

# Testimony of Paul J. Hinton, NERA Economic Consulting

Before the Committee on the Judiciary  
Subcommittee on the Constitution  
United States House of Representatives  
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## Hearing on: **Excessive Litigation's Impact on America's Global Competitiveness**

Thank you Mr. Chairman and distinguished Committee members for inviting me to provide testimony today on the effects of litigation on U.S. competitiveness. My name is Paul Hinton and I am a Vice President at NERA Economic Consulting. NERA is a global firm dedicated to applying principles of economics, finance, and quantitative analysis to complex business, legal and public policy challenges. I have co-authored a number of empirical studies that estimate the direct costs of litigation to businesses including a forthcoming study commissioned by the U.S. Chamber Institute for Legal Reform that compares litigation costs across countries. It is the results of this forthcoming study comparing the costs of litigation in the United States with European countries and Canada that provides the basis for my testimony today.<sup>1</sup>

U.S. litigation, whether arising from tort claims or otherwise, affects the ability of American companies to compete globally by imposing additional costs. But higher *direct costs* of doing business are just the tip of the iceberg: litigation also imposes *indirect costs*. Uncertainty created by litigation may affect companies' borrowing costs and hence their ability to invest, grow and create jobs. Many foreign companies are wary of becoming embroiled in U.S. litigation, which may deter foreign direct investment. Multinational companies may choose to limit the extent of their operations in the United States. Dealing with litigation can occupy

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<sup>1</sup> The U.S. Chamber Institute for Legal Reform (ILR) is an affiliate of the U.S. Chamber of Commerce dedicated to making our nation's legal system simpler, fairer and faster for everyone. Founded by the Chamber in 1998, ILR has a comprehensive approach to reform, working to improve not only the law, but also the legal climate. The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than three million businesses and organizations of every size, sector and region.

management time, result in unproductive risk avoidance and otherwise distort business decision-making. These indirect costs imposed by the tort system reduce productivity.

The actuarial firm of Towers Watson estimates that U.S. tort costs exceed \$250 billion a year, representing 1.7 percent of the United States' GDP.<sup>2</sup> Our forthcoming study expands on this body of knowledge and estimates that **U.S. litigation costs are about two and a half times the average level of the four largest Eurozone economies** – Germany, France, Italy and Spain. Furthermore, when compared to the least costly European countries such as Belgium, the Netherlands and Portugal, U.S. litigation costs are estimated to be about four times as high as those countries.

Our study uses prices of liability insurance bought by businesses in the United States, Canada and Europe, provided by the insurance broker Marsh Inc., as a basis for estimating relative litigation costs. Liability insurance prices provide a useful basis for analysis because they reflect the cost of litigation risk even though only a fraction of aggregate litigation costs may be insured. We also examine the differences in costs of automobile third party liability insurance and corporate director and officers' liability insurance – commonly called D&O insurance – to provide additional insights on differences in litigation costs.

Automobile liability insurance represents more than half of all liability insurance in the United States and an even greater proportion in Europe. It follows that automobile liability costs constitute a significant portion of all insured liability costs. While differences in auto insurance coverage across countries means that *price* comparisons are not very meaningful, comparisons of *claim costs* in different countries reveal that **on average U.S. costs in 2008 were almost four times the level of the largest Eurozone economies.**

Furthermore, directors and officers (D&O) insurance is specifically designed to cover the costs of litigation. Litigation involving directors and officers is only a small component of the overall liability costs in each country; however, the large U.S. share of the global D&O market is an illustration of how differences in legal systems can affect liability costs. According to Allianz, a major global insurance company, U.S. aggregate D&O premiums in 2009 amounted to between \$5 billion and \$6.7 billion, whereas the European aggregate was only \$2 billion for an economy of about the same size. However, it is important to note that European D&O costs of multinational companies in large part result from exposure to litigation in the United States and not on their domestic exposure. **As a result, on average, domestic European D&O litigation exposure would be much less than a third of the U.S. level.**

Simple comparisons of insurance costs may not provide a reliable basis for comparing litigation costs across countries because there are many factors that affect liability insurance rates but are unrelated to the operation of the legal system in each country. The contribution of our latest study is to separate out cost differences due to economic factors, demographics and spending on government programs, factors which vary by country. The cost differences that remain are attributable to features of the legal environment and other unidentified factors. We find that a common law (rather than civil law) tradition, and a high number of lawyers per capita are

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<sup>2</sup> Towers Watson, "U.S. Tort Cost Trends, 2011 Update." Released January 26, 2012.

strong indicators of the relative costs of litigation. The U.S. legal system is ranked number one by these measures and this translates into litigation costs as a percent of GDP that are larger than any other country in the study.

**In conclusion, we find that the United States has much higher litigation costs than Europe and the difference is attributable to features of the legal environment. Unfortunately, this means that – on the assumption that these countries provide businesses the same benefits of legal protection – higher litigation costs put U.S. businesses at a disadvantage in terms of their global competitiveness.**

Thank you again Mr. Chairman and distinguished Committee members for this opportunity to testify on this important topic. I would be happy to answer any questions that you may have.