and the law neither does, nor should it, encourage so callous and barbaric a practice").

109. Ironically, critics of increased litigation invert Coke's rationale for banning maintenance and champerty, arguing in effect that more numerous and weak tort victims oppress the few and powerful corporate tortfeasors by bringing lawsuits. See supra notes 12-13, 96-97.


111. E.g., Alexander v. Unification Church of Am., 634 F.2d 673 (2d Cir. 1980).
investors would not assign much value to them, and would face potential liability in a countersuit for having brought such suits.

Moreover, it is not clear that assignment of tort claims would necessarily lead to increased litigation. Part of the function of the tort system is to encourage innovation and improve safety. To the extent that more claims may be brought in the short run, potential tortfeasors will have greater incentive to reduce hazardous activities or produce safer products in the long run. Furthermore, because investors will purchase the claims promising the highest returns, contingency-fee attorneys will not be able to bring more speculative cases. In addition, investors will be more able to develop information and match corporate defendants' resources. Greater equality in bargaining between plaintiffs and defendants should lead to more, faster, and fairer settlements.

The second critique, that permitting assignment of personal injury claims is tantamount to trafficking in human pain and suffering, misconceives the nature of a transaction in a market for tort claims. A tort victim has already experienced injury and may continue to experience pain and suffering. A tort victim's claim is not the same as his injury or suffering. It is an attempt to seek restitution by approximating the monetary worth of the damages incurred by the victim. For better or worse, whether under the current tort regime or in a market for tort claims, money is the form by which most tort victims, especially personal injury victims, seek redress.

Under any system of redress, a personal injury victim has experienced an injury which she cannot alienate. The relevant question is how many options the tort victim will have in her effort to seek redress for that injury. At present, a victim may only recover from her insurer or the tortfeasor, either by settlement or by trial. A market for tort claims simply expands a victim's options by permitting her to sell the claim to someone other than the tortfeasor, and in doing so introduces a number of advantages—for victims, for society, and for tortfeasors as well.

But despite the legal and economic arguments in favor of investing in tort claims, many critics will continue to conceive of a victim's injury as too personal and inalienable to permit assignment, just as medieval

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112. See infra notes 181-83 and accompanying text.
113. See infra Section III.A.2.c.
114. MARC A. FRANKLIN & ROBERT L. RABIN, TORT LAW AND ALTERNATIVES 14 (4th ed. 1987). This effort to translate suffering into money can itself be emotionally draining. See JAMES S. KUNEN, RECKLESS DISREGARD, CORPORATE GREED, GOVERNMENT INDIFFERENCE, AND THE KENTUCKY SCHOOL BUS CRASH 279-82 (1994) (describing process by which plaintiffs' own psychologist tried to quantify parents' trauma resulting from child being incinerated alive in school bus crash).
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jurists did.\textsuperscript{115} However, a number of markets which may have seemed inappropriate or even immoral or ghoulish a short while ago now exist, although not without controversy. For example, the Chicago Board of Trade has established a market for investors to speculate in government-issued permits to emit pollution\textsuperscript{116} and set up futures contracts in insurance “that will allow insurance companies to limit their losses from hurricanes, earthquakes and riots, and let speculators profit when these events occur.”\textsuperscript{117} And investors now speculate on the life expectancy of persons with AIDS by purchasing their life insurance policies at a discount.\textsuperscript{118} There is evidence that a market for tort claims will not be far behind.\textsuperscript{119}

B. Examples of Selling Tort Claims: Present Practices and Future Possibilities

Although the law presently prohibits third parties from purchasing

\textsuperscript{115} One court stated:

[W]e have not been able to find a single case holding that, in the absence of a statute, an unliquidated claim for personal injuries may be assigned . . . . The reasons for the rule are that a claim for personal injuries is peculiarly a personal right that the injured party may or may not assign as he pleases and that to permit one’s pain and suffering to become a matter of speculation is not looked upon with favor by the law.


\textsuperscript{118} Michael Quint, \textit{Pre-Death Cash: A Business Grows}, N.Y. TIMES, Nov. 14, 1994, at D1; Peter Kerr, \textit{Now, AIDS Patients' Lives Are Drawing Speculators}, N.Y. TIMES, Aug. 20, 1992, at A1 (reporting that since 1988 a total of 25 businesses nationwide have “bought an estimated $100 million in insurance policies from terminally ill patients, offering them anywhere from 50% to 90% of a policy’s face value, depending on how long the patient is expected to live”).

entire lawsuits and discourages other conditions necessary for the construction of a tort claims market, the law does allow third parties to acquire a limited interest in prosecuting tort claims. Some examples from current tort practice will illustrate how the law has introduced at least some prerequisites for a market in tort claims. These examples will also expose shortcomings in the present system and thus the relative advantages of a tort claims market.

In order to highlight some of the economic relationships between tort parties, let us consider the simple case of tortfeasor T, injured victim V, and V’s insurer, VI. Assuming that V wishes to pursue her claim, the law currently allows four approaches to settling the dispute.

1. **Traditional Lawsuits**

One way of settling tort claims is to litigate them in court before a judge and most likely a jury. It is expensive, time-consuming, and introduces significant uncertainty by adding others to the decision-making process. In place of the parties, six to twelve men and women employ their learning and insights to decide the merits of the claims and the value of the injury. With more people assessing the claims, the judgment may reflect society’s valuation of the injury more accurately.

However, jury verdicts may also be skewed since juries are not required to feel the cost of their valuation, i.e., jurors do not pay for the damage awards. In addition, if the claim is not a class action, the valuation may be very idiosyncratic, with jury awards varying considerably for similar injuries. A market, by contrast, would both expand the number of decision-makers and force those valuing claims to

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120. Another adjudicatory procedure is alternative dispute resolution, where an independent arbitrator decides the controversy. While contract disputes are frequently referred to arbitrators, usually as a condition of the contract, tort claims are less susceptible to arbitration. One important reason is that parties in a tort action have no pre-existing relationship on which they can build compromise and which they seek to preserve. To the contrary, parties in a tort action are brought together involuntarily, often violently, over a harmful event—making a trial a more appealing forum for dispute resolution. Although torts are sometimes settled by arbitration, as in worker’s compensation arrangements, usually there are previous contractual commitments to submit to arbitration. In any event, the injured worker may still resort to the tort system for certain types of damages.

121. For criticisms of jury awards, see HUBER, supra note 5; O’CONNELL, supra note 21 at 85-88; OLSON, supra note 9; see also 1 AMERICAN LAW INST., supra note 16, at 64-66 (finding a small number of very large awards responsible for significant increase in tort liability); AUDREY CHIN & MARK A. PETERSON, DEEP POCKETS, EMPTY POCKETS (1985) (finding corporate, hospital, and government defendants paid higher damage awards than individuals). But see supra note 17.

122. See O’CONNELL, supra note 21 at 84-106.
bear the full cost of their valuation. It would also sharply reduce the variance in compensation received by individual plaintiffs. For while the purchase price for a tort claim in a claims market will in part reflect the potential jury award for the claim, this value would derive from the average jury award, not atypically high or low awards, thereby eliminating the “lottery” aspect of bringing a lawsuit for individual plaintiffs.

2. Settlemnt

A second option would be for V to sell to T, the tortfeasor, or to T’s insurer, TI, the complete value of her claim. This kind of sale is commonly called “settlement.” Assuming the parties can agree, the law gives the tortfeasor the exclusive right to buy the injured party’s entire claim. Although this provides for an efficient, low-cost resolution of a dispute, the law in effect is constructing a market in which the sole purchaser is the tortfeasor. Depending on the particular economic circumstances of the parties, the bargaining positions might be so unequal that the settlement process becomes far more a function of power than the substantive merits of the case. In a tort market, buyers will have to compete in offering a purchase price.

3. Subrogation

A third possibility (for an insured victim) combines elements of the first and second. After suffering harm, V receives payment for her damage from her insurer. In effect, by prior agreement she would sell all or part of her claim to her insurance company, VI. VI would then proceed against T or T’s insurer, TI. VI is said to have a right of subrogation

123. See supra note 21.
124. For other criticisms of the settlement process, especially involving disputes between multiple parties over issues of concern to the broader public, see Fiss, supra note 98. See also Marc Galanter & Mia Cahill, “Most Cases Settle”: Judicial Promotion and Regulation of Settlements, 46 STAN. L. REV. 1339 (1994) (arguing resolution of most lawsuits by settlement not intrinsically preferable; settlements should be scrutinized for certain desirable qualities).
125. See infra Sections III.A.2.b-c.
126. For example, with no-fault insurance, as it exists in many states, V’s insurance company pays V and then settles with TI. TI may then charge T higher premiums or drop its coverage altogether. Here, the negotiating parties, both insurance companies, have relatively equal bargaining power. Because insurers negotiate fault along with damages, they usually avoid the expense of a trial which could easily exceed the value of the claim. Instead, no-fault allows insurers to pursue settlement in a quick, low-cost manner. For a proposal to expand no-fault insurance to other areas of tort law, see O’Connell & Beck, supra note 469.
against T.\textsuperscript{127} VI’s subrogation right derives from, and is limited to, V’s rights.

V has numerous incentives to cooperate with VI in its proceeding against T.\textsuperscript{128} Even though V has surrendered her right to proceed against T, she must still cooperate with VI in any proceedings against T if she is to receive her insurance benefits.\textsuperscript{129} If V has suffered injuries not covered by her insurance or injuries which exceed her coverage, she again may have incentive to cooperate in VI’s action against T in order to establish liability and recover damages. These incentives continue so long as both VI and V may pursue their causes of action jointly, there are issues of law and fact common to both VI and V, there is no conflict in VI’s and V’s theories of liability in pursuit of their different damage claims, and T possesses sufficient assets to pay both VI and V in full.

Professor Jeffrey O’Connell has proposed building upon this system and expanding it to nearly all tort claims.\textsuperscript{130} But just as the current system of subrogation may often lead to conflicts between the insured, V,

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\textsuperscript{56} Other commentators, however, point out the mixed record of no-fault regimes in saving costs and deterring accidents, see ROBERT E. KEETON & ALLAN I. WIDISS, INSURANCE LAW § 4.10(e) (1988); Schwartz, supra note 18, at 394-97, as well as the problem of underinsurance or no insurance, see, e.g., William R. Keeton & Evan Kwerel, Externalities in Automobile Insurance and the Underinsured Driver Problem, 27 J.L. \\& ECON. 149 (1984). For a very thoughtful, balanced discussion of no-fault compensation applied to medical malpractice, see WEILER, supra note 57, at 114-58.

\textsuperscript{127} See generally KEETON \\& WIDISS, supra note 126, at § 3.10. Under current law, not all kinds of insurance may be subject to a right of subrogation by the insurer. Id. at § 3.10 (a), (d). For a description of the difference between subrogation and assignment, see O’Connell \\& Beck, supra note 56, at 76 n.109.

\textsuperscript{128} Most jurisdictions require that VI and V pursue their claim together. See Andrea L. Parry, Comment, Subrogation in Pennsylvania—Competing Interests of Insurers and Insureds in Settlements with Third-Party Tortfeasors, 56 TEMP. L.Q. 667 (1983). For a brief discussion of approaches to assigning control between insured and insurer to proceed against the tortfeasor, see June F. Entman, More Reasons for Abolishing Federal Rule of Civil Procedure 17(a): The Problem of the Proper Plaintiff and Insurance Subrogation, 68 N.C. L. REV. 893, 908-11 (1990).

\textsuperscript{129} For example, many insurers do not actually settle the injured’s claim, but make a kind of loan to V. In return, V promises to repay the insurer out of any recovery from the tortfeasor. J. Kent Miller, Subrogation: Principles and Practice Pointers, 20 COLO. LAW. 11 (1991). If the insurer, VI, has not paid the claim, V’s failure to cooperate or attempt to seek a separate settlement could be a partial or complete defense by VI against any subsequent benefit claims by V. If VI has paid V’s claim, VI could pursue a claim for breach of contract in the case of an express subrogation provision, in equity for quasi-contract, for constructive trust, or for injunctive relief against V to force cooperation. See KEETON \\& WIDISS, supra note 126 at § 3.10(c)4. Obviously coercive measures are less likely than incentives to produce vigorous assistance from V in prosecuting the claim.

\textsuperscript{130} O’Connell, Harnessing the Liability Lottery, supra note 56; O’Connell \\& Beck, supra note 56.
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and the insurer, VI,\textsuperscript{131} Professor O'Connell's proposal may also pit insured against insurer.

Under a subrogation agreement, if V’s insurance does not fully compensate her—either because of insufficient coverage or inappropriate type of insurance—V does have an incentive to assist VI against T in order to recover the uncompensated amount. However, if T or TI does not pay all of V’s claims and V has already received some money from her insurer VI (so that VI now has a right of subrogation), then V and VI essentially must compete for the partial compensation T can provide.\textsuperscript{132}

The conflict between insured and insurer which arises from less than full compensation by the tortfeasor appears in Professor O'Connell's proposal as well. In brief, Professor O'Connell proposes that insurers could offer no-fault coverage in increments of $10,000 for economic losses, principally medical costs and lost wages.\textsuperscript{133} In return, the insurer would receive an absolute assignment of V’s tort claim (both the economic and non-economic components) against T. To prevent adverse selection, insureds would be bound to transfer their claims by prior agreement. For its part, VI would agree to pay periodic payments for economic damages and to pay V any amount in excess of the no-fault benefits recovered as economic losses in the tort action. Because V’s payments would not be reduced by attorneys’ fees in the action against T, Professor O’Connell predicts that tort victims might recover close to what they would have received by pursuing their tort claims and at the same time would be assured compensation.

An immediate problem presents itself. As with Professor Sugarman's proposal for the pre-sale of tort claims, with Professor O'Connell's proposal courts might invalidate such contracts as unconscionable. In response, Professor O’Connell allows insureds to opt out of no-fault


\textsuperscript{132} Courts employ three approaches to divide between insured and insurer partial recoveries collected from the tortfeasor. The majority of jurisdictions first reimburse the insured for her uninsured (or undercompensated) losses. If any money remains, the insurer then collects. Other courts choose to reimburse the insurer first, no matter the amount of the insured's losses. Finally, some courts prorate the recovery, so that insurer and insured share the tortfeasor’s payment in proportion to their loss. See Parry, supra note 128.

For a discussion of how partial reimbursement affects assigning the right to bring suit against the tortfeasor, see KEETON & WIDISS, supra note 126, § 3.10(b); Entman, supra note 128, at 911-31.

\textsuperscript{133} This proposal is summarized in O’Connell & Beck, supra note 56, at 55-58.
benefits after the accident.\textsuperscript{134} Although he candidly admits that adverse selection might well result, he cites surveys to predict that most people would prefer the certainty of coverage to the uncertainty of separate tort actions.\textsuperscript{135}

But additional problems exist. Insureds would have an incentive to purchase low coverage in order to have insurers bear the cost of trial or settlement negotiations. Insureds would receive their full economic damages while shifting legal fees to insurers. Conversely, insurance companies would have a disincentive to insure for certain types of injuries, such as real property damage where economic losses comprise most, if not all, of the claim. On the other hand, it is unclear what would happen to insurance coverage for activities which often result in high personal injury claims, such as auto insurance. For although insurers could offer inexpensive coverage in hopes of reaping large personal injury awards, they would also be vulnerable to pay such claims. It may be that, contrary to Professor O'Connell's intention that his system extend no-fault type insurance to a larger number of people and activities, a significant class of people would become uninsurable because of one or two minor accidents. A bifurcated insurance pool between those paying very low rates and those unable to obtain any insurance could result from such a recovery scheme.

A final problem with Professor O'Connell's proposal is that insurance companies would have a great incentive to pursue—either by settlement or at trial—low economic claims and high non-economic claims in order to maximize their share of the damage award. Professor O'Connell suggests arbitration to settle disputes between insureds and insurers.\textsuperscript{136}

Arbitration, however, has its own problems. The arbitration process reintroduces the very delay and uncertainty which Professor O'Connell attempts to alleviate with his no-fault proposal. The insureds' need to hire lawyers for the arbitration proceeding also reintroduces significant legal expenses. In addition, insurance companies would have an incentive to reduce payments to the victim in amounts small enough to make seeking arbitration financially unfeasible for the victim. Furthermore, if an insured

\textsuperscript{134} Id. at 59.

\textsuperscript{135} Id. The problem with such surveys, of course, is that the questions are posed in the abstract without information about the value of tort claims and the likelihood of recovery. The problem of adverse selection exists because people will pursue strong claims themselves, while agreeing to subrogation for the weaker ones. In addition, widespread reports of large injury awards since the 1978 survey might make litigation more attractive to tort victims today. \textit{See} 1 AMERICAN LAW INST., \textit{supra} note 16, at 65 nn.25-26 and accompanying text.

\textsuperscript{136} O'Connell, \textit{Harnessing the Liability Lottery}, \textit{supra} note 56, at 700-01.
person exercised her arbitration option often, she might become black-balled by insurance companies and therefore unable to purchase insurance. Finally, the procedural protection and integrity of industry-based arbitrations may come into question. In order to be approved by insurance companies whose lawyers would repeatedly encounter them, arbitrators could not be perceived as hostile to insurers' interests. By contrast, unless a plaintiff's bar sprang up to represent tort victims before such arbitrators, individual victims would have less knowledge of, and influence with, arbitrators.

4. Contingency Fees: Lawyers As Partial Claims Purchasers

A fourth alternative would, like the first, allow V to pursue her claim against T. However, in many cases legal costs may discourage or even prevent V from pursuing her claim. Just as the law allows V to sell her claim to T (settlement) or her right to pursue her claim to VI (subrogation), the law also allows V to sell part of her claim to her lawyer, L. In essence, L agrees to represent V, and even to finance litigation costs in addition to legal fees, in return for a contingency fee—a percentage of any recovery. V receives a chance of recovering most of her claim without risk; whereas L, based upon presumably sophisticated appraising, negotiating, and litigating skills, acquires a significant stake in the suit.

As with subrogation, there is substantial potential for principal-agent conflicts in contingency-fee arrangements. These include the incentive for lawyers to limit their work in order to maximize the difference between their recovery and their hours invested; the incentive for lawyers to settle early rather than pursue costly litigation (a particular expression of the first incentive); the uneven positions of lawyers versus clients in evaluating and assigning risk to lawsuits; and the ability of lawyers to conduct the litigation with little oversight or control by the client. There are public policy considerations which both support and disfavor contingency fees. On the one hand, permitting attorneys to bear the full cost of litigation substantially reduces wealth barriers to the legal system. On the other hand, such increased access may further strain the court system.

137. See Margaret A. Jacobs & Michael Siconolfi, Investors Fare Poorly Fighting Wall Street—and May Do Worse, WALL ST. J., Feb. 8, 1995, A1, A8 (reporting how securities industry-selected arbitrators often are unfair to plaintiffs, but industry increasingly skeptical of growing costs and idiosyncratic awards).

138. For a list of literature on contingency fees, see William J. Lynk, The Courts and the Market: An Economic Analysis of Contingent Fees in Class-Action Litigation, 19 J.
a. *Auctioning Claims*

As a solution to the conflict between attorneys and clients under contingency-fee arrangements, some commentators have suggested permitting attorneys to bid for certain kinds of class or derivative actions in an auction. These proposals suggest that, in order to avoid duplicate discovery costs, the court would conduct discovery and then provide potential purchasers with information about the cause of action so that they may bid for the entire lawsuit.

In addition to the fact that only limited kinds of suits are appropriate for such an auction and the numerous problems and limitations which auction advocates themselves recognize, other problems exist. These include vastly overestimating the ability of judges to conduct discovery such that the court limits costs yet provides sufficient information to potential bidders about the lawsuits, failing to explore the propriety of judicial discovery, the likelihood that plaintiffs will opt out of the class action after the auction, the idiosyncracies in individual claim values that limited discovery would not identify, and the danger that the auction transaction costs borne by the claimants might well exceed the marginal benefit they receive from an auction. This is so because bidders would receive the exact same information from the court. As a result, each bidder would presumably value the claims very similarly and thus bid approximately the same amount for the lawsuit. An auction would be superfluous since any marginal gain in bids could well be exceeded by the costs of conducting the auction.

b. *A Promising Start: Selling Tort Claims*

Marc A. Shukaitis has suggested a more promising approach, the one

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140. See Macey & Miller, *Plaintiffs' Attorney's Role*, supra note 139, at 106.

141. See *id.* at 110-16; Thomas & Hansen, supra note 139, at 424-25, 450-51, 456.
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adopted and developed by this Article: a market for the total purchase of a tort victim's claim.\textsuperscript{142} Such an arrangement would possess some of the advantages of a tort claims market proposed in this Article, including larger and quicker payments to the tort victim, increased access to compensation for low value claims, appropriate assignment of litigation risks to those more able to bear them, and closer monitoring of legal representation.\textsuperscript{143}

Although Shukaitis's proposal goes far toward realizing the potential of market forces to address many of the inadequacies of the present tort system, it does not propose a secondary market—that is, reselling or trading tort claims after the initial purchase of claims from tort victims—and thus misses the greater advantages a secondary market offers.\textsuperscript{144} Moreover, Shukaitis's proposal does not recognize many of the limitations of a primary market for tort claims.\textsuperscript{145} One obvious limitation is that a primary market offers limited liquidity to purchasers, who must discount the purchase price to reflect the risk and opportunity costs associated with illiquid assets. Another limitation of Shukaitis's proposal is that, like others, he identifies the most likely purchasers of tort claims, those with experience in finding and valuing claims, to be lawyers.\textsuperscript{146} By purchasing the whole claim, attorneys would be essentially constructing a one hundred percent contingency-fee arrangement for themselves.

Such an arrangement immediately presents oligopsony concerns, for state bar admission requirements limit the number of would-be purchasers of tort claims. The partnership structure of law firms, currently required


As developed more fully below, this Article argues that attorneys would be inefficient purchasers of tort claims. Furthermore, this Article proposes a secondary market for tort claims, and analyzes how a tort claims market would function when applied to mass torts and to insolvent defendants in bankruptcy.

\textsuperscript{143} Shukaitis, \textit{supra} note 142, at 334-41.

\textsuperscript{144} \textit{See infra} Section III.C.

\textsuperscript{145} \textit{See} Shukaitis, \textit{supra} note 142, at 341-48 (identifying four traditional objections to a tort claims market—such a market allegedly would encourage nuisance suits, increase the volume and duration of litigation, violate public values against trafficking in personal injury claims, and risk exploitation of unsophisticated victims).

\textsuperscript{146} \textit{Id.} at 347 n.81.
by law in all fifty states, would further reduce that number. Traditionally, the two main drawbacks to partnership as a form of investment are its limited ability to raise capital and bear risk. But there seems to be no reason why law firms could not develop capital in the form of money, from their own pension funds or from borrowing, to invest in tort claims. And liability for plaintiffs' firms may be less than it is now, since as owners of the claims, lawyers would no longer face malpractice liability from clients.

Instead, the main limitation posed by law partnerships as tort purchasers results from the tension between the need to diversify investment risk and the costs of decision-making in order to achieve such diversification. Although law partnerships may contribute money for purchasing tort investments, other investors with greater access to capital may do so as well. The unique and therefore most valuable or competitive form of capital a law firm possesses is its labor.

But in order to invest this form of capital in many lawsuits, plaintiffs' law firms would have to be huge. Under most contingency-fee arrangements, law firms currently invest in a third or less than a third of tort claims. For example, a contingency fee of thirty-three percent of the tort recovery represents the firm's investment (legal labor and other costs) plus projected profits. If law firms were to buy claims in their entirety, they would need to invest considerable capital in each claim, thereby limiting the total number of lawsuits in which they could invest. This in turn would reduce the number of bidders for any one suit and therefore the competitiveness of bids for that lawsuit and for tort claims generally. Furthermore, the limited number of lawsuits would reduce the ability of firms to diversify their risk when making such investments.

148. Id. at 1771-72.
149. Coffee, supra note 138, at 889 & n.31 (noting that "[e]mpirical surveys of class actions recurrently report statistics in the 20 to 30 percent range" for contingency fees); Stuart J. Logan & Beverly C. Moore, Attorney Fee Awards in Common Fund Securities & Antitrust Class Actions, 13 CLASS ACTION REPS. 249, 250 (1990) (reporting survey of 404 cases with aggregate recovery of $6.3 billion since promulgation of "lodestar/multiplier" method reported "percentage of the class recovery consumed by attorney fees and costs is fairly constant for recoveries under $10 million, averaging from 24.5% to 28.0%, but the percentage begins to decrease after recoveries exceed $10 million"); Francis E. McGovern, Resolving Mature Mass Tort Litigation, 69 B.U. L. REV. 659, 689 & n.90 (1989) (in some mass tort cases contingency fees range from 30% to 40%). See also Lynk, supra note 138 (constructing mathematical model of court-awarded fees as reflection of market forces).
150. For a discussion of portfolio diversification, see STEPHEN A. ROSS ET AL., CORPORATE FINANCE 255-89 (2d ed. 1990). For an application of portfolio theory to law firms, see Ronald J. Gilson & Robert H. Mnookin, Sharing Among the Human Capitalists:
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thereby raising the cost of capital and further reducing the bidding price for tort claims. Plaintiffs' law firms, then, would most likely prefer contingency-fee arrangements to purchasing tort claims, since such arrangements allow lawyers to invest the capital which they monopolize—legal labor—in sufficiently varied claims to diversify their investment risks.

Expanding the size of plaintiffs' firms so that they may invest in a large and diverse number of claims would still not make the complete purchase of tort claims any more attractive to law firms. For unlike the mega-firms which began in the 1980s, and which in personal injury cases overwhelmingly represented defendants, plaintiffs' firms would most likely be unable to grow very large. This is true because the high costs of governance inherent in partnership structures generally would become intolerably large as plaintiffs' firms tried to make decisions about diversifying risk with ever larger numbers of decision-makers (partners).

Diversification of risk when investing in capital (labor, in the case of a law firm) depends not only on the number, but also on the types, of investment (in this case, tort claims). The partnership structure of law firms would make investment decisions for large numbers of cases prohibitive because of the collective decision-making costs of such vital decisions. In defense firms, there is far less pressure to diversify cases since these firms are compensated by fees, not by investing in the outcome of their clients' lawsuits, and by practicing in different areas of the law.

By contrast, the plaintiffs' bar practices in only one area of the law—litigation, and usually a subspecialty such as securities or medical malpractice—and diversifies risk by the cases it prosecutes. Accordingly, each decision regarding which cases to bring, the amount of resources to devote to each case, and the strategies for prosecuting the case become extremely important for the profitability, or even the survival, of a plaintiffs' firm. The more lawyers evaluating cases and the more cases brought, the greater the transaction costs of developing and acting upon information. In smaller firms, trust and confidence in each partner's judgment and skill serve to reduce, if not replace, these monitoring and

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151. Cf. Glenn Collins, A Tobacco Case's Legal Buccaneers, N.Y. TIMES, Mar. 6, 1995, at D1, D3 (reporting on ad hoc consortium of 60 plaintiffs' firms contributing $100,000 each to litigate against tobacco companies and one well-known attorney's claim that "[t]he good of the whole enterprise has transcended the individual egos").

governance costs.\textsuperscript{153}

Management committees in theory might be able to make some of the firm’s investment decisions, such as which cases to bring in order to diversify the firm’s overall risk. But such committees are more appropriate for the large, fee-driven firms of the defense bar. Although a committee may be able to select cases, the monitoring costs of tracking the prosecution of these cases would be very high, perhaps impossibly high.\textsuperscript{154} And imposing upon partners decisions concerning which claims to represent and how to do so would substantially subvert the very concept of partnership for many practitioners.\textsuperscript{155} Furthermore, a significant portion of a partner’s value to a firm is not simply her legal skills but her ability to generate clients, or, in the case of a plaintiffs’ firm, to attract and assess the value of tort claims. If the selection of claims to pursue is limited to a management committee, the value-added of partners to a plaintiffs’ firm would be significantly reduced\textsuperscript{156}—again undermining the value of lawyers as tort investors.

Current practice seems to confirm the preceding analysis. For although the plaintiffs’ bar is the wealthiest in the United States,\textsuperscript{157} most plaintiffs’ firms are rather small (the largest are no more than forty or fifty lawyers).\textsuperscript{158} If profitability is not the main determinant of the size of


\textsuperscript{155} See Hansmann, supra note 147, at 1783.

\textsuperscript{156} Contrast this with the defense bar, in which a few “rainmakers” may bring in clients for the rest of the firm or large institutional clients often have long-standing ties to the firm and are handed down to successive generations of partners. These clients are sufficiently large and offer sufficiently diverse work so as to enable non-rainmakers to be valuable to the firm by contributing specialized legal skills which the rainmakers may not possess. In plaintiffs’ firms, the legal skills are far more homogeneous, thereby placing a greater premium on attracting and assessing the value of claims.

\textsuperscript{157} Cf. Telephone Interview with Ward Bower, Principal, Altman Weil Pensa, Inc. (Apr. 23, 1993) (describing high compensation statistics as somewhat misleading because less successful plaintiffs’ firms often do not participate in bar economic surveys and/or are driven out of business).

\textsuperscript{158} In 1991, Ness, Motley, Leadholt, Richards & Poole, one of the largest plaintiffs’ firms, had approximately forty lawyers. Without its asbestos practice, it would most likely have had approximately fifteen. Telephone Interview with Terry E. Richardson, supra note
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plaintiffs' firms, the most likely cause is the above-outlined governance limitations imposed by a partnership structure.\(^{159}\) This Article will argue that because the partnership structure of law firms limits their ability to assume the risk of purchasing one hundred percent of tort claims,\(^{160}\) other investment forms, coupled with a secondary market, will be necessary to permit such purchases.

There are other reasons to question whether law firms would be the most competitive purchasers of tort claims, such as whether as institutions they possess sufficient entrepreneurial sophistication or can identify innovative claims more quickly and successfully than other potential investment groups. Nonetheless, Shukaitis's proposal for purchasing entire tort claims would take contingency fees and subrogation rights one logical step forward. It would eliminate the peculiar, legally-imposed restraints on the complete alienability of a particular kind of property—tort claims. The next section of this Article attempts to go yet further, proposing a full-fledged market in which tort claims are traded. In doing so, it explores the potential of a tort market to address some of the most difficult challenges confronting our tort system today.

III. Torts "R" Us: Constructing a Market for Tort Claims

A. Buyers and Sellers of Tort Claims

As with all transactions, a tort claims market requires willing buyers and sellers. But unlike many sales in which the parties must have a meeting of the minds only long enough to complete the sale, the dynamics of a lawsuit require that the parties maintain a relationship throughout

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\(^{159}\) But cf. Telephone Interview with Ward Bower, supra note 157 (describing how maverick personality of many plaintiffs' lawyers best suited to small firm practice).

\(^{160}\) A number of writers have suggested removing legal restrictions so that non-partners may invest in and own law firms. See, e.g., Hansmann, supra note 147, at 1814-15; Gilson & Mnookin, supra note 150, at 329 n.30 and sources cited. While Hansmann provides little elaboration of his proposal, the advantage of investors would presumably be to provide capital and to alleviate governance problems inherent in partnerships. Hansmann, supra note 147, at 1789-90.

Investment in law firms warrants more serious consideration than is possible here. It is important to note, however, that these proposals do not adequately distinguish between the plaintiffs' and defense bars. The above analysis regarding governance and monitoring problems and the corresponding differences between plaintiffs' firms and large, fee-driven defense firms would make investment in defense firms far more likely than in plaintiffs' firms.
settlement negotiations and possibly through trial.

Specifically, a potential buyer must be assured that the tort claimant is reliable and will assist, if necessary, in the vigorous prosecution of a claim which she no longer owns—or of which she owns only a small part. For her part, a seller must receive a fair purchase price as well as an incentive to continue to assist in the litigation if necessary. And as with all markets, both buyers and sellers will need confidence that such a market is free of fraud before they will participate. As we shall see, if there is a secondary market, in which tort claims are traded or resold to other purchasers, then information about such claims will have to be standardized and easily transferable so that non-primary purchasers will know and trust what they are buying.

1. Tort Claimant-Sellers

a. Incentives to Sell

A tort victim will have numerous incentives to sell her claim. In contrast to the present tort regime in which the process of discovery, settlement negotiations, and trial often takes years, such a sale will provide an accident victim with an immediate payment for her injuries. In the case of severe injury, where medical and other expenses may exceed a victim's insurance coverage, a quick payment could spare the victim and her family considerable additional hardships beyond the immediate ones brought about by the injury. And unlike in the current system where recovery is never certain, a tort victim who sells her claim would be assured, without risk, of payment for her injuries.

In addition to certainty and speed, the sale of tort claims will almost always provide tort victims with greater compensation than would be available under the present tort system. Under contingency-fee arrangements, as discussed above, plaintiffs' attorneys, as oligopsonists, do not offer competitive rates. And because they cannot diversify risk as

161. In fact, a victim need not sell her claim in order for a market to work. What is important is that the victim assign her claim to an investor in exchange for something of value. Instead of a sale, she could receive a loan, as in some subrogation agreements. See Miller, supra note 129. As we shall see, there are a wide variety of possible arrangements between a tort victim and an investor.

162. Only in the case of a bankrupt defendant, when some victims can race to the courthouse ahead of others and before bankruptcy is declared, will a few victims possibly be able to recover more than if they sold their claims to investors. See infra Sections III.B.3.a-c, III.D. The unfairness of some plaintiffs rushing to court to receive the full value of their claims while others have their claims discounted during bankruptcy exists currently as well.
well as tort investors due to the governance and diversification limitations of partnership structures in plaintiffs' firms, contingency-fee attorneys also have a higher cost of capital than would investors, again making them less competitive in bidding for claims. Investors will also be able to bring more innovative claims—claims which might never have been brought, such as those relying upon a novel legal theory—because of their greater ability to diversify risk. And in cases where claims are too small to litigate independently, 163 claimants will be able to sell them to investors who can consolidate them and pursue the claims economically.

Even absent a contingency-fee arrangement, tort claims investors will still be able to offer a tort victim a higher payment than she would receive if she paid her lawyer hourly rates. Not only will investors diversify the risks of litigation in ways that tort victims cannot, but investors will also be more sophisticated purchasers and monitors of legal services than are the vast majority of tort victims. And if, as in current class actions, tort claims investors were able to purchase and combine multiple claims, they could eliminate much of the duplication in litigation costs and, in turn, offer high purchasing prices to the tort victims. Furthermore, tort investors will be more effective settlement negotiators 164 than individual plaintiffs' firms, again passing on to the victim at least part of the claim's previously unrealized value. In sum, a tort claims market will enable a tort victim to receive a more certain, speedier, and larger damage award than is available under the current system. And in some cases, a market will enable a victim to receive an award when she might not otherwise have been able to pursue her claim.

b. Incentives to Participate in Subsequent Proceedings

Although a tort victim may have ample reasons to sell her claim, a buyer must be assured that the victim will be willing to assist in the vigorous prosecution of the claim, if necessary. 165 A tort victim may be called upon to testify, to be available for medical tests, and to endure a host of other arduous and possibly intrusive procedures. Without the

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164. See infra Section III.A.2.c.
165. In theory, all the elements of a tort would have to be proved for each claim and it is usually in the interest of defendants to litigate each issue to the full extent possible. See In re Joint E. & S. Dist. Asbestos Litig., 129 B.R. 710, 747 (E. & S.D.N.Y. 1991), vacated, remanded, and mandamus denied, 982 F.2d 721 (2d Cir. 1992). However when settling very large numbers of claims, the opposite extreme of relying upon general information subject to random audits may be more likely. Id. at 756-58; infra note 187 and accompanying text. In addition, such a large volume of claims often results in averaging claim values. See infra note 207.
victim's cooperation, however, an investor will be unable to bring the claim, rendering it valueless.

There are a number of ways to induce a tort victim's cooperation, even after she has sold her claim. As in insurance subrogation, a victim could contractually commit herself to assist in the litigation as part of the sales agreement between herself and the buyer. If a victim receives a loan instead of a payment, as in some subrogation agreements, all of the protections available to creditors would help ensure compliance. A victim might also be offered a continued stake in the claim. For example, she could receive a base amount and a percentage of the final award. Or she could be offered financial bonuses to participate at later stages, such as for testifying at trial. Another incentive would permit her to keep all or part of any punitive damages.

These examples by no means exhaust the kinds of incentives possible. Potential buyers could make all sorts of offers to tort victims, and in doing so will compete with each other on the terms of the purchase as well as on the amount. Furthermore, even after the sale of the claim, the claim purchaser (or if a secondary market for tort claims existed, a subsequent claims purchaser) could offer the tort victim additional incentives to render further assistance in prosecuting the claim if such help will make the claim more valuable.

This will allow tort victims to share in any increase in the value of their claims—whether as a result of a ruling, new information about the defendants or plaintiffs, or for any other reason—that accrues after the victims sell their claims. It is true that—unless tort victims retain a stake in their claims—tort claims purchasers will bear all of the risk of claims value fluctuation. This is so because victims will not have to refund the payments which they received for their claims, even if the values of such claims fall below the initial payment amounts, unless the victims originally agreed to do so. However, the ability of claims holders to enter into subsequent agreements with tort victims will offset somewhat the risk of claims value fluctuation. Such agreements will allow claims holders to maximize the value of their claims no matter when they purchased them, and thus will reduce their risk of purchasing claims in a secondary market.

Thus, a well-developed market will offer tort victims a wide variety of choices and incentives throughout the course of litigation. And, as discussed below, in light of the alienation from the litigation process plaintiffs in class actions currently experience, and the discounted damage awards plaintiffs currently receive, the options and incentives available in a tort claims market may even enhance the vigor with which some tort

166. See supra Section II.B.3.
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victims prosecute their claims even after selling them.

Finally, it is important to remember that tort victims are not simply profit-maximizers. On the contrary, plaintiffs generally, and tort victims especially, bring lawsuits not merely to recover damages. Whether motivated by justice or revenge, many tort victims will want to prosecute their claims whether they have sold them or not. These psychological incentives, while not prominently addressed in legal scholarship, are quite often the strongest incentives of all and are very familiar to practitioners and judges alike.167

2. Tort Claims Buyers

a. Purchasers and Purchase Prices

For ease of explanation, the term “claim” will refer to the value of all possible damages which a tort victim may pursue, including punitive damages. As already noted, tort victims may choose to sell only some of these damages, while retaining others. However, this may lead to conflicting interests between investors and victims during settlement negotiations with defendants, similar to those involving subrogation. Free-rider problems might also develop, with investors subsidizing most of the cost of litigation and the original claimants retaining a chance to collect the most lucrative part of the recovery. Accordingly, a market would encourage the sale of at least a portion of punitive damages along with the other damages involved in a claim.

From a jurisprudential perspective, there is no reason to prohibit the sale of punitive damages. Such damages are intended to punish behavior which threatens society generally and to discourage similar, future dangerous behavior.168 Since the goals and justification for punitive damages are not specific to the tort victim’s injury—certainly less so than compensatory damages—the transfer of punitive damages should be permitted. In any event, a developed market should enable buyers and sellers of tort claims to agree among themselves on the rights and responsibilities of the parties, thereby reducing the likelihood of such conflicts.

Whatever the composition of the claim to be sold, in theory anyone

167. See The People’s Court (television broadcast) (displaying vigorous advocacy by parties, despite small claim value and elimination of risk of out-of-pocket loss); see also McKay v. Ashland Oil, Inc., 120 F.R.D. 43, 50 (E.D. Ky. 1988) (discussing opportunity provided by summary jury trials for litigants to satisfy “psychological need for a confrontation with each other”).

168. See 2 AMERICAN LAW INST., supra note 16, at 236-43.
willing to purchase a tort claim would be able to do so. For a claim with an expected value of $10,000, for example, a buyer could offer $9,000 to a tort victim, the $1,000 difference reflecting both the time value of money and the risk that the claim will not be successful. Or, if the claim were for a sufficiently large amount of money, as in *Texaco, Inc. v. Pennzoil Co.*, investors will be able to buy shares in a single claim. The original plaintiff could retain an interest in the suit and control of the litigation, or the majority shareholders of the claim could take control of the litigation.

In either case, the buyers will then proceed against the tortfeasors as if the investors were the original plaintiff: pursuing discovery, participating in settlement negotiations, filing motions, and preparing for trial. To ensure that jury decisions will not be affected, knowledge of the transfer of claim ownership will have to be kept from the jury, just as the collateral source rule bars jurors from knowing that a tort victim is self-insured.

In addition to the amount and kinds of damages, the purchase price of a claim will reflect such factors as the solvency of the defendant and the number and nature of other, similar claims. As a result, not just anyone will be able to value, purchase, and pursue a tort claim profitably. In order to compete against contingency-fee attorneys and other investors and to realize the substantial advantages of purchasing large numbers of claims, purchasers will have to possess significant legal and technical sophistication as well as financial resources. With their understanding of

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See also Kurt Eichenwald, *Market Place: A Legal Strategy Ends in Dismissal*, N.Y. TIMES, Nov. 4, 1992, at D8 (reporting how, although eventually dismissed for lack of evidence, plaintiff-company's $1.8 billion lawsuit comprised its primary "asset" for which investors traded otherwise low-value company stock); *Shareholders to Get Goodwill Securities at California Federal*, supra note 119 ("California Federal Bank said it will issue a new security that will allow its investors to cash in big if the thrift wins a lawsuit [for $300 million] pending against the federal government. . . . the [Bank] has filed a registration statement with the Securities and Exchange Commission covering the new securities and hopes that they'll trade on Nasdaq.").

170. In the case of a single large claim by a publicly held company, some protection might have to be erected in order to uphold the rights of the company's shareholders who might still have a stake in the litigation, despite having been compensated in large measure by the company receiving the purchase price for shares of the claim. Furthermore, as discussed more fully *infra* Section III.C.3, parties will be able to hedge their exposure to risk by buying shares in each other's companies, again requiring special protection.

171. *See infra* Section III.B.3.a.
accidents, claims, and legal probabilities of success, insurance companies will be well-positioned to invest in a tort claims market. Independent investment companies or partnerships will be convenient vehicles.

Whatever their structure, and whether formed from insurance companies or as new ventures, investors will find a tort claims market attractive because of the numerous litigation advantages they will enjoy over both plaintiffs' firms and tort victims who can afford to pay hourly rates. Since these advantages will mean higher profits, investors will be able to provide victims with more compensation for their claims than would be obtainable under contingency arrangements and often under hourly fee arrangements. These advantages over the current tort system alone should be sufficient to induce investors to participate in a primary tort claims market. As we shall see, a market for mass torts and a secondary market in which investors may resell or trade their claims will offer investors additional incentives to participate.

b. Competitive Advantages and Profits

As already discussed, the unique form of capital possessed by plaintiffs' lawyers is legal labor, which is not very liquid. Because of governance problems associated with partnership structures, plaintiffs' law firms cannot indefinitely increase their legal capital (in the form of adding lawyers) in order to diversify their risks by taking on more and different kinds of cases. All fifty states currently prohibit investing in law partnerships, thereby retarding the ability of law firms to raise other forms of capital.

By contrast, investors in tort claims will contribute money rather than labor, will not have the same kinds of governance costs and limitations as law partnerships do, and will be capable of raising as much capital as they can attract. Accordingly, they will be able to invest in a greater number and variety of lawsuits, and thereby diversify the risk of their tort claims portfolios more than contingency-fee attorneys can. As more efficient risk-bearers, tort investors will have a lower cost of capital than contingency-fee attorneys.

172. See, e.g., SCHUCK, supra note 3, at 202-04 (finding financial contribution by some plaintiffs' attorneys far more crucial than legal labor to plaintiff class's ability to prosecute Agent Orange claims). However, the Second Circuit later struck down contingency fees based upon financial contribution. In re Agent Orange, 818 F.2d 216 (2d Cir. 1987). Cf. Glenn Collins, Judge Allows Big Lawsuit on Tobacco, N.Y. TIMES, Feb. 18, 1995, at A1, A47 (reporting consortium of 60 prominent negligence law firms each contributing $100,000 per year to fund lawsuit).
173. See supra note 150 and accompanying text.
Furthermore, to the extent that plaintiffs' attorneys cannot withdraw from a case after they determine that it is uneconomical to continue, their risk of undertaking contingency-fee arrangements will be even greater, especially for highly speculative lawsuits. As a result, the cost of their capital (legal labor) will also rise to discount this risk, thereby forcing them to demand an even greater percentage of the award as their contingency fee. By contrast, tort investors will be outright owners of the claims. They will be able to drop costly or risky litigation whenever they choose. With their risk of litigation and therefore cost of capital lower, tort investors will have a further competitive advantage over plaintiffs' firms.

Because they will be able to attract greater financial resources than plaintiffs' firms, tort investors will be able to employ or hire more experts in various technical areas, such as actuarial sciences, pharmacology, and even specialized legal fields, and to develop more sophisticated databases regarding various kinds of torts and tortfeasors. They will also be able to develop research in previously undeveloped areas of torts.

Thus, tort claims investors will be better able not only to prosecute claims but also to assess quickly the potential value of claims. For a multi-victim tort, a well-developed market will enable investors to collect a diverse but representative number of claims quickly, making valuation quick and accurate. Indeed, fast and efficient information processing is one of the hallmarks of capital markets.

By consolidating claims, investors will be able to capture certain economies of scale, such as avoiding duplicative discovery costs and attorneys' fees. Even when the claims are not related, similar claims against the same tortfeasor can be handled in bulk, much the way insurance companies handle claims in no-fault schemes. Investors will be acting as a kind of clearinghouse for claims in those states where, or for those types of torts for which, no-fault insurance is unavailable. Investors will also be more sophisticated purchasers of legal representation than

174. See, e.g., Haines v. Liggett Group, Inc., 814 F. Supp. 414 (D.N.J. 1993) (refusing to permit law firm's withdrawal from representation of plaintiff in tobacco litigation absent plaintiff's consent, despite fact that firm determined continuing litigation was uneconomical).

175. See infra Section III.C.2.a.

176. Cf. infra note 277 and accompanying text (describing inefficiency, high administrative costs, and other problems that currently plague claims resolution facilities handling mass tort claims against insolvent defendants).

individual plaintiffs, and will be able to monitor legal costs more effectively than would sole tort victims.

Furthermore, investors will not be as limited as lawyers regarding the amount of financial resources they are able or willing to commit to litigation. Under the current tort system, contingency-fee attorneys will not invest more resources than they believe they will recover from their fee. A lawyer or firm with a thirty percent contingency fee on a potential award of $100,000, for example, will invest a maximum of $29,999 in order to be profitable. (In fact, a lawyer will generally invest far less.) Plaintiffs' attorneys have a strong incentive to settle the case at less than the full value of what the client could have received in order to minimize the firm's costs and maximize its profits. In this way, contingency-fee arrangements often pit the interests of attorneys against those of their clients.

The alternative lodestar method for determining plaintiffs' attorneys' fees also gives plaintiffs' attorneys incentives to work against their clients' interests. The lodestar method requires judges to multiply the attorneys' "reasonable" number of hours worked by an hourly rate as established by lawyers of comparable skill in the community. Judges may then adjust this calculation for special factors, such as the riskiness of the litigation. One problem with this method is that it requires judges to assign values to a range of variables with little reliable data available. More troublesome from the plaintiffs' perspective, it also encourages attorneys to amass as many hours as possible—even by padding their hours or rejecting favorable settlement offers. And they may do so without monitoring by the clients whom they putatively serve.178

By contrast, tort investors will own the full value of the claim and pay attorneys an hourly fee. Because investors, not attorneys, will control the litigation, attorneys will have no incentive to settle below the actual value of the damages. Even if plaintiffs were able to afford to retain lawyers for a fee, investors would have far more resources and could resist being worn down by wealthy defendants more readily than could

178. See Swedish Hosp. Corp. v. Shalala, 1 F.3d 1261 (D.C. Cir. 1993) (discussing lodestar and percentage fee approaches and endorsing latter); Herzel & Hagan, supra note 139, at 25 (discussing practitioners’ view that lodestar formula’s emphasis on hours worked and hourly rates encourages padding of hours versus percentage fees which encourage pursuit of greater recoveries for clients). For a discussion of the problems posed by both compensation methods, see Macey & Miller, Plaintiffs’ Attorney’s Role, supra note 139, at 48-61. For a general discussion of agency problems in class actions, see id. at 12-27; Miller, supra note 142.
individual tort claimants. Permitting investors to purchase claims will also eliminate some of the attorney-attorney and plaintiff-plaintiff rivalries in class actions which may also undermine plaintiffs in settlement negotiations.

The advantages tort investors have over contingency-fee attorneys will result in fewer spurious lawsuits. This is so because investors will invest in those claims promising the highest expected returns. Deprived of those cases with the highest potential returns, contingency-fee attorneys will not be able to afford to bring more risky cases (those with a low probability of success and with damage values not high enough to offset the low probability). Contingency-fee attorneys will therefore be relegated to individual cases with relatively certain recoveries and low damages (damages small enough not to be attractive to investors because of the transaction costs associated with purchasing them).

179. See, e.g., Alison Frankel, Another Smoking Victim?, AM. LAW., July/Aug. 1993, at 60, 61 (reporting “strategy of attrition” by tobacco industry cost plaintiffs’ firm “more than $500,000 in out-of-pocket expenses (not counting the cost of more than a million photocopies) and another $3.75 million in lawyer and paralegal time.”); Charles Strum, Major Lawsuit on Smoking Is Dropped, N.Y. TIMES, Nov. 6, 1992, at B1, B5 (reporting law firm discontinued representing plaintiffs in smoking litigation “because of the cost and length [of the case] and because the firm would get little money unless the family were awarded damages. Such a prospect is daunting in the face of armies of highly paid legal talent retained by the tobacco companies during decades of litigation.”).

180. See infra Section III.B.3.b.

181. The expected return is defined as (i) the product of the probability of success and the value of the total damages, minus (ii) the anticipated cost of litigation. For example, if the damages are $10,000, the probability of success is 80%, and the expected cost of litigation is $3,000, the claim’s expected return is $5,000 ($10,000 x .80) - $3,000), not factoring in the time value of money, which would discount that amount by the prevailing interest rate and the estimated time it would take to prosecute the claim.

182. If the damage amounts are very high, the claim might still be worth pursuing even with a low probability of success unless the cost of litigation is prohibitively high. However, such damages would have to be very high indeed, and an attorney very lucky, to make this roulette strategy for bringing cases pay. This is because most contingency-fee lawyers do not have the capital backing to continue bringing low-probability cases until they finally get a successful verdict and reap a large damage award.

Of course, tort investors with their greater access to capital may be tempted to bring these and even riskier claims if they deem them profitable. This seems unlikely, however, since the owners and creditors of the tort investing entities would not tolerate such levels of risk when other capital market opportunities are available. Furthermore, investors who invested in such highly speculative cases would become vulnerable themselves to countersuits alleging that such lawsuits were brought in bad faith. Courts might also intervene to impose sanctions for such behavior.

183. It may be that some contingency-fee attorneys will try to offset the loss of their most lucrative cases from their portfolios by pursuing risky cases—whether or not the damage claims are very high. In the short term, then, a tort claims market may lead to a greater number of less meritorious lawsuits being filed. But such a strategy is bound to be unprofitable over the long term and would drive such attorneys out of business. Again,
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c. *Faster and Fairer Settlements*

Though investors will not have the same incentive as contingency-fee attorneys now do to settle for less than the actual value of the claims, they will, for a variety of reasons, settle as quickly or more quickly and at a higher price than contingency-fee attorneys.

As in the present tort regime, settlement eliminates risk and reduces some of the transaction costs involved in trial. Furthermore, since investor-plaintiffs will achieve closer parity in litigation resources with defendants than plaintiffs currently can, defendants will not be able to wear down plaintiffs as easily. And, as noted above, in mass tort litigation a tort market will develop information more quickly and fully, thereby providing investor-plaintiffs with greater access to information than current class action plaintiffs possess, even before discovery. As a result, discovery costs, which represent a huge proportion of litigation costs, should be smaller than under the present system. Even if the cost of developing information remains the same and is simply front-loaded to the time investors begin assessing claims in order to purchase them, similar levels of information between plaintiff-investors and defendants should lead to quicker settlement agreements.\(^{184}\)

Quicker settlements will enable investors to pass on to tort victims some of the savings from reduced uncertainty and from the time value of money. And since investors will recover more of the value of the damages than plaintiffs do when their contingency-fee lawyers settle at reduced values, investors will be able to pass on to tort victims part of this additional value in their purchase price.

3. *Market Integrity*

A well-developed tort claims market will minimize the possibility of fraudulent or unconscionable purchases. In contrast to neocontractual proposals under which potential victims sell their tort rights before any injury occurs,\(^{185}\) this proposal calls for sale after the injury occurs, when courts might also impose sanctions on those who adopt such a strategy.

\(^{184}\) *Cf.*, *e.g.*, McGovern, *Harnessing the Liability Lottery*, supra note 149, at 679 ("A multi-billion dollar difference between management's estimates and the plaintiffs' alleged total value of the Dalkon Shield claims, coupled with over a one billion dollar difference in estimates of the total value of the company, prevented negotiations from progressing past the preliminary stages.").

\(^{185}\) See, *e.g.*, HUBER, supra note 5; O'CONNELL, supra note 21; SUGARMAN, supra note 8; O'Connell, *Harnessing the Liability Lottery*, supra note 56. See generally 2 AMERICAN LAW INST., supra note 16, at 521-36.
a victim is in a better position to ascertain the extent of her injuries and her goals in pursuing her claim. A market will offer the tort victim numerous and diverse purchasing arrangements and a corresponding range of purchase prices offered by multiple would-be purchasers, in addition to those offered by contingency-fee attorneys. As a result, it will be difficult for a tort victim to be misled or deceived. Furthermore, some sort of mandatory buy-back option, which will allow the tort victim to repurchase her claim within a specified period of time, will also extend a considerable degree of protection to unsophisticated claims sellers (victims).

As discussed below, the cost to investors of developing initial information about the existence and nature of tort claims may sometimes be significant. But in a developed tort claims market, victims themselves will come forward to tort investors, virtually eliminating these costs in many circumstances. Just as modest, individual stock market investors could once seek advice at most Sears outlets, and patients can now have minor surgery performed at thousands of walk-in medical clinics throughout the country, tort victims will be able to contact tort-purchasing outlets. Furthermore, a well-developed market should spawn agents, possibly plaintiffs' attorneys, who will be able to package and promote tort claims—including medical records, videotaped affidavits by witnesses and victims, and brief summaries of legal issues—thereby enabling tort victims to market their claim for the best price and most favorable terms.186 Such standardized information187 will be important in a

186. I am indebted to Professor Geoffrey C. Hazard for this point. An example of the market responding to profit possibilities offered by mass tort litigation is Chemical Bank/Manufacturer Hanover's GEOSERVE, which manages "all aspects of claim settlement: establishment and notification of the classes, investment of funds, production and disbursement of checks and/or securities, and all related tasks." Letter from Leonard Wasserman, Vice President, Chemical Bank, to Honorable Eugene H. Nickerson, Eastern District of New York, 1 (Feb. 14, 1992) (on file with author). GEOSERVE manages claims settlements primarily in securities suits after lawyers have reached a settlement. It has already handled more than 200 class action cases, distributing more than $1 billion. Telephone Interview with Leonard Wasserman (Oct. 22, 1992).

187. See, e.g., In re Celotex Corp., 152 B.R. 661, 665 (Bankr. M.D. Fla. 1993) (allowing eight asbestos-related property damage claims to be selected as representatives for much larger number of claims in order to determine scope of insurance coverage); Cimino v. Raymark Indus., 751 F. Supp. 649 (E.D. Tex. 1990) (suggesting statistical sampling to extrapolate individual awards in large numbers of asbestos cases); Kenneth S. Abraham & Glen O. Robinson, Aggregative Valuation of Mass Tort Claims, 53 L. & CONTEMP. PROBS. 137, 139-149 (1990) (endorsing statistical claims profiles to value claims and for use as evidence by trier of fact in adjudication proceedings); McGovern, supra note 149, at 669 (reporting data pool to standardize information on hundreds of asbestos claims developed by parties under supervision of special master in Jenkins v. Raymark Indus., 109 F.R.D. 269, 288 (E.D. Tex. 1985), aff'd 782 F.2d 468, 471 (5th Cir. 1986)); McGovern, supra
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secondary market so that claims can be easily traded. Agents will also provide protection for purchasers against alleged victims selling fraudulent claims.

Thus, by creating incentives for large numbers of purchasers to buy claims, and for agents to assist victims in selling their claims, a tort claims market will minimize fraud for both buyers and sellers as well as expand competition for purchasing claims. Obviously, current laws against fraud and other legal protections will apply as well.

B. Mass Torts

The analysis thus far has focused primarily on buying and selling individual tort claims. But mass tort litigation in which numerous plaintiffs sue a common tortfeasor or set of tortfeasors based upon similar claims will also provide profit opportunities for investors. Although such litigation is sometimes handled by class actions, courts often refuse to certify class actions in mass torts due to the many individual questions as to liability, damages, and defenses, whereas the courts that have certified class actions have cited specific reasons for doing so.

note 149, at 683–84, 687 (reporting statistical sampling and individual case summaries of Dalkon Shield plaintiffs supervised by court-appointed expert and examiner).

188. Mass torts vary from single disasters with many victims, e.g., In re Federal Skywalk Cases, 680 F.2d 1175 (8th Cir. 1982) (regarding collapse of two Hyatt skywalks killing 114 and injuring hundreds), to prolonged exposure to or use of hazardous products or materials, e.g., In re DES Cases, 789 F. Supp. 552 (E.D.N.Y. 1992) (regarding in utero exposure to DES). Characteristics of mass torts include numerous victims seeking damages from the same defendants; claims arising from similar events or series of events; high costs attending individual litigation; and injuries being widely dispersed over space, time, and jurisdictions. See 2 AMERICAN LAW INST., supra note 16, at 390-91.


190. See, e.g., In re A.H. Robins Co., 880 F.2d 709, 740-43 (4th Cir.) cert. denied sub nom. Menard-Sanford v. A.H. Robins Co., Inc., 493 U.S. 959 (1989) (involving class action to determine only whether insurer jointly liable for manufacture and distribution of Dalkon Shield, with parties stipulating that individual issues of proximate cause and damages to be resolved in separate claims resolution procedure); In re Agent Orange Prod. Liab.

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Moreover, the Supreme Court in *Phillips Petroleum Co. v. Shutts*\(^\text{191}\) has raised doubts as to whether class actions in mass torts may be made mandatory so that plaintiffs cannot opt out.\(^\text{192}\)

1. The Benefits of Class Actions Without the Procedural Obstacles

Permitting investors to buy tort claims will achieve many of the advantages of a class action while eliminating many procedural and other difficulties of class certification in mass torts. This is so because as owners of claims, investors will be able to bring together in the same legal proceeding numerous claims without necessarily seeking class certification. Though the claims will have to be sufficiently similar legally and factually and arise out of the same transactions or occurrences in order to qualify for permissive joinder under Federal Rule of Civil Procedure 20(a),\(^\text{193}\) many class certification issues revolving around the litigation rights of individual plaintiffs (and the interests of their attorneys) will no longer apply. Nor will investors have to bring all of their claims.
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together in the same suit as contingency-fee attorneys do in classes actions. Instead, investors could file their claims in combinations which they believe would maximize their chances of recovery, or they could join claims for purposes of combining some phases of litigation, such as discovery, while conducting separate proceedings for other aspects of the litigation, such as determining damages.\textsuperscript{194}

Of course, the cost advantages of class certification for both plaintiff-investors and defendants will continue to make class certification the more desirable option for the vast majority of cases. A tort claims market will eliminate possibly the strongest objection to certifying a class in the mass tort context—that the personal injury victim will lose control over the litigation.\textsuperscript{195} Although in practice court dockets are often so overwhelmed as a result of mass torts as to render such individual control theoretical at best, victims in a tort claims market will have surrendered that control voluntarily.

Class actions pose jurisdictional problems as well. For example, each member of the class must meet the $50,000 “matter in controversy” minimum in order to satisfy diversity jurisdiction.\textsuperscript{196} Most jurisdictions permit a liberal good faith pleading to satisfy this minimum; but in a tort claims market, the market value of the claim would provide a stronger basis for courts to determine jurisdiction,\textsuperscript{197} especially when one party seeks to evade federal court jurisdiction.

Under current law, non-resident plaintiff class members who have little or no contact with the forum may pose a further jurisdictional problem.\textsuperscript{198} But if these plaintiffs sell their claims to investors,\textsuperscript{199} they will not be exposed to the expense, inconvenience, or other difficulties associated with litigating in a foreign forum.

Notice, too, presents a potential problem in mass torts. Currently, depending on the type of class action, each class member must receive either individual notice\textsuperscript{200} or notice reasonably calculated to reach all

\textsuperscript{194} For a discussion of consolidation of actions brought by different plaintiffs, see 7B CHARLES A. WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE AND PROCEDURE § 1783, at 75 (2d ed. 1986 & Supp. 1992); 9 WRIGHT & MILLER, supra, § 2384, at 271.

\textsuperscript{195} See 2 AMERICAN LAW INST., supra note 16, at 430.


\textsuperscript{197} This would also be true of claims not in a mass tort context.


\textsuperscript{199} Just as plaintiffs' attorneys currently do, plaintiff-investors will shop for a forum which has uncrowded dockets, traditionally generous jury awards, and other perceived advantages.

interested parties.\textsuperscript{201} As already discussed, not only will investors seek to contact as many claimants as possible, but claimants themselves, perhaps assisted by agents, will come forward in an effort to sell their claims. Even if all tort victims do not decide to sell their claims, a developed tort claims market will at least establish an information network, making it easier and less expensive for investors to publicize pending litigation and for potential sellers to come forward.

2. \textit{Investing in Mass Torts}

In addition to circumventing many class certification problems, a market will offer investors further advantages over contingency-fee attorneys in pursuing mass tort claims. Such a market will also streamline the litigation process in mass torts generally, by providing faster information on the number and diversity of claims.\textsuperscript{202}

As with purchasing a single tort claim, investors in a mass tort will purchase claims from individual victims. But by purchasing a claim, investors will possess a proportion of the total damages represented by the price of a particular claim. For example, if out of a total of $100,000 in damages from a particular tort, Investor X purchased a claim of $16,000 from Victim A, $9,000 from Victim B, and $10,000 from Victim C, Investor X would own $35,000 or thirty-five percent of the total damages. Investor Y might purchase a claim from Victim D for $40,000 and another from Victim E for $25,000, giving Investor Y a sixty-five percent share in the overall damages. In the simplest cases, the purchase price offered for each tort claim will be the value of the actual harm incurred minus a discount reflecting litigation risk and the time value of money. But as discussed more fully below, in mass tort litigation the nature and number of claims and the solvency of the defendants will also affect the value of the claim. After purchasing the claims, investors X and Y may bring their claims separately, join in the same suit but retain separate counsel, or jointly retain and monitor legal counsel. Section C will suggest various forms of investment structures.


3. **Complex Mass Torts**

Left unexplained in the above example are the factors affecting the purchase price of each claim. If each claim shares a certain uniformity as to cause of action, proof of liability, and other elements of a tort suit, the differences in purchase prices will primarily reflect the differences in damages. In such cases, mass torts will resemble an aggregate of simple, individual torts and a tort claims market will offer investors similar advantages. But in fact, there are a variety of mass tort scenarios which pose varying degrees of uncertainty for investors distinct from those involving individual claims.

Mass torts vary according to the type and value of the claims. One kind includes claims sufficiently large for plaintiffs to bring them separately by paying an attorney an hourly or contingency fee. In another, the claims are so small that only by combining them by means of a class action will they be brought at all. A tort claims market will work equally well for both of these kinds of claims, and will offer investors significant advantages over contingency-fee or even hourly-fee arrangements.

The third kind of mass tort combines the first and second kinds of claims, so that claims large enough to be litigated independently exist along with those which are not. The distinctive feature of these kinds of suits, according to Professor Coffee, writing in the context of class actions, is that "a high variance characterizes the settlement values . . . [and w]ith this variance come conflicts" among the tort victim plaintiffs.\(^{203}\)

a. **Claims Values in Mass Torts**

Whether a claim is settled or litigated, a variety of factors affect the variance in its value. In addition to the amount of damages, these factors include different or auxiliary causes of action among different plaintiffs, differences in the strength of claims, and differences in how sympathetic a jury is toward plaintiffs.\(^{204}\)

For example, in the case of a nuclear waste spill, a variety of people—children, pregnant women, landowners, and exposed workers—will be affected in some way. Their claims will not only differ as to the amount of damages involved, but also might present different causes of action, assert different duties of care, argue different theories of causation, involve different kinds of injuries, and require different kinds

\(^{203}\) Coffee, *supra* note 138, at 905-06.

\(^{204}\) See *supra* Section I.B.1.
of proof. These differences all affect the value of the claims.

The process of joining claims may also affect their value. Theoretically, in a mass tort action each claim should receive the same full value as if brought independently. However, when large numbers are resolved together either at trial or by settlement, some averaging of claims or decrease in aggregate claims value can occur, especially when the defendant is insolvent. Thus, in the case of a mass tort, the size of the plaintiff class may affect the aggregate award and, as a result, the value of each individual award when brought together.

These many variables may seem extraordinarily speculative and expensive for tort investors to value, but they are not at all unique to a market for tort claims. Currently, plaintiffs' attorneys, defendants, and insurance companies all estimate the aggregate value of damages in a mass tort. As already discussed, a tort claims market will expand the number of participants engaged in this type of analysis and will result in the development of greater legal and technical sophistication to assess these factors. Furthermore, a tort claims market will develop this information far earlier and more accurately than does the current tort system, thereby allowing the court and all parties to make more informed decisions much earlier.

b. Rivalries Among Plaintiffs, Between Plaintiffs and Their Attorneys, and Among Plaintiffs' Attorneys

The above differences between various groups of claimants in mass torts often result in conflicting interests. In class actions, this conflict is referred to as "interclass rivalries," and includes adverse selection problems in which weaker claims are combined with stronger ones, sometimes resulting in either averaging of damage awards or permitting questionable claims to recover at the expense of strong claims in order to achieve settlement; free rider problems in which some

205. E.g., McGovern, supra note 149, at 671 (in asbestos class action, "average value of the class action cases was 25% lower than the mean prior settlement values").
206. Cf. infra notes 273-74, 277 and accompanying text (describing inefficiency, high administrative costs, and other problems that currently plague trusts and claims resolution facilities handling mass tort claims against insolvent defendants).
plaintiffs benefit from efforts undertaken on behalf of others, such as sharing in the fruits but not the full cost of discovery; incentives to opt out of the class and to race to judgment in an effort to ensure full and quick payments\textsuperscript{209} when the ability of the defendants to satisfy all claims is in doubt or when the number of claims will substantially prolong litigation; and other problems associated with the nature of class actions which attempt to resolve different issues and interests together.\textsuperscript{210}

Furthermore, class actions present attorney-attorney rivalries. Under the present tort regime, ad hoc plaintiffs' firms form in mass tort litigation. These firms represent different blocs of clients and use these blocs to bargain and politick with other attorneys for control of the case and division of attorneys' fees.\textsuperscript{211} Often, important strategic litigation decisions are made based upon this attorney competition and not upon the interests of the clients.

Currently, Federal Rule of Civil Procedure 23(c)(4) permits the division of claimants with different interests into subclasses, so that mass tort claims may sometimes still proceed as a class action despite interclass rivalries.\textsuperscript{212} Despite the potential for conflicts, most class actions are settled.\textsuperscript{213} Rule 23(e) requires courts to approve the settlement in order to protect absent class members who will be bound by the judgment.\textsuperscript{214} In approving settlements, judges must weigh several factors, including the conflicting interests of various plaintiff class members, their attorneys, and defendants; the general reasonableness and fairness of the proposed settlement; the risks and benefits of proceeding to trial; and public policy considerations.\textsuperscript{215} While not impossible, the task is Herculean, as courts


\textsuperscript{210} See generally Coffee, supra note 138, at 906-20; supra Section I.B.2. For an illustration of the divisions between various plaintiff groups in a complex mass tort litigation, see In re Joint E. & S. Dist. Asbestos Litig., 129 B.R. at 776-84.

\textsuperscript{211} See SCHUCK, supra note 3, at 192-223; Coffee, supra note 138, at 911-19; see also McGovern, supra note 149, at 667 (describing how 52 of 805 potential asbestos class members opted out because attorneys feared loss of control over their own cases and because lump-sum award would reduce their clients' recovery).

\textsuperscript{212} Compare cases cited, supra note 189 with cases cited, supra note 190.

\textsuperscript{213} See Franklin v. Kaypro Corp., 884 F.2d 1222, 1225 (9th Cir. 1989); 2 AMERICAN LAW INST., supra note 16, at 403 & n.38. It may be that only those cases in which interclass conflicts were not significant were granted class certification, thereby making settlement possible.


typically lack information underlying the settlement negotiations and face strong pressure to avoid further delay and expense.

By contrast, a market for mass tort claims will reduce if not eliminate many of the rivalries described above among different plaintiff groups and among their attorneys. Furthermore, since settlements will reflect agreement between the defendants and a small number of investors with aligned interests, courts will be spared having to balance so many diverse, sometimes nebulous, interests as they currently must do with class actions.

In an efficient and therefore liquid tort claims market, it would be unlikely that investors would hold only one kind of claim, i.e., to purchase only claims belonging to what would now be a particular subclass. Instead, investors will most likely hold combinations of claims—as measured by factors such as amount of damages, strength of evidence, varieties of causation theories available, sympathy value, and so forth—in order to diversify their risk and to protect their interests in litigation and settlement. Because of this diversity, investors will have aligned, not conflicting, interests in settlement negotiations. Although investors may be represented by different attorneys, these attorneys will be paid on a fee basis and thus will not have interests at odds with those of the investors. In the absence of conflicting interests, since defendants will no longer be able to divide investor-plaintiffs and since blocs of lawyers will no longer compete with one another in an effort to maximize their own fees, investors and defendants should be able to achieve faster and fairer mass tort settlements—again, passing on some of these savings to tort victims in the purchase price of the claims. Thus, just as a tort claims market will eliminate attorney-client conflicts, a mass tort claims market will reduce conflicts among plaintiffs and among plaintiffs' attorneys.

c. **Opting Out of a Mass Tort Claims Market**

In contrast to current class actions, there will be less likelihood in a tort claims market that victims will “opt out” by not selling their claims. If tort victims do not sell their claims, they will have to pay hourly attorney’s fees or contingency fees in order to pursue their claim. As outlined above, tort investors will be able to offer immediate, riskless, and

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216. Indeed, under most circumstances, trial courts are not supposed to inquire into the negotiation process (which might reveal much about the interests served by the proposed settlement), but are limited instead to examining the settlement as proposed. See, e.g., Thornton v. Syracuse Sav. Bank, 961 F.2d 1042 (2d Cir. 1992); Mars Steel v. Continental Ill. Nat. Bank & Trust, 834 F.2d 677 (7th Cir. 1987); cf. 129 B.R. at 849 (regarding judicially appointed advisers reporting to court throughout negotiations).

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often more competitive compensation to tort victims, making the prospect of pursuing their tort claims independently less attractive for victims.

Those tort victims with very high potential for jury sympathy and punitive damages\(^\text{218}\) might choose to pursue their claims alone in an effort to avoid the devaluation of their claims when mass tort claims are brought together.\(^\text{219}\) It is important to remember, however, that a particularly strong claim might enhance the overall success of the litigation. As a result, investors might offer a higher, not lower, purchase price, which should reflect the marginal benefit of combining that claim with the others. In that instance, a tort victim will likely sell her claim. Indeed, a tort victim will have an incentive to pursue her claim independently rather than selling it to a tort investor only if three conditions are met: (1) the claims are joined or certified as a class, (2) the claims would be devalued as a result of being brought with other claims, and (3) the devaluation would make it cost-effective to pay an attorney an hourly fee or the devaluation would enable a contingency-fee attorney to offer a higher recovery than the purchase price offered by an investor.\(^\text{220}\)

Although the number of victims opting out under a tort claims market is likely to be small, those tort victims that do opt out will not pose serious problems for a mass tort claims market. Though high value claims will help diversify the tort portfolios of investors, neither all nor even a majority of victims will have to sell their claims in order for investors to make a profit in mass torts. Investors could bring their combined claims separately or with other investors, leaving individual victims with high value claims to bring their own suits. This will lead to some adverse selection regarding which claims will be sold in a mass tort market. However, as long as the claims available for purchase are sufficiently numerous and varied, investors will still be able to diversify their risk and realize certain economies of scale and will receive these benefits to a greater degree than contingency-fee attorneys or individual claimants.

\(^{218}\) See Coffee, supra note 138, at 916-17.

\(^{219}\) See supra note 205 and accompanying text.

\(^{220}\) For example, an individual tort claim of $100,000 might be devalued to $90,000 if brought with others in a class action. An investor might be able to offer $80,000 to reflect some risk and the time value of money. A tort victim will choose to bring her claim independently and will not sell to an investor only if a contingency-fee lawyer will agree to represent her for less than 20% of the total value of her claim (so that she will recover more than $80,000) or if she can afford to pay hourly attorneys’ fees which will total less than $20,000. In fact, since investors can offer immediate and certain payment, the contingency or hourly fees will have to be even lower in order to induce a victim to bring her claim independently.
paying hourly fees. 221

In the case of mandatory class certification of all plaintiffs, tort investors will be subject to some free-rider problems. For example, investors might expend significant amounts of money pursuing litigation, whereas a few individual tort victims with high value claims will benefit without contributing their proportionate share. Another difficulty will be assigning control of the litigation. Plaintiffs' attorneys of individual victims might seek a premium for accepting reduced roles in the litigation. 222

But coplaintiff-investors will have significant leverage over individual claimants who risk devaluation of their claims in mass tort settlements. Even if tort victims were not willing to sell their claims, investors might be able to obtain cooperation from these victims and their attorneys in exchange for sharing information and resources and for agreeing to limit, as a condition of settlement, the degree to which individual tort victims' claims (and thus attorney contingency fees) will be devalued. While such cooperation cannot be coerced because a judge would have to approve the settlement, individual claimants and their attorneys will have significant incentives to cooperate and thus reduce free-rider problems.

C. A Secondary Market

The above sections illustrated how tort and mass tort claims markets will provide investors with numerous advantages over the current tort system in which tort victims pay hourly legal fees or retain contingency-fee attorneys. These advantages will result in profits for investors and faster, more certain, and often greater compensation for tort victims. A secondary market will bring additional advantages, such as providing greater liquidity to the claims, thereby reducing overall risk and allowing both investors and defendants to hedge their risks more effectively, and lowering the cost of capital to investors.

Thus far, this Article has described a tort claim in primarily legal terms—the holder of a claim may assert various rights and demands for compensation against an alleged tortfeasor. But as something suitable for exchange, a tort claim must have economic attributes as well. Since a claim may be traded or resold in a secondary market, a tort claim investment instrument must satisfy the demands of the market and state

221. Section III.D describes further competitive advantages over plaintiffs' attorneys that claims investors will enjoy when the defendant is unable to pay all claims in full.

222. See Coffee, supra note 138, at 911.
and federal regulatory regimes governing markets.223

1. **Forms of Investment**

There will be a variety of possible organizational structures for claims investment firms, including partnerships and publicly or privately held investment companies. Whatever their structure, the greater their access to capital markets to issue debt or equity, the greater the ability of such firms to lower their cost of capital and diversify risk. (Again, this lower cost of capital will offer claims investment firms a competitive advantage over plaintiffs' law firms.)

Like any business enterprise, tax, securities, and other legal considerations will influence the structure of the claims investment vehicle. But aside from various business and legal factors, the very nature of the tort will affect what sorts of rights and relationships exist between investors.

a. **Individual Claims from Single Torts**

Whether an investor would be willing to purchase an individual claim stemming from a single tort depends on the value and complexity of the claim. Investors might buy individual claims, even for a relatively small amount of damages, if issues such as liability are straightforward and the claims are easy to prove. Nearly all such claims will be settled, based as much on actuarial data as on the specifics of the claim. In such cases, investors will act as clearinghouses much the way insurance companies do in no-fault regimes, making up in volume what they lose in margin in order to make such claims purchases profitable.

As for more complicated idiosyncratic claims, just as under current tort law, these will have to be of greater value in order to be profitable for investors to pursue. By purchasing a variety of these claims, investors will be able to diversify their risk. Because investors can invest in a greater number and diversity of claims, they will be able to reduce their risk far more than contingency-fee lawyers.

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223. As already noted, it may be possible to sell different parts of a claim, such as compensatory damages, punitive damages, or even different theories of liability. For ease of explanation, however, a complaint will be considered as a whole, with only the total prospective damages subject to division into shares to be bought or traded.
b. **One Large Tort Suit**

In the case of a large suit, a plaintiff company may seek to spread to other parties the costs of litigation and the risk of non-recovery. In addition, it may wish to use what it believes will be its eventual award immediately, rather than wait. If so, the plaintiff may choose to sell shares of its suit to various investors who will then become co-owners of the lawsuit and divide the recovery in proportion to the amount they invested, minus costs. With voting based on ownership, shareholders of a suit could then elect a group, analogous to a board of directors, to direct the litigation, dividing costs among all shareholders. Or, if the company retained a significant stake in the suit, it could manage the litigation. Presumably any shareholder could retain separate counsel, but there would be no point in doing so since all shareholders, large and small, would have exactly the same claims with exactly the same interests. A majority vote would be necessary to approve settlement, with minority shareholders able to challenge any offer which distinguished between shareholders.

c. **Mass Torts**

Investing in a mass tort with multiple claims against possibly numerous defendants creates a different relationship among investors. As already explained with respect to a single mass tort, investors will purchase claims from a variety of tort victims in order to diversify their risk, thereby accumulating a diverse portfolio of claims. Although each investor could then bring his or her claims independently, investors will be more likely to bring them together in order to share litigation costs. Since each investor's portfolio of diverse claims will parallel that of other investors, investors will not be susceptible to division the way plaintiffs in class actions currently are.

For example, Investor 1 might own ten percent of Mass Tort A, Investor 2 might own twenty percent, Investor 3 might own thirty percent and Investor 4 might own forty percent. But each investor will own a roughly similar variety of claims in order to diversify his risk. Thus, Investor 1's ten percent will have some large claims and some small, some speculative and some relatively certain, some with novel legal theories and some which rely upon more established jurisprudence. So, too, will the portfolios of the other investors. Investors will likely want to share the costs of litigation, and thus will bring claims related to Mass Tort A together either by joinder or as a class action.

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224. See *supra* note 169 and accompanying text.
Presumably because there will be additional mass torts in which to invest, investors could further diversify their risk and share the costs of litigation by investing in Mass Torts B, C, and D. Plaintiffs’ attorneys almost never have the resources to invest in more than one mass tort at a time. As a result, a market in mass tort claims will provide a second layer of risk diversification for investors, again driving down the cost of capital.

In order to litigate jointly their claims against the same defendants in a particular mass tort, investors could adopt a variety of options to monitor the attorneys. They might form a joint holding company, agree informally or contractually as to certain rights and responsibilities, form a management committee or board to supervise the litigation, or adopt some other strategy. As with other kinds of joint action, voting could be in proportion to the purchase price of the claims held by each investor or, if there is an exchange market for such claims, in proportion to the market value of the claims.

2. Exchanging Claims

Investors will wish to sell or otherwise exchange claims in order to reduce their cost of capital and risk. Depending on the type of claim, such exchanges may not be economically practical. Furthermore, tax and securities regulations will affect the degree to which claims may be exchanged.

a. The Importance of Liquidity

Because of the time value of money, the longer an investor holds an asset such as a claim, the greater the risk that the value of the asset may be affected by fluctuating interest rates and other market changes. This uncertainty as to the value of an asset is itself a cost. Put another way, the longer a market investor must hold an asset before realizing a return, the riskier it is to purchase that asset. By contrast, the more liquid an asset—that is, the more easily the asset may be exchanged for something else of value—the easier it is for investors to change their asset holdings in order to adjust their overall portfolios for risk and rate of return on their investment. As a result, the more liquid an asset, the less the cost of owning the asset. Of course, the advantages of making tort claims liquid apply even more to the original tort victim, who in essence holds a portfolio of one claim: her own. Because she is unable to diversify her risk at all, she will have a strong incentive to sell her claim.
Furthermore, as discussed below, enabling the free exchange of tort claims will provide investors and defendants with additional opportunities to hedge their risk. From an economic perspective, a tort claims market will permit investors to agree upon who can derive maximum value from pursuing a tort claim and thus ensure assignment of the claim to the most efficient user.\footnote{225 See POSNER, supra note 53, § 1.2 & ch. 3 (discussing importance of transferability in order to achieve efficient use of property).}

b. Government Regulations

An overview of government regulatory requirements is far beyond the parameters of this Article. Because tax and securities laws might have a significant effect on the economic viability of a tort claims market, however, some of the more significant issues warrant the following brief discussion.

Currently, section 104(a)(2) of the Internal Revenue Code excludes from income any damages received (whether by settlement or verdict) for personal injury or sickness so long as the claim arises in tort. Although the law is neither simple nor settled, as a general matter tort victims are not taxed on recoveries for their personal injuries. If, however, a tort victim were to face taxation on the income derived from selling her claim to an investor, the purchase price would have to rise accordingly in order to induce the victim to sell. Investors will certainly be taxed on their profits just as plaintiffs' attorneys are taxed. If an investor is a publicly held company, the shareholders will also be taxed. Thus, a tort claims market might subject personal injury recoveries to a multitude of taxes. Adjustments in the tax law may be necessary in order to make such a market economically feasible.

Securities regulations may also affect a tort claims market. If investors are publicly held companies, they will have to meet various disclosure requirements in order to issue securities. Trading or selling claims in a secondary market may similarly invoke reporting requirements of various securities laws. But since each tort suit would be unique and relatively short-lived, an exemption from, or modification of, these requirements may be necessary in order to avoid the significant costs of compliance. If purchasing and trading tort claims were limited to sophisticated investors, as most likely would occur given the expertise necessary to compete in such a market, the registration and reporting requirements could be minimized.
c. **Market Demand for Information**

Even without securities regulations, the market will demand that sellers develop information and make it available to potential buyers in a secondary market. The costs of developing information about various elements of the claim—the kind of tort, damages, injuries, causation, and liability—will be low for some kinds of torts such as single event disasters. However, many kinds of tort claims are not nearly so straightforward. In the mass tort realm of toxic or pharmacological torts, for example, the very existence of a cause (or causes) of action may take substantial research to discover, let alone to prove.

Those who undertake this research will want to protect their costs of discovery, since information regarding one claim may apply to other claims not yet purchased by those funding the research. This information, in addition to the amount of damages underlying the claim, will constitute part of that claim’s value. But a market for tort claims will require public disclosure of information about claims. For an efficient market to ensure the best price for the tort victim, all potential purchasers must have equal access to information about the claim at the time of the initial sale. Purchasers in a secondary market will also need some basis by which to appraise the claim’s value. Beyond trading concerns, investors will eventually need detailed information about their claims in settlement negotiations or as evidence in trial. Some investors might then free ride on such public information when prosecuting their own claims.

How might a tort claims market deal with information development, information verification, and the sale of a sometimes idiosyncratic product such as an individual tort claim? One way to address these issues would be to distinguish between the different kinds of investment scenarios outlined above. Miscellaneous individual claims stemming from their own, distinct torts will most likely not be traded or exchanged on a secondary market. Unless the claims were very valuable, the costs of standardizing and packaging information will most likely exceed any benefit from being able to trade it in an exchange. However, as discussed below, pooling and securitization of these claims or private sales arranged through a kind of clearinghouse may still afford opportunities for a secondary market in these claims.226

Most claims of modest value should not require protection of information costs incurred during the initial sale (the primary market) between buyers and sellers. Because of the limited value of these claims, investors will not spend very much money to develop information about

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226. See infra Sections III.C.2.d-e.
them in the first place. In fact, as already discussed, victims themselves will be more likely to spend money for agents to market their claims.\footnote{227}{See supra note 186 and accompanying text.} Although investors might need to invest money to develop information about distinct, high value tort claims, the costs of discovery will be minimal while subsequent information about the claim will not have to be disclosed until after a purchase from the tort victim. Since no other claims would be similar, no free rider problems posed by other investors would result.

As for selling shares in one very large claim, such as \textit{Texaco, Inc. v. Pennzoil Co.}, the original plaintiff will want to invest sufficient money to appraise the claim and market it successfully to investors. Just as it would when issuing any other security, the plaintiff will have to issue standard information to all investors. Investors could then split the subsequent information costs. And since each share in the total claim will resemble another, information about the shares could easily be standardized for sale in a secondary market.

In purchasing individual claims in a mass tort, investors will face certain costs of developing information. Other investors may attempt to appropriate information already developed by bidding for similar claims from other tort victims. However, any competitive enterprise faces similar sorts of challenges. A secondary market could standardize the collection and distribution of information, through the use of questionnaires, affidavits, and even videotaped depositions.\footnote{228}{See supra note 186 and accompanying text (marketing claims); supra note 187 (standardizing information about claims).}

d. \textit{Reselling Claims}

Just as there will be a variety of ways to structure firms investing in tort claims, so too there will be a variety of ways in which investors can resell tort claims in an effort to reduce the risk and cost of capital of purchasing tort claims. This Section describes secondary markets for claims purchasers attempting to resell tort claims they have purchased. Because information costs vary with the type of tort claim, the form of exchange between purchasers and subsequent buyers should also vary depending on the type of claim. The next Section describes various ways tort claims may be securitized to provide even greater liquidity to a tort claims market.

Because information about an individual's distinct tort claim is idiosyncratic, and because such information constitutes part of the value
of a claim, the exchange of such claims will most likely take place in private placements between investors unless securitization is possible. The majority of such claims, such as slip-and-fall or minor car accidents, will have a relatively low value. If exchanged at all, these claims will probably be sold or traded in bulk either to other investors or to a common defendant as a settlement. Although the selling investor will provide some basic information to support the sales price, this investor will be acting as a clearinghouse, informally providing its own credit to support the value of the claims. High value claims, with proportionately more information available, could be sold at auction or in private placements.

A plaintiff with a single, very high value claim (most likely a corporation) could sell shares over-the-counter. This is possible because there will be numerous, identical shares with standardized information.²²⁹ Again, securities laws requirements, which might inhibit such a market, could be minimized or avoided through exemptions.

Over-the-counter trading may also be possible for claims in a mass tort. Though each claim will have individual characteristics, once information regarding these variables is established, the value of the claims will primarily depend upon the progress of the litigation as a whole. As a result, large holders of these claims, independently or jointly, could act as market makers. Alternatively, some kind of informal exchange could be created among such holders. Even if subsequent information arose affecting the value of a particular set or subclass of claims, holders could still sell those claims to those more willing to bear the risk of holding them. Sellers could also bundle together for sale different kinds or subclasses of claims stemming from the same mass tort. These bundles would reduce idiosyncratic risks associated with particular claims, and limit risks to those affecting the litigation as a whole.

e. **Securitizing Tort Claims**

In addition to sales between tort claims purchasers, either in private placements or in a clearinghouse format, securitization of some kinds of tort claims offers another possibility for a secondary market in tort claims.²³⁰ For the purposes of this Article, securitization may be

²²⁹. See supra note 187.
²³⁰. This Section describes securitization of the underlying assets, the tort claims. Some of the advantages of asset securitization, such as access to capital markets and risk diversification, may be achieved to a degree by tort claims investors forming publicly held companies and using their tort claims holdings as equity for the company to issue stock or as collateral to issue debt. Cf. supra note 160. Unless an exemption were available, such companies would most likely be investment companies under the Investment Company Act.
understood as

the sale of equity or debt instruments, representing ownership interests in, or secured by, a segregated, income-producing [tort claim] or pool of [tort claims] in a transaction structured to reduce or reallocate certain risks inherent in owning or lending against the underlying [tort claim(s)] and to ensure that such interests are more readily marketable and, thus, more liquid than ownership interests in and loans against the underlying [tort claim(s)].

The chief advantage of securitization is that it provides greater liquidity than the sale of the underlying asset. In doing so, securitization both permits a reduction or reallocation of the risks of holding an asset and generates smaller, standardized, more fungible units which will attract a broader range of potential purchasers. This second point may be put another way: securitization provides greater access to capital markets. Because securitization results in a more efficient movement of capital, the cost of capital—whether debt or equity—will be lower. As a result, the yield demanded from purchasers of the tort claims securities will be lower, thereby lowering the cost of capital for tort investors. Again, this lower cost of capital will permit tort investors to offer greater compensation to tort victims than plaintiffs’ attorneys can offer.

A wide variety of assets have been securitized. Most of these assets have certain features in common. Securitization in a tort claims of 1940, as amended, and therefore subject to considerable regulation. See 15 U.S.C. §§ 80a-1 to 80a-64 (1988 & Supp. II 1990).

231. Shenker & Colletta, supra note 78, at 1374-75.

232. For a more sophisticated treatment of the advantages of asset securitization, see id.

233. Id. at 1375. Indeed, some have defined market efficiency in terms of securitization. See James C. Van Horne, Of Financial Innovations and Excesses, 40 J. FIN. 621, 622 (1985) (“A complete market exists when every contingency in the world corresponds to a distinct marketable security.”).

234. See Shenker & Colletta, supra note 78, at 1372, 1380.

235. Examples include commercial buildings, credit card and health care receivables, automobile and boat loans, mobile home loans, computer and other equipment leases, loans to franchisees, loans against the cash value of insurance policies, problem bank loans and junk bonds. Id. at 1380.

236. For example, most securitized assets produce a stream of cash flow to pay dividends on equity or interest and principal on debt. However, zero coupon bonds yield one variable payment at the time of maturity. Standardized terms, delinquency and loss experience sufficient for actuarial analysis of expected losses, and uniform underwriting standards and servicing procedures to satisfy rating agencies and investors characterize most asset securitization. Id. at 1377. However, not all of these features need be present in order
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market can take one of two forms. As already discussed, for a suit involving a very large claim, the claim may itself be securitized so that tort investors, rather than the company's owners, bear the risk and potential reward of litigation. A second scenario involves pooling claims237 with different profiles—damage amounts, causes of action, novelty of the theory of liability, the defendant's asset base, and so forth—and then issuing securities based upon the grouped claims. Of course, the two scenarios could be combined, with interests in large damage claims pooled with smaller claims.

f. Integrity of Secondary Markets

In any kind of exchange of tort claims, court rulings or any surprises in the litigation may have a substantial effect on the value of claims and thus their marketability.238 Assuming the claim values will be reported publicly on a regular basis as are other investment instruments, will the judicial process be influenced by the market in an unseemly way? Is it proper for a securities (tort claims) market to hinge on the vicissitudes of legal proceedings to determine the value of investments? The simplest answer is that neither scenario is unique to a tort claims market. Risk arbitragers and other investors currently monitor courtroom proceedings and trade stock as a result of litigation developments.239 Yet, there is no evidence that courts have made specific rulings as a result. Of course, appellate review provides another check against undue influence of a claims market on the judicial process.

for an asset to be securitized. Id. & n.31.

237. Assets are typically pooled for three reasons: (1) to achieve a sufficiently large asset value to make securitization economically feasible from a transaction cost viewpoint, (2) to reduce certain risks inherent in the assets through diversification, and (3) to create a large enough dollar volume to make a secondary market in the asset-backed securities feasible.

Id. at 1377 n.29.

238. See Bradford Cornell, The Incentive to Sue: An Option-Pricing Approach, 19 J. LEGAL STUD. 173 (1990) (attempting to construct option-pricing model to describe decision to continue or drop suit at various stages of litigation).

239. See, e.g., Seth Faison, Jr., Cigarette Ruling: Hour of Confusion, N.Y. TIMES, June 26, 1992, at D4 (describing wild fluctuation of cigarette stocks as tobacco company analysts and traders attempted to interpret initial reports of litigation); Lawrence M. Fisher, Ruling on Apple May Ease Development of Software, N.Y. TIMES, Apr. 16, 1992, at D1 (reporting computer manufacturers' stock prices rise after ruling dismissing numerous copyright infringement claims); Michael Orey, Smoke Signals on Wall Street, AM. LAW., May 1995, at 69 ("Suits against tobacco companies have turned industry analysts into docket watchers.").
3. **Hedging Strategies**

In addition to greater liquidity, which will itself reduce the risk of purchasing tort claims, a secondary market will provide both investor-plaintiffs and tortfeasor-defendants with new opportunities to hedge and thereby reduce the risk of either prosecuting or defending a claim in tort litigation.\(^{240}\)

**a. Hedging for Plaintiffs**

Currently, if the defendants are publicly traded companies, tort victims might in theory buy stock, purchase options, or otherwise invest in the defendants in order to hedge their risk. If they lose their litigation, tort victim-plaintiffs will at least receive some money from the increase in the value of the defendants’ stock. In practice, however, plaintiffs rarely have sufficient capital to make such a hedging strategy worthwhile. Furthermore, conflict of interest rules would prohibit contingency-fee attorneys from buying their adversaries’ stock. In a tort claims market, investors would be able to exploit these hedging possibilities more fully by investing in tort defendants. Any hedging strategies involving litigation may require modified insider trading prohibitions, such as Chinese walls and other methods, in order to prevent manipulation of the market prices of either tort claims or defendant stocks by means of litigation tactics. Otherwise, privately held information developed from litigation preparation might be used unfairly in public markets.

**b. Hedging for Defendants**

A tort claims market will also offer defendants new ways to hedge against the risk of litigation. Currently, in order to reduce their potential liability, defendants might buy, through settlement, some claims in a mass tort if a plaintiff class has not been certified. But it is difficult for defendants to identify those claims most worthy of settlement. In addition, such settlements might induce others to bring suit.

As already discussed, a tort claims market will improve the development and dissemination of information about tort claims, often at no cost to the defendant, thereby making settlement of the most meritorious claims easier. Furthermore, if investor-plaintiffs were publicly traded companies, defendants could invest in a tort investor’s stock,

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240. For a general description of financial hedging, see **Ross, supra** note 150, at 649-74.
thereby offsetting some of their loss if the claims prove successful. And for a very large tort claim, the defendants could buy shares in the claim just as other investors would, again offsetting potential losses. Here, however, non-party investors would definitely need protection in order to maintain the integrity of their investments during litigation.

c. An Options Market for Plaintiffs and Defendants

For those claims traded on a market—shares in a single, very large claim; multiple, similar claims in a mass tort; or securitized claims—an options market will provide an additional means for both plaintiffs and defendants to fine-tune their risks.\(^{241}\) An option is technically a contract which gives the owner the right to purchase or sell an asset—here, the tort claim itself or stock or debt in a tort claim investment firm—at a given price on or before a certain date.

For example, suppose that someone at the time a lawsuit is filed believes that the value of the claim will rise. She may purchase a call option so that she owns the right to buy the claim at the lower, earlier price if its value goes up. If the claim’s value goes down, she is “out of the money” and her option is worthless. Conversely, if she believes the claim is overvalued and the price will go down, she may “put the claim” so that she has the right to sell it at the earlier, higher price if its market price declines.

In the context of litigation, options in a claims market would provide an opportunity for tort defendants to recover some of their litigation costs. Currently, unless sanctions or costs are granted, successful defendants cannot recover any costs of litigation.\(^{242}\) However, with an options market in tort claims, if a defendant believes it will prevail, it can put a claim with a long expiration date and recover some of its litigation costs if it prevails. As one example, if the defendant wins during the life of the option, the claim will be worth nothing but the defendant will nonetheless be able to sell the claim (or the stock or debt of the claim investment firm) for the exercise price, thus profiting by its victory. Even absent an outright victory, any positive development throughout the litigation will reduce the claim’s value and potentially benefit the defendant put option holder. Similarly, for plaintiff-investors, an options market will further reduce the risk of litigation by allowing them to hedge and thereby drive

\(^{241}\) See id. at 562-93.

\(^{242}\) Cf. H.R. 988, 104th Cong., 1st Sess. § 2 (1995) (Contract with America proposal passed by House of Representatives modifying “loser pays” rule to require party which refused settlement offer and receives judgment inferior to such offer to pay opposing side’s legal costs accrued since the time of last offer).
4. Financial Markets

The following brief discussion attempts to show from the perspective of finance that tort claims investments will attract institutional investors who seek to diversify their portfolios with investments whose returns are relatively uncorrelated with that of the stock market. It also argues that the rate of return would be near the risk-free rate, thereby allowing investors to pay tort victims a high price for their claims.

Because tort investments will be uncorrelated with investors' existing investment holdings, they will offer a way of diversifying the risk of an investor's overall portfolio. A special case of this is the Capital Asset Pricing Model (CAPM). The model assumes the availability of a risk-free asset (such as treasury bills) with mean variant optimizers who seek the greatest expected rate of return for a given variability of risk. The model implies that everyone holds some combination of the risk-free asset and the market portfolio (M). M is defined as the point of tangency of the securities market line and the set of portfolios yielding the highest expected rate of return at a given standard deviation of risk.

In assessing the value of a particular security, the variance of a security's return is not the relevant consideration. The value to an investor of an instrument is determined by its effect on the investor's overall portfolio. The beta value is a measure of how adding a security affects the risk to a portfolio, enabling investors to plan what combination of the risk-free asset and the market portfolio they will keep. The beta value of an investment is the standardized co-variability of a stock's return with the market's return.

A very low beta indicates that return from the investment has a limited correlation with that of the market. Investors seek to minimize the risk in their portfolios. A low beta allows managers to reduce the overall risk of their investments while retaining high-yield securities in their portfolio. Because the return on tort litigation should be relatively

243. See Ross, supra note 150, at 295-312.
244. See id. at 255-89, 317-30. The beta of a security is the covariance of a security with the market divided by the variance of the market. In essence, it measures how closely the return of stock correlates with the return from the general market. A positive beta indicates that the investment is correlated with the market, whereas a negative beta indicates an inverse relationship. In addition, a high beta value, either positive or negative, indicates that the investment has a high sensitivity to market changes. For example, a beta of two would indicate that if the return on the market increased by 10%, the return on the individual security would rise by 20%. In other words, the expected return on an investment instrument is positively and linearly related to the security's beta.
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unrelated to that of the market, it would allow investors to diversify their portfolios.

Tort claims investments could offer portfolio managers an investment opportunity with a beta of near zero,\(^{245}\) which means that the return should be near the risk-free rate for the investors. With a near-zero beta, such securities would be an attractive means for portfolio managers to diversify their overall portfolio risk. The market appeal of tort claim securities would enhance the price received by the original claims holders (victims).

Within a tort claims market generally, the systematic risk will vary. Some influences on the value of claims will be specific to the individual claim, while others will affect all claims in the same suit. Interest rates, information revealed during discovery, new information about the original victim on which a particular claim is based, changing financial condition of the corporate defendants or their insurers, and even particular rulings at trial could affect the value of the whole suit or the value of particular claims.

Although these elements of risk may make such investments seem highly speculative, as explained above, risk is not measured on a claim-by-claim basis, but rather by the effect of an additional investment on an investor’s entire portfolio. With less access to capital markets and less ability to diversify their portfolios, contingency-fee attorneys will not be able to reduce appreciably the risk posed by individual lawsuits. By contrast, investors will be able to diversify away much of the risk posed by the variables listed above. Furthermore, all of these risks are present in the current tort regime.\(^{246}\) Even so, class action suits are still brought

\(^{245}\) The above analysis assumes that tort investments would be relatively uncorrelated with the entire non-claims market of investment opportunities. Claims investments would, of course, be correlated with each other. If the tort claims market expanded such that tort claims became a significant portion of the overall investment market, then tort investments would not have as strong a risk diversification effect on investors' portfolios. The beta of such investments will rise and therefore the expected rate of return will become higher than the risk-free rate. As a result, tort victims will not receive as high a purchase price for their claims. This does not present a problem for a tort claims investment market, however. This scenario merely states that if everyone becomes a tort victim and wants to sell his or her damages, people will not get as much money for their claims. Though it is highly unlikely that a tort claims market would assume such a significant portion of the overall investment market, the market would to some degree offset the increase in potential claims by lowering the amount of money people could receive for them.

\(^{246}\) In practice, these variables, individually or collectively, should not be difficult to assess. Information about particular claims should be highly developed in a tort claims market, as should information about the corporate defendants. As noted above, with greater technical expertise and more in-depth information from the victims, discovery should produce fewer surprises than under the present system. It would certainly not produce any more. In the case of a mass tort, once information regarding particular claims is developed, then the
by firms with less sophistication in predicting and monitoring many of these variables, or in diversifying risk. Finally, the financial markets have many kinds of highly speculative investment instruments. The market, not ancient legal prescriptions, should be the ultimate arbiter of whether such suits are attractive investment opportunities.

D. Bankruptcy: Tort Litigation Against Insolvent Defendants

Tortfeasors are sometimes, although not commonly, unable to meet fully their potential liability from a mass tort. Tortfeasor liability exceeding tortfeasor assets poses special legal and equitable problems, because those who have been injured must compete with each other, as well as non-tort creditors, in order to receive as large a portion of their claims as possible. A tort claims market will not solve the basic dilemma of tort victims' claims exceeding tortfeasors' assets. Nonetheless, a

only variables will be systematic ones affecting all the claims together and in like manner. It is also important to remember that even now, lawyers constantly assess litigation strategy and the odds of success. An expanded market would expand the number of persons making these assessments, thereby adding to the expertise and information regarding the suit. Compare polling, jury sampling, mock trials, and other examples of using social science techniques to minimize uncertainty in high-stakes litigation.

247. See, e.g., Saul Hensell, For Rogue Traders, Yet Another Victim, N.Y. TIMES, Feb. 28, 1995, at D1, D8 (reporting derivatives trading losses of billions of dollars in, and bankruptcies of, Orange County and Barings P.L.C.); Jonathan R. Laing, The Next Meltdown?, BARRON'S, June 7, 1993, at 10 (describing derivatives as "those Computer Age combinations of off-exchange swaps and options that are designed to mimic . . . . the price action of underlying interest-rate, foreign-currency, stock-index or commodity markets").


tort claims market will perform many of the functions of a bankruptcy proceeding in a quicker and more comprehensive manner.

In bankruptcy, all creditors, including tort victims, receive a fraction of their credit claim against an insolvent defendant who cannot pay everyone in full. This partial payment occurs after a long and very often expensive process initiated by either creditors forcing the debtor into, or by the debtor voluntarily declaring, bankruptcy. The debtor then notifies its creditors and additional creditors file claims. Next, the debtor and sometimes the creditors propose a plan of reorganization or liquidation. In mass tort cases, a representative is appointed to protect latent tort claims, the value of which is very uncertain. The creditors vote upon the plan of reorganization, which must eventually be approved by the bankruptcy court. A trust is established from which payments to present and future claimants are made; and a claims resolution facility is established to adjudge the value of present and future tort claims.

A tort claims market will similarly pay people the present value of their claim, which will again be discounted as a result of the defendant’s insolvency and the time value of money. A market, however, will provide incentives for more people to come forward more quickly to assert their claims in order to get paid immediately. With faster and more accurate information, a claims market will indicate the defendant’s potential tort liability quickly. As a result, it will signal the need for bankruptcy proceedings early; will provide highly accurate information about present and future claims; will provide a basis for estimating the size of the trust; will, in some cases, eliminate the need for a trust; and will reduce the complexity and costs of claims resolution facilities to appraise the value of present and future claims.

1. Developing Information About Tort Claims and Defendants in the Bankruptcy Context

As already discussed, mass torts pose enormous potential problems for courts and litigants. These problems include overwhelmed court dockets; delays; costly and redundant proceedings; state-federal and federal-federal jurisdictional problems; choice of law issues; and class rivalries, as when plaintiffs with high damage claims rush to judgment at the expense of the remaining plaintiffs. Bankruptcy law provides courts with powerful tools to mitigate these problems. By combining all proceedings before one forum, the court in effect creates a mandatory
class action in which plaintiffs may not opt out. Furthermore, the court can apply uniform rules of law in order to streamline the litigation. As is frequently done in toxic tort cases, the court can protect the rights of future claimants by appointing a representative. And, as a general matter, the court has considerable powers and potential to innovate, since a bankruptcy is an equitable proceeding.

A defendant corporation need not be insolvent in order to be eligible for bankruptcy protection. In the current tort regime, mass tort defendants usually file for voluntary bankruptcy. Indeed, in the Johns-Manville case, the plaintiffs challenged, albeit unsuccessfully, Manville’s good faith filing of its bankruptcy petition, claiming that the corporation was using Chapter 11 to suspend asbestos litigation and avoid its exposure to tort liability.

Despite the power of bankruptcy courts to handle mass tort cases in an equitable and innovative manner, serious problems persist. The

250. Although the district court retains jurisdiction over tort claims, 28 U.S.C. § 157(b)(2), (5) (1988), and the bankruptcy court over “core proceedings,” id. at § 157(b)(2), (3), a bankruptcy court may make recommendations of law and fact as to tort liability subject to de novo review by the district court, unless the findings are by trial, in which case § 157(b)(5) requires that the trial be before the district court. See Newton v. Johns-Manville Corp. (In re Johns-Manville), 45 B.R. 827, 829 (S.D.N.Y. 1984); In re UNR Indus., Inc., 45 B.R. 322, 326 (N.D. Ill. 1984).

251. See, e.g., In re Joint E. & S. Dist. Asbestos Litig., 129 B.R. 710, 869-905 (E. & S.D.N.Y. 1991), vacated, remanded, and mandamus denied, 982 F.2d 721, 745-49, 751 (2d Cir. 1992) (admonishing that “[w]hatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code” (citation omitted)).

252. See, e.g., In re Johns-Manville Corp., 36 B.R. 743 (Bankr. S.D.N.Y. 1984) (appointing legal representative for future claimants who were deemed parties in interest under 11 U.S.C. § 1109(b)).

253. See, e.g., In re Joint E. & S. Dist. Asbestos Litig., 129 B.R. at 842-43 (limitations on trial court’s authority to innovate once reorganization plan “confirmed and substantially consummated” imposed by § 1127(b) of the Bankruptcy Code); see also Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206 (1988) (equitable powers of bankruptcy court must be exercised within confines of Bankruptcy Code). For criticism of bankruptcy proceedings in mass torts, see Peter Huber, Catastrophe and Compensation: Reassembling the Pieces, in LEGAL SYSTEM ASSAULT, supra note 10, at 31 (criticizing both class actions and Chapter 11 reorganization, as means of mass compensation, as “post hoc, ad hoc, and under the largely unguided control of a single judge”). See also RICHARD B. SOBOL, BENDING THE LAW: THE STORY OF THE DALKON SHIELD BANKRUPTCY (1991) (highly critical of district judge’s rulings in Dalkon Shield case as unfair to plaintiffs).

254. See, e.g., In re Johns-Manville Corp., 36 B.R. at 745.

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uncertainty as to future liability and therefore the extent of the debtor corporation’s debt currently presents significant problems for approving a plan of reorganization. Upon confirmation of a plan of reorganization, the debtor is discharged from any debt that arose or is deemed to have arisen before the date of confirmation, unless the order of confirmation provides otherwise. 256 Because Chapter 11 proceedings almost always extinguish all outstanding debt at the time of approval of the plan of reorganization, tort claimants can be excluded from recovery if they do not participate in the proceedings. For latent injuries which will not manifest themselves until after the confirmation date, a court may appoint a representative in order to protect the interests of future claimants. However, these representatives often fail to gain full entitlements for future claimants. 257

Even those victims who are already aware of their injuries and have reason to know their causes may also face problems. These victims must usually file their claims before a “bar date” or else their claims will be permanently disallowed. 258 However, some courts have allowed class action proofs of claim to be filed in an effort to protect claimants who, for lack of notice or some other reason, have not filed individual proofs of claim for themselves as required by the Bankruptcy Code in order to assert a claim against the debtor. 259 Whether by means of class action proofs of claims or some other process, courts often estimate the number of claimants and their damages when developing a reorganization plan in an effort to approximate the debtor’s total liability resulting from personal injury claims. 260

Yet current methods of estimating tort liability must usually rely upon limited information, resources, and expertise. These problems are heightened when estimating future contingencies, especially future claims. As a result, estimates of tort liability are very imprecise in the bankruptcy

257. See SOBOL, supra note 253, at 107-15 (zealous efforts of representative insufficient to protect future claimants in Dalkon Shield litigation); Smith, supra note 177, at 371-78 (future claimants receive less than fair share in mass tort bankruptcy); Yang, supra note 153.
context.\textsuperscript{261}

Markets, by contrast, involve thousands of decision-makers assessing complex information quickly. A tort claims market will already have developed information regarding mass tort claims in a relatively quick, efficient, and accurate manner. Thus, a market will provide an alternative to class action proofs of claims and reliance upon court-appointed or court-approved experts for estimations of total tort liability. The market value of such tort claims will indicate, with far greater accuracy than currently available to bankruptcy courts, the present value of all tort claims—no matter whether retained by the original plaintiffs, owned by investors, or held by future claimants—and thereby aid in determining the feasibility of a proposed reorganization plan.\textsuperscript{262} Moreover, the market value of these claims will have been discounted for future liability stemming from future tort claims. Thus, a claims market will treat present and future claimants alike for purposes of compensation.\textsuperscript{263}

Ascertaining this information will entail costs for investors. Although sophisticated tort claims purchasers will most likely develop information quickly, there may be some situations where investors will purchase a significant number of claims before ascertaining the full scope of the claims facing the defendants and the ability of the defendants to pay the claims. If so, the investors will likely have overpaid for these initial tort claims, because they will not have discounted the purchase price of the claims to reflect the probability of the defendant’s inability to pay the full amount of damages. Nonetheless, the mandatory inclusion of all claims in a bankruptcy proceeding, the subsequent discounting of the claims’ value, and the delay accompanying such proceedings may induce most

\textsuperscript{261} See Sobol, supra note 253, at 97-114 (reviewing problems with proofs of claim in Dalkon Shield mass tort, though not in certified class action context); id. at 178-97 (reviewing problems with tort liability estimation procedure followed by Dalkon Shield bankruptcy court); Gregory A. Bibler, The Status of Unaccrued Tort Claims in Chapter 11 Bankruptcy Proceedings, 61 Am. Bankr. L.J. 145, 181-82 (1987) (criticizing practice of bankruptcy courts’ estimating debtor’s tort liability for purposes of approving reorganization plan as effectively limiting recovery prospects of future claimants); Bono, supra note 259, at 327-28 (class actions unhelpful for estimating tort liability of debtor in bankruptcy); Smith, supra note 177, at 384 (“Empirical evidence suggests that bankruptcy courts tend to overvalue reorganized firms, resulting in at least the temporary illusion that the reorganization gives all creditors and interested parties some reasonable value for their claims.”).


\textsuperscript{263} Because all debts of the defendant corporation will be discharged, future claimants will still be under the jurisdiction of the bankruptcy court. Otherwise, these later claimants would receive more in damages than those who had filed claims during the bankruptcy and whose claims had as a result been discounted. See infra note 278 and accompanying text.
victims to sell their claims after the tort defendant-debtor enters bankruptcy even as the value, and consequently the purchase price, of the remaining tort claims decrease.

Accurate information regarding the value of tort claims is important not only for estimating the debtor's liability, but also for purposes of voting in order to approve a reorganization plan. The Bankruptcy Code provides that the court may deem a plan of reorganization accepted by a class of claims if votes in favor of the plan are cast by creditors "that hold at least two-thirds in amount and more than one-half in number" of the claims in each creditor class. This two-thirds requirement is important because many people with small claims who would most likely receive nearly the full value of their claims would otherwise be able to override the interests of the relatively smaller number of people with large claims, the value of which might be significantly discounted in a reorganization plan.

Nonetheless, because of the lack of developed information regarding the number and amount of claims, courts in mass tort cases often treat all claims as the same and disregard the Code's specific requirement of the approval of creditors holding at least two-thirds of the aggregate value of all claims in each creditor class. A tort claims market, by contrast, will approximate values for each of the claims, thereby permitting courts to satisfy both prongs of Section 1126(c). Indeed, since investors would most likely hold similar portfolios of large and small claims, they should vote together, thereby easily satisfying the Code.

The market's determination of the value of claims would not be binding on a court, but it most likely would be followed. A tort claims

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264. Bankr. R. 3013. A class of creditor claims for purposes of a plan of reorganization is different from classes of tort claims for purposes of class certification. So long as they do not formulate classes in order to manipulate voting, reorganization plan proponents have significant discretion in grouping claims, including tort claims, into creditor classes.


266. Because small tort claims could be more easily paid in full than large tort claims, it seems reasonable to expect that they should be grouped in different classes in any reorganization plan. See generally William Blair, Classification of Unsecured Claims in Chapter 11 Reorganization, 58 Am. Bankr. L.J. 197, 228-30 (1984).

market will already have done the work of a claims resolution facility, at
least for present claimants, and investors will already possess information
in standardized form to support the value of their claims before the court.
Of course, a court (on its own, by means of a claims resolution facility,
or with the help of experts) will still have to assign values to the claims.
A market will not obviate the need for this determination, but it will assist
the fact-finder by providing an abundance of well-developed, standardized
information with which to value claims. Although a court could seek
additional evidence and differ with the market’s valuations, it is difficult
to see what information a court would seek, what previously untried
methods and resources a court would apply, or what determinations a
court would make that investors would not. In any event, the possibility
of a court award deviating from the market value is part of the risk or
reward of investing in such claims.

Just as now, a trust will pay present claimants as money becomes
available from the reorganized company, and will pay future claimants
as their claims arise. Assuming present claimants will not have the option
to seek separate trials until all other claims have been paid, as is usual in
such mass tort cases, the task of the future claims resolution facility will
be ministerial and involve matching future claimants with those who had
come before them. Indeed if torts investors, based upon their appraisal
and settlement experience gained from earlier claims, purchase these
future tort claims when they ripen, the task of a claims resolution facility
will be quite ministerial. Much of the complex and costly fact-finding of
claims resolution facilities\(^{268}\) will be significantly reduced, if not
avoided. A court will still have to determine how much money will
eventually go into the trust in order to determine how much each claim
will be discounted before payment. But again, the court will be aided by
the information produced by the tort claims market.\(^{269}\)

2. **Tort Claims and Leveraged Buyouts: Further Reducing
   Transaction Costs and Eliminating the Need for a Trust**

   In addition to allowing the rapid development of information, a tort
claims market will enable investors willing to accept ownership of the
ongoing enterprise to do so. The huge costs and delays caused by
negotiating reorganization plans can be reduced or avoided, a claims

\(^{268}\) See infra note 277.

\(^{269}\) If tort claims continued to trade, their value will signal to the court what the
market believed the appropriate amount of the trust to be: a decline in the trading price
would signal less than the market expected, a rise would signal more.
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resolution facility will be largely ministerial, and claims trusts to pay tort victims may sometimes be unnecessary.

The vast majority of tort victims, especially those suffering from severe medical harm, are interested in recovering as much of their claim as quickly as possible. A share in an ongoing interest which could be sold or traded, similar to stock, might offer tort victims an alternative form of compensation. But under the present system, corporations in bankruptcy either reorganize under Chapter 11, with a trust created to pay tort damages, or sell their assets under Chapter 7 and use the proceeds to pay the creditors, including tort claimants.

Although Chapter 11 is generally favored because participants usually receive greater value from an ongoing concern than from liquidated assets, the transaction costs of reorganizing a company and creating and administering a trust can be huge. Under the original trust established in the Johns-Manville case, for example, in one year alone expenses included $50 million for outside counsel, $25 million in administrative costs to settle claims, $1 million for office rent, and an expensive insurance policy to protect the trustees in addition to a $30 million protective fund to do the same. Constructing the reorganization plan and creating the trust had cost millions more. Even after these efforts, the payments from the trust were too small and too late to meet the needs of many of those injured.

270. For an interesting proposal to divide the bankrupt corporation into easily transferable shares while minimizing transaction costs, see Lucian Arye Bebchuk, A New Approach to Corporate Reorganizations, 101 HARV. L. REV. 775 (1988). See also Smith, supra note 177 (proposing issuing tort claimants interest-bearing shares in trust comprised of liquidated assets of tortfeasor).

271. Whether or not the firm is sold would depend on whether the sale from its assets would exceed the value of the firm as an ongoing enterprise. If the value of the sale of assets is greater (and this would depend on market conditions, not simply on the book value of the firm’s assets) than the value of the ongoing firm, claims investors would take this into account in their purchase price for claims.


274. In re Joint E. & S. Dist. Asbestos Litig., 129 B.R. at 759 ([Manville] trust was predicting waiting periods of up to twenty-five years between filing and complete payment); id. at 762 (trust effectively out of funds twenty-one months after it began operating); Huber, supra note 253, at 30-31; Feder, supra note 255, at D6 (trust endowed for an estimated
Investors, by contrast, will not have the same kinds of pressing, personal interests in recovering damages immediately. A group of investors might be willing to take over the company in a new sort of "leveraged buyout."\textsuperscript{275} Through the corporate debt (primarily the value of the tort claims which they already would own), tort investors together with other creditors will be able to assume ownership of the company. Except for latent claims and whatever senior debt existed,\textsuperscript{276} the tort claims investors will already own the vast majority of the company's liabilities. Of course, investors need not take over the company, but instead can simply hold or trade various claims as they see fit.

Complicated reorganization plans may be expedited or side-stepped altogether if the tort claims investors bought out the other creditors at a discounted rate in order to become the sole or dominant creditors. Furthermore, tort claims investors who choose to take over the company will avoid the significant delays, expenses, inefficiencies, and inequities which commonly plague claims resolution procedures established in bankruptcy proceedings for mass tort cases.\textsuperscript{277} Of course, investors will not have to assume actual control of a company. Instead, once it becomes evident that the investors will possess a controlling amount of debt, they can sell their shares in the market. As for future claimants, a court-appointed representative could vote their interests in any proposed plan of reorganization.

\textsuperscript{275} Cf. \textit{In re Allegheny Int'l, Inc.}, 118 B.R. 282 (Bankr. W.D. Pa. 1990). In Allegheny, the court had permitted purchasing claims of the debtor corporation in an earlier ruling, and recognized that claims trading was permissible under certain circumstances. \textit{Id.} at 289. However, the court believed claims purchases by a reorganization plan proponent, especially to obtain veto power over all other plans, \textit{id.} at 289-90, and by means of inside information, \textit{id.} at 298, were a manipulation of the bankruptcy process, \textit{id.} at 295-96, and would not be permitted. \textit{See also} Richard Lieb, \textit{Vultures Beware: Risks of Purchasing Claims Against a Chapter 11 Debtor}, 48 BUS. LAW. 915 (1993); James D. Prendergast, \textit{Applying Federal Securities Law to the Trading of Bankruptcy Claims}, F. & G. BANKR. L. REV., Winter 1992, at 9 (changes in Bankruptcy Rule 3001(e) intended to restrict bankruptcy court review of claims transfers, but proposing application of securities laws to protect claim holders).

\textsuperscript{276} For proposals to make tort claims superior or equal to contract creditors, see Hansmann & Kraakman, \textit{Toward Unlimited Shareholder Liability}, \textit{supra} note 249, at 1929-30 & n.133.

Market Strategies for Tort Reform

There may, however, not be a need for such a representative. If the tort investors (or their successors) agreed not to discharge the corporation's debt for future tort claimants, the ongoing entity could, by means of a court order, limit future claims to the same (inflation-adjusted) value paid to present claimants for similar claims. Because the purchase price of current tort claims will have discounted any future liability posed by future tort claimants, the new owners of the ongoing entity will pay future claims as they presented themselves. A claims resolution facility will only be needed to match future claims to similar, present ones in order to assure impartiality when assigning them value for purposes of payment. Thus, the ongoing concern will take the place of a trust, and a claims resolution facility will have a ministerial, rather than complex, adjudicative function.

Currently, equity holders of a corporation emerging from bankruptcy will not accept such risks associated with future tort liabilities because they lack the actuarial sophistication which claims investors will possess.

Conclusion

There is ample precedent for a tort claims market: settlement, subrogation, and contingency fees all involve buying tort claims to varying degrees. There is another precedent as well: insurance. Insurance enables people to allocate the risks and costs of accidents to those most willing and able to bear such risks and costs. A tort claims market will do the same, but, notably, after the accident has occurred.

Currently, insurance coverage spreads the costs of future accidents

278. Such future claimants will have been brought under the jurisdiction of the bankruptcy court, and thus bound by the method to value tort claims. If it were not for this provision, those taking over the defendant company would face unlimited liability. See Kane v. Johns-Manville Corp., 843 F.2d 636, 640 (2d Cir. 1988) (upholding provision for "Bankruptcy Court [to] issue an injunction channeling all [present and future] asbestos-related personal injury claims to the Trust").

279. This process of discounted valuation performed exclusively by the market is important. By contrast, Professor Smith has proposed that a bankruptcy judge assign, after consultation with experts, a set number of years (plus five years "to allow for a five-year margin of error") to the life of the trust which will pay present and future claims. Smith, supra note 177, at 396-400. Depending on interest rates, this random selection of a time period could have more effect on the present value of a claim than the underlying injury! A market would automatically discount the value of the claim based upon the market's determination of future liability, not some expert's. Paradoxically, Professor Smith's entire article is premised on the advantages of markets over bankruptcy judges and court-appointed experts.

280. There may, however, be other advantages to establishing a trust rather than having the ongoing entity retain liability, among them tax considerations and easier access to capital markets if the company discharges all debts during bankruptcy.
among potential tortfeasors, and in some cases, among tort victims who insure themselves. But problems in the insurance industry, including uninsureeds and under-insureeds, as well as insurance company fraud, can limit the degree to which the cost of accidents are spread before they occur. A tort claims market can respond to these insurance market imperfections by enabling tort victims to share with others the risks and benefits of pursuing a claim after the accident. Such a market would enable tortfeasors, who insure against potential liability, to hedge further their risk of future liability as well.

As instructive as these precedents are, many additional issues need to be addressed and more empirical work done before we can fully understand how a tort claims market will work. For example, what are the ethical dimensions of a tort claims market? Would a tort victim be obligated to respond to information requests from all subsequent potential claims purchasers? Or would she be obliged to respond only to those approved by the current owner (and new seller) of the claim? Would the tort victim be obligated to report all relevant developments to the tort purchaser and all subsequent purchasers? Who would be liable to subsequent buyers for providing inaccurate information about the claim—the tort victim or the owner of the claim?

One response is that such problems should not be considered in isolation, but rather should be compared to the current tort regime. For example, tort victims must now submit to discovery requests by defendants, which often include intrusions into their medical histories and personal lives. The victims often must participate in sometimes contentious depositions and often endure the rigors of a trial. Although a tort claims market might introduce some additional demands on tort victims, the marginal burden posed by these demands may be small—especially after investors include incentives for tort victims to continue prosecuting their claims. Of course, if a tort victim finds that the offer of certain, quick, and higher compensation is insufficient to offset these burdens, she may simply refuse to sell her claim.

As for empirical work, how will capital markets value tort claims and the securities issued by tort claims investors? The development of credit ratings was crucial for fostering a market in such idiosyncratic financial

281. See Peter Kerr, Insurers Are Limiting Sales in Risky Areas, N.Y. TIMES, May 4, 1993, D1, D5 (eliminating coverage or sharply raising rates in response to huge losses along East and West Coasts); Peter Kerr, Offshore Insurers Creating Concerns Among Regulators, N.Y. TIMES, Oct. 19, 1992, at A1, A7 (unlicensed and unregulated offshore insurance companies often lack sufficient assets to compensate claimants); supra note 16.

282. See KUNEN, supra note 113.
products as mortgage-backed securities. How can this be done for a tort claims market? Empirical studies on plaintiffs’ firms’ capital costs, and on pricing lawsuits, will also need to be undertaken. In addition, a more complete regulatory framework, especially regarding taxation and market integrity, will need to be developed.

Yet even if all of these questions are resolved, many people will still not be convinced that a tort claims market is desirable. Many in our legal culture maintain as an article of faith that selling tort claims is bad for society and for those who would do so, just as some societies have justified usury laws.

A second kind of dogma may also be at work. Despite the resurgence of free market principles both domestically and internationally, there still seems to be an abiding faith in our legal culture that administrative and judicial institutions are the best decision-makers in matters affecting the social good. Put another way, support for a market in tort claims requires faith in the market’s invisible hand and how it operates.

A tort claims market also requires faith in those who would participate in the market. Even when hurt or injured, people deserve the freedom to control their own lives. Allowing people to sell the value of their tort claims enhances their freedom to decide what is best for themselves. Ancient rationalizations for denying such freedom are cloaked in the rhetoric of protecting tort victims and society.

But the rhetoric is not only paternalistic, it is also false. The present tort regime protects some defendants from having to face full liability for their actions and insulates the plaintiffs’ bar from true competition. Tort victims are often left undercompensated or not compensated at all. A tort claims market would not only introduce market efficiency, it would also enhance personal freedom and bring greater justice.

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283. See Shenker & Colletta, supra note 78, at 1401-03.

284. Significantly, the tort reform debate is dominated by members of four professions—legislators, judges, litigators, and academics—that do not require sustained, extensive, practical experience in markets.