

Testimony of Professor Henry N. Butler

GMU Foundation Professor of Law and
Executive Director, Law & Economics Center
George Mason University School of Law

March 5, 2013

Hearing on “Excessive Litigation’s Impact on America’s Global Competitiveness”

House Committee on the Judiciary
Subcommittee on Constitution and Civil Justice

I. INTRODUCTION

Chairman Franks, Ranking Member Nadler, and Members of the Subcommittee, thank you for the invitation to testify today. My name is Henry Butler. I’m employed at George Mason University School of Law where I am a GMU Foundation Professor of Law and the Executive Director of the Law & Economics Center. The views that I express here today are my personal opinions. Neither George Mason University School of Law nor the Law & Economics Center take positions on these types of matters.

I have a Ph.D. in Economics from Virginia Tech and a law degree from the University of Miami. I’ve held academic positions at Texas A& M University, University of Chicago, University of Kansas, Chapman University, and Northwestern University. I have devoted a great deal of my career to trying to improve our civil justice system through the education of literally thousands of state and federal judges with a focus on the important, productive role that our legal system plays in our dynamic market-based economy.

The impact of our civil justice system on international competitiveness is a vitally important issue, and I congratulate the subcommittee for holding the hearing. The premise of the hearing – that we, in fact, have “excessive litigation” – is one that I am willing to accept based

on observations during the course of my 30 years as a legal scholar, although I cannot quantify the extent to which litigation is excessive. One area of the law that has seen extraordinary amounts of litigation in recent years, and an area of particular interest to me – and which will serve as a focal point for this testimony – is state consumer protection law.

I hope to make two main points in my brief testimony. First, optimal legal rules recognize the tradeoff between the costs of accidents and the costs of accident prevention. Second, excessive litigation can tip this balance, leading firms to make socially wasteful expenditures, which ultimately harms both their global competitiveness and consumers. One thing that we must keep in mind, however, as we evaluate the international impact of excessive litigation and consider possible solutions, is the tremendous societal benefits that flow from a well functioning civil justice system. We must take care to not throw out the baby with the bathwater.

II. ECONOMIC ANALYSIS OF LEGAL RULES

My research area is the economic analysis of law. A persistent theme of the economic analysis of law is that our common law heritage, founded on private property rights, freedom of contract, private ordering, and the rule of law, has served us well. The economic analysis of law provides a systematic framework for analyzing the impact of alternative legal rules, procedural as well as substantive.¹

Tort law is perhaps the most analyzed area of law and economics. This framework of analysis can trace its lineage to one developed by Judge Learned Hand in the seminal *U.S. v.*

¹ See generally Butler, Henry N. and Drahozal, Christopher R., *Economic Analysis for Lawyers* (2nd Ed., 2006).

*Carroll Towing*² opinion over sixty years ago. Judge Hand opined that the determination of tort liability should be based on whether the alleged tortfeasor had failed to take additional precautions that would have cost less than their expected benefit, in terms of reduced likelihood and severity of injuries. A similar approach is found in the work of Judge (then Yale law professor) Guido Calabresi. Calabresi famously wrote in his seminal book, *THE COSTS OF ACCIDENTS*, that the goal of tort law should be to minimize the combination of the costs of avoiding accidents and the costs of accidents. That is, in evaluating a legal regime, we should think about the tradeoff of costs and benefits: we can have too much safety; we can have too much consumer protection; we can have too much disclosure; and so forth. Because the marginal cost of accident reduction increases as the probability of accidents decreases, the law tolerates some injuries. The optimal number of injuries is not zero.

The important point to take from the economic analysis of tort law is that incentives matter; diverse rules create different incentives and, thus, result in a diverse set of outcomes. Accordingly, alternative legal rules should be evaluated in terms of how they guide behavior. A straightforward normative implication of this analysis is that we should create legal rules that provide businesses incentives to invest in injury avoidance so long as the marginal cost of achieving additional safety is less than the expected marginal benefit of increased safety (where the marginal benefits are the expected value of prevented injuries). It is socially wasteful to force businesses to overinvest society's scarce resources beyond this point.

The benefits of holding American businesses liable for injuries or damages to consumers, customers, users of products and services are well known: compensation for injured parties; incentives for improvements in product quality and safety; and higher prices for risky products, which again reduces consumer harm by reducing purchases of these products. On the other side

² 159 F2d. 169 (2d Cir. 1947).

of the benefit-cost tradeoff, the costs of our civil justice system have increased dramatically over the past 30 years or so. Litigation transactions costs have increased dramatically – due in part to increased costs of legal representation, litigation delays, class actions, and, more recently, the dramatic increase in the costs associated with electronic discovery. Additionally, if the legal rule does not reflect an optimal balance of costs and benefits, it will deter the socially beneficial activity. Higher liability costs for risk-reducing products, for example, can actually *increase* accidental deaths. Finally, a civil justice system characterized by excessive litigation can lead to lower levels of production, employment, innovation, and business openings.³ Unfortunately, some areas of American law have strayed far from the balancing approaches articulated by Judges Hand and Calabresi. Their common sense notions have become uncommon in some areas of American law.

III. STATE CONSUMER PROTECTION LAWS

State consumer protection acts are an unsettling example of an area where private litigation has strayed far from a common sense balancing approach. In my view, the amount of such litigation – which imposes a tremendous toll on all American businesses that directly interact with consumers – is clearly excessive. States passed these laws – often referred to as “Little FTC Acts” because they are modeled after Section 5 of the U.S. Federal Trade Commission Act – for what appeared to be sound economic reasons. In our modern mass produced economy, it is often uneconomical for individual consumers to bring lawsuits against manufacturers when they are dissatisfied with a product. To solve this problem, Little FTC Acts allow for private actions, awarding of attorneys fees to a winning consumer, statutory damages

³ See generally Shepherd, Joanna M., Products Liability and Economic Activity: An Empirical Analysis of Tort Reform’s Impact on Businesses, Employment, and Production, *Vanderbilt Law Review*, Vol. 66:1:257 (2013).

(often as high as \$1,000 per occurrence), and relaxation of traditional common law requirements of reasonable reliance and actual injury.⁴ At about the same time as states were adopting Little FTC Acts, the class action lawsuit was coming into favor as another solution to the uneconomical lawsuit problem. Somewhere along the way, the two solutions merged so that consumer class actions now benefit from the procedural and substantive advantages found in the Little FTC Acts.⁵ This combination of solutions has brought about a perfect storm of litigation resulting in a dramatic increase in litigation during the first decade of this century.⁶

It is ironic that private litigation under state consumer protection acts is expanding when consumers are more empowered than ever. Searching for the availability of products is incredibly easy and inexpensive, as is learning about price, quality, and value. Consumers are better able to find the exact product they want at the lowest possible price than was imagined even a decade ago. Businesses are forced to compete in this information-rich environment. A business that violates consumer trust, moreover, does so at the peril of near-instantaneous retribution via social media and other online fora. The threat of losing their reputational capital – not the threat of legal liability – forces businesses to behave. In this way, the informational revolution that is the Internet has helped harness competitive market forces to provide

⁴ See Schwartz, Victor E. & Silverman, Cary, Common-Sense Construction of Consumer Protection Acts, 54 KAN.L.REV. 1, 7 (2005).

⁵ See Butler, Henry N. and Johnston, Jason Scott, Reforming State Consumer Protection Liability: An Economic Approach (August 6, 2009). Columbia Business Law Review, Vol. 2010; Northwestern Law & Econ Research Paper No. 08-02; U of Penn, Inst for Law & Econ Research Paper No. 08-29; U of Penn Law School, Public Law Research Paper No. 08-47. Available at SSRN: <http://ssrn.com/abstract=1125305> or <http://dx.doi.org/10.2139/ssrn.1125305>; and Butler, Henry N. and Wright, Joshua D., Are State Consumer Protection Acts Really Little-FTC Acts? (May 5, 2010). Florida Law Review, Vol. 63, No. 1, pp. 163-192, January 2011 ; Northwestern Law & Econ Research Paper No. 10-11; George Mason Law & Economics Research Paper No. 10-45. Available at SSRN: <http://ssrn.com/abstract=1600843>.

⁶ Wright, Joshua D., State Consumer Protection Acts: An Empirical Investigation of Private Litigation (November 12, 2010). Searle Civil Justice Institute Preliminary Report, 2009 . Available at SSRN: <http://ssrn.com/abstract=1708175>.

unprecedented protection for consumers. Against this market backdrop, one would expect there to be less need for consumer protection lawsuits. Yet, private actions under consumer protection lawsuits keep increasing.

Consumers ultimately pay the costs that excessive litigation imposes on businesses through higher prices. Of course, because the law of demand dictates that higher prices will result in fewer goods being sold, some consumers will be forced to go without products altogether, and firms will need fewer workers. To the extent that businesses cannot recover all of these costs from consumers, moreover, they will result in reduced profits, which translate into lower returns for shareholders and other investors.

IV. IMPACT ON GLOBAL COMPETITIVENESS

Now, consider how excessive private litigation under state consumer protection acts impacts America's global competitiveness. Corporations have to respond to these lawsuits.⁷ They cannot ignore them. Every lawsuit filed against a business diverts resources from otherwise productive pursuits. The greater the expected costs of litigation, the more a company will invest in avoiding litigation. If there are problems with a product, a firm will invest resources in to improve it to avoid litigation. Even if there is nothing wrong with the product (and no consumers have relied or been injured), however, the mere threat of class actions and potential liability under broadly interpreted state consumer protection acts can also lead companies to pour more resources into safety. The potential for enormous financial liability as well as the potential for unfavorable publicity can force even the most stable and reputable business to settle cases that they believe they could win at trial. But, because this increased investment is tied to the costs of handling unfounded legal claims, rather than consumer injury, it

⁷ Elliott, E. Donald, Twombly in Context: Why Federal Rule of Civil Procedure 4(b) is Unconstitutional (December 14, 2010). 64 FLA. L. REV. 895 (2012).. Available at SSRN: <http://ssrn.com/abstract=1711229>.

is socially wasteful. In this manner, excessive litigation disrupts the balance between the marginal benefits and costs of precaution that tort law attempts to strike.

What's more, consumer class actions are very disruptive of ordinary business activities, diverting managers' time and ingenuity from the productive pursuits of trying to grow a business in dynamic global markets. This diversion of resources increases costs, putting U.S. companies at a competitive disadvantage relative to their foreign rivals that have not yet been subjected to such suits. Clearly, excessive consumer protection litigation is a drag on our economy.

V. CONCLUSION

The upshot of my brief remarks is that excessive litigation under something as benign sounding as a state consumer protection act can have serious adverse consequences for America's competitiveness. Thank you for allowing me the opportunity to express my views.