

The U.S. Litigation Environment and Foreign Direct Investment

Supporting U.S. Competitiveness by Reducing Legal Costs and Uncertainty



“A way to make sure America is the best place to do business in the world, a way to make sure jobs continue to exist here is to tackle the tough issues of legal reform.... [F]rivolous and junk lawsuits cost our economy about \$240 billion a year... which is a competitive disadvantage ... in a global economy.”

—President George W. Bush, January 7, 2005

Introduction

The overall quality and fairness of the U.S. legal system is widely recognized as one of the great strengths of the United States. This outlook is not just a domestic view, but one that is recognized internationally.¹

There is an international perception that the pervasive nature of litigation in the United States and other related aspects of the legal system increase the costs of doing business and add uncertainty. The United States is increasingly seen from abroad as a nation where lawsuits are too commonplace.²

Critics in the United States who agree with this assessment see an increasingly cumbersome and expensive U.S. legal system that contains features that serve as an unnecessary drag on the economy and as an implicit international competitive disadvantage.³ For example, those features typically include excessive punitive damages, “forum shopping,” and certain categories of class action lawsuits. Other critics, such as those on the tort plaintiff’s side of the legal profession, see a system that has evolved as fully justified and as the only way many claimants might receive either justice or compensation.⁴

In either case, tort costs have reportedly increased in relation to the U.S. gross domestic product (GDP) since 1950 (0.62 percent to 1.87 percent).⁵ Interestingly, this mirrors information that U.S. tort costs as a percentage of GDP are triple that of France and the United Kingdom and at least double that of Germany, Japan, and Switzerland.⁶ Such numbers make this issue an important U.S. competitiveness concern.

October 2008

Introduction	1
Importance of Foreign Direct Investment (FDI) to the United States.	2
Importance of the Legal System in Attracting Foreign Investment	3
The U.S. Legal System’s Distinctive Features	3
The U.S. Litigation Environment As a Competitiveness Issue	4
International Investors’ Concerns with the U.S. Legal Environment	5
What Is Being Done to Address These Concerns.	8
Additional Legal System Features Relevant to FDI	9
Areas Where Additional Attention Is Needed	9
Need for Economic Research and Analysis.	10



Any issue that erodes competitiveness has the potential to affect foreign direct investment (FDI). FDI plays a major role in the U.S. economy as a key driver of the economy and as an important source of innovation, exports, and jobs.

Experienced international investors understand that discriminatory treatment based on foreign ownership (a problem international investors face in many countries) is rare in the United States, and that it is contrary both to U.S. policy and our longstanding tradition of openness to foreign investment.⁷

However, the concerns with excessive litigation and navigating what is seen as an expensive U.S. legal system are among a small number of issues that are front and center whenever the U.S. climate for FDI is discussed.⁸

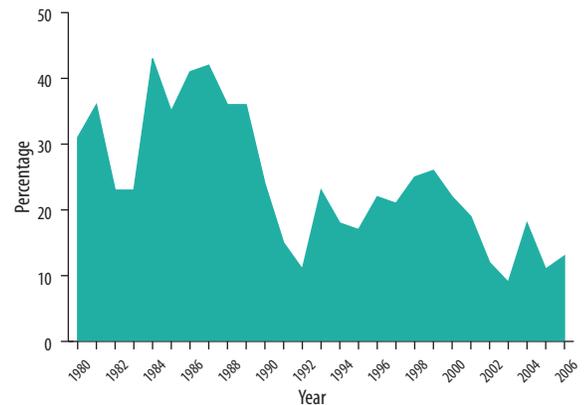
Fear of litigation is among the top issues listed by senior executives who manage internationally owned U.S. businesses.⁹ Significantly, U.S.-owned companies that operate in other advanced economies do not express a similar concern.¹⁰ Also, there is the perception that, at least in some contexts, other countries' legal systems are more predictable and that the legal costs of doing business are substantially less.¹¹ These perceptions exist even though the overall high quality of the U.S. legal system is also well recognized internationally.¹²

Policymakers need to address the international concerns involving the U.S. litigation environment. If high U.S. legal costs are not commensurate with high benefits, policymakers will need to find ways to reduce uncertainty and to bring U.S. legal costs more in line with those of other advanced economies.

However, they also need to recognize that, as a competitiveness issue, this topic is relatively new. A need exists for additional economic research that will give a better understanding of how the U.S. litigation environment influences FDI. Although the U.S. legal environment is costly in some respects, and although perceptions of the litigation environment are negative, there is not enough evidence or research to determine the actual effects of the litigation environment. It remains unknown whether the litigation environment has material effects on FDI; what the size of those effects might be; whether the effects differ depending on factors such as type of investment, industry, or size of firm; and what aspects of the litigation environment are the most important deterrents.

As is often said, investment capital goes and stays where it is well treated. The positive news is

Figure 1. U.S. Share of Global FDI Inflows



Source: United Nations Conference on Trade and Development, World Investment Report, Analysis of data provided in UNCTAD Foreign Direct Investment data base, September 2008.

that key areas (for example, class action suits and punitive damages) are recognized as problems that face all U.S. businesses and, therefore, rank high on the national policy agenda. Important progress has also been made in recent years in those areas.

Importance of Foreign Direct Investment to the United States

Foreign direct investment plays a major role as a key driver of the U.S. economy and as an important source of innovation, exports, and jobs.¹³ Because the U.S. share of global FDI inflows has declined since the late 1980s and the competition to attract FDI has grown more intense, the United States must strive to maintain its ability to attract FDI. Fear of litigation and potential liability under the U.S. legal system are among the more important concerns to those interested in investing in the United States.¹⁴

The United States is the world's largest recipient of FDI (\$238 billion in 2007, more than double that of 10 years earlier).¹⁵ In 2007, at \$2.4 trillion, total U.S. FDI was equivalent to 17 percent of U.S. GDP. Foreign firms employ more than 5.3 million U.S. workers through their U.S. affiliates and have indirectly created millions of additional jobs. More than 30 percent of the jobs directly created through FDI are in manufacturing, and these jobs account for 12 percent of all manufacturing jobs in the United States.¹⁶ In addition, foreign firms account for 11 percent of U.S. private-sector capital investment, nearly 15 percent of annual U.S. research and development, and almost 20 percent of U.S. exports.¹⁷ Furthermore, in 2006, the average compensation at foreign-owned firms

“Our nation is built upon the rule of law and guided by our founding promise of freedom, equality, and justice.”

—President George W. Bush, “Proclamation by the President: Law Day,” April 27, 2007

in the United States was more than 25 percent higher than at private-sector firms in the remainder of the economy.¹⁸

However, the U.S. share of global FDI inflows has fallen since the 1980s (see Figure 1). This trend reinforces the need for the United States to renew its commitment to open investment and to policies that make this Nation attractive to FDI.¹⁹

Importance of the Legal System in Attracting Foreign Investment

As indicated, the United States is widely recognized as one of the leading destinations for FDI, and the U.S. legal system’s strengths are an important reason why this is the case. The first concern of any international investor is that a system of predictable and enforceable rules be in place so that an investment will not be arbitrarily taken or diminished once it is made. In countries that have poor legal systems, investors seek additional protections and demand a higher return.

The World Bank, which ranks country investment environments, has consistently placed the United States at or near the top of its list of *Doing Business* indicators (see Table 1).²⁰ The United States, out of 181 economies surveyed, ranks third for ease of doing business overall, first with respect to employing workers, and sixth in terms of enforcing contracts. The United States ranks sixth in terms of the ease of starting a business and fifth with respect to protecting investors.²¹

In addition, the high quality of the U.S. legal system overall is reinforced by the open investment

policy, which is based on the principle of national treatment—specifically, that “[f]oreign investors should not be treated differently from domestic investors.”²²

International investors often operate in environments that are much less transparent and predictable. Although no system is perfect in all respects, the United States is justifiably proud of the overall high quality of its legal system and the level of international investment subject to its protection.

The U.S. Legal System’s Distinctive Features

Several aspects of the U.S. legal system are recognized as unique to the United States and are, therefore, sometimes difficult for a non-U.S. investor to assess. However, this factor is present to some extent in any investment made outside an investor’s home market. Typically, investors address such issues by retaining a management team familiar with the market in which they intend to invest.

Since the founding of the United States, the country has had a unique role and reputation among nations. It was the first nation founded on principles of limited self-government. Rejecting monarchy, the founders created a Federal Government with three separate branches: executive, legislative, and judicial. Each branch, while performing its own assigned function, holds the other two branches in check. This structure is closely connected with and, in many ways, found its expression in the U.S. legal system, which draws on principles of English common law regarding a Federal system, where power and sovereignty are shared with the various State governments.

An international investor might find some distinctive features of the U.S. legal system (see Box 1) unfamiliar. Although many of the differences may seem unusual to people outside the United States, they are firmly rooted in the American tradition. Experienced international investors understand that each country has distinctive and unfamiliar aspects to its legal system. Those who invest in the United States take comfort in understanding that (a) everyone competing in the market faces these factors; (b) the factors can be handled with strong local management and legal, accounting, and banking relationships; and (c) other international investors have adjusted to these factors.

Table 1. Rank of United States for Investment Environment

Category	Rank ¹
Doing business with ease	3
Starting a business	6
Dealing with construction permits	26
Employing workers	1
Registering property	12
Getting credit	5
Protecting investors	5
Paying taxes	46
Trading across borders	15
Enforcing contracts	6
Closing a business	15

Source: World Bank, *Doing Business 2009: Comparing Regulation in 181 Economies* (Washington, D.C.: Palgrave Macmillan and World Bank, 2008).

Box 1. Distinctive Features of the U.S. Legal System

Federal and State levels. Both Federal and individual State laws may govern any given matter. Even with 50 States (plus the District of Columbia), it is typically clear which State legal systems are relevant. In many cases, State rather than Federal law may govern the result.

Common law system. The U.S. legal system is, for the most part, derived from the English common law system in which previous case decisions have precedential value and are followed. Many other countries have a code-based legal system in which case law is far less important.

Civil litigation. Private litigation plays a much broader role in the United States than elsewhere, even in comparison to other common law systems. The U.S. system is also noted for having many rules that are seen as favorable to plaintiffs (for example, each party to a private lawsuit pays its own legal fees and a loser does not pay a winner's legal costs as in the United Kingdom).

Contingency fees. U.S. courts allow a distinctive method of financing private lawsuits. They allow lawyers to finance their clients' cases on a contingent basis in return for the chance to receive 30–40 percent of any damages awarded. This contingency arrangement is often attractive to those who cannot afford to bring a lawsuit to assert their claims (as plaintiffs are not required to pay their lawyers if they are unsuccessful) and means that plaintiff lawyers, who may or may not receive a windfall, have a financial interest in the outcome. Contingency fees also make litigation more likely.

Role of juries. Juries (as opposed to judges) are much more widely used in the United States to decide cases and to resolve questions of fact. Even in the United Kingdom, where the U.S. right to a jury trial originated, juries are not as widely used. Juries are seen as most effective when a dispute affects primarily the parties to the case, but juries are seen as problematic when the matters in dispute are relevant to an entire industry.

Regulatory agency litigation. Both Federal and State regulatory agencies have their own procedures for litigating issues internally, and they may be authorized to file civil or criminal suits in court to enforce decisions. In some areas, State regulatory agencies have not recognized Federal law (or Federal agency decisions) as dispositive, and they may sometimes seek to impose different, higher, or additional standards.

Role of the legislature. In addition to a legislature's responsibility for passing laws, there is also a legislative oversight function. Legislative committees may decide to hold hearings, including on matters in dispute in existing cases, with the potential for ongoing legal issues to end up in the headlines.

Unfamiliar legal subject areas. A number of important legal subject matters, such as securities law and antitrust law, were developed in the United States and have to some extent been adopted outside of the United States. However, even in countries where the U.S. example has been followed, the nature and extent of U.S. law in such unfamiliar legal areas can be surprising.

The U.S. Litigation Environment As a Competitiveness Issue

In recent years, the U.S. litigation environment has been the subject of a number of surveys and reports, which have raised policy concerns related to U.S. competitiveness.

Rising Costs

On the most basic level, the effects of the litigation environment on the U.S. economy can be measured by rising costs. Towers Perrin, an international professional services firm, has issued a series of reports on U.S. tort costs.²³ According to the firm, between 1950 and 2006, total U.S. tort costs²⁴ increased from \$13 billion to \$247 billion per year (in 2006 dollars), rising from 0.62 percent to 1.87 percent of U.S. GDP (see Table 2). The study measures the increase in *commercial* tort costs,²⁵ which grew to \$159.6 billion in 2006 and had nominal average annual upward growth of 6.9 percent per year (4.3 percent real average annual growth) since 2000.²⁶

Competitive Impact

Over time, the growth in tort costs has had a competitive impact on the relative cost of doing business in the United States. Towers Perrin has

also focused on the comparative aspects (see Figure 2). For 2003, the U.S. tort costs as a percentage of GDP were reported to be twice those of Germany and three times those of France and the United Kingdom.²⁷ Despite common origins, the United Kingdom has a very different system than the United States. Lord Leonard Hoffman, a judge serving on the highest court in the United Kingdom, described the differences succinctly as “no punitive damages, limits on pain and suffering, no contingency fees, loser pays, no juries in most civil cases, and a trial bar with almost no political influence.”²⁸ The fact remains, however, that the United Kingdom and several other industrial countries, including Japan and Switzerland, are now seen as having a significant cost advantage compared to the United States.²⁹

Professional Survey-Based Assessment

Similarly, a series of studies conducted annually since 2001 by Harris Interactive for the Institute for Legal Reform (ILR) at the U.S. Chamber of Commerce surveyed a national sample of in-house general counsels for U.S.-based companies and other senior corporate litigators. The surveys explore and attempt to quantify the extent to which the U.S. tort liability system is perceived

as reasonable and balanced by U.S. business.³⁰ In 2008, Harris Interactive reported that 55 percent of those responding to the survey indicated an overall rating of State court liability systems in the United States as “only fair” or “poor” (see Figure 3). In addition, the extent to which States were seen as “creating a fair and reasonable litigation environment” varied widely.³¹ The study also noted that courts and localities within a State can vary a great deal in how they are seen in terms of fairness and efficiency.³² A substantial majority (63 percent) of respondents indicated that “the litigation environment in a State is likely to impact important business decisions at their company, such as where to locate or do business” (see Figure 4). If the litigation environment affects the location decision of U.S. firms, it could also affect the decision by foreign investors to invest in the United States.

Perceptions

There is also a perception within the United States and elsewhere that the U.S. tort system has, at times, produced decisions that are inappropriate and not grounded in common sense. One well-known example is the \$2.9 million verdict against McDonald’s (later reduced to \$640,000), which was awarded to a person who spilled hot coffee while leaving a drive-through restaurant. Although it is generally recognized that verdicts of that kind are the exception, the possibility of being sued, as well as the awareness that unreasonable and extreme verdicts are possible, has had a negative impact on businesses, as well as on Americans in general.³³ Also, substantial anecdotal information suggests that many in society, including businesses, are increasingly reluctant

Table 2. Tort Costs as Percentage of U.S. GDP

Year	Percentage
1950	0.62
1960	1.03
1970	1.34
1980	1.53
1990	2.24
2000	1.82
2001	2.03
2002	2.22
2003	2.24
2004	2.23
2005	2.10
2006	1.87

Source: Tillinghast Insurance Consulting, “2007 Update on U.S. Tort Cost Trends,” Towers Perrin, Stamford, Conn.

to undertake what were previously considered to be ordinary activities because of the potential for being sued.³⁴

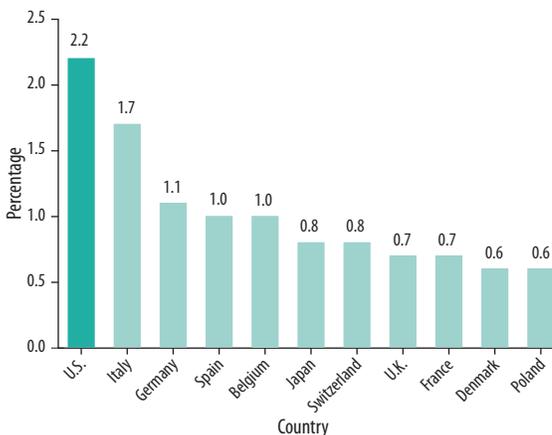
U.S. Treasury Secretary Henry M. Paulson put the issue well. “A sophisticated legal structure—with property rights, contract law, mechanisms to resolve disputes, and a system for compensating injured parties—is necessary to protect investors, businesses, and consumers. But our legal system has gone beyond protection.... Simply put, the broken tort system is an Achilles heel for our economy. This is not a political issue, it is a competitiveness issue and it must be addressed in a bipartisan fashion.”³⁵

International Investors’ Concerns with the U.S. Legal Environment

Two areas stand out to international investors: (a) the comparatively high legal cost of doing business in the U.S. market and (b) the unpredictable and unfamiliar nature of liability in the United States. Each is directly related to the litigious nature of the U.S. legal system. Each is relevant for assessing whether foreign companies will choose to make investments in the U.S. economy or, if an international company is already doing business there, to what extent the company will choose to continue to fund its U.S. businesses instead of subsidiaries doing business in other parts of the world.

Three recent studies have indicated that international investors do have concerns about those aspects of the U.S. legal system. “Obstacles to

Figure 2. Tort Costs as a Percentage of GDP, 2003



Source: Tillinghast Insurance Consulting, “2005 Update on U.S. Tort Cost Trends,” Towers Perrin, Stamford, Conn.

“[T]he highly complex and fragmented nature of our legal system has led to a perception that penalties are arbitrary and unfair, a reputation that may be overblown, but nonetheless diminishes our attractiveness to international companies. To address this, we must consider legal reforms that will reduce spurious and meritless litigation and eliminate the perception of arbitrary justice, without eliminating meritorious actions.”

—New York Mayor Michael Bloomberg and New York Senator Charles E. Schumer, foreword to *Sustaining New York’s and the U.S.’ Global Financial Services Leadership*

Transatlantic Trade and Investment,” a study conducted by Eurochambres and the U.S. Chamber of Commerce, found that European companies doing business in the United States rank “fear of legal liability” among their top concerns. The report also indicated that U.S. investors doing business in European Union countries expressed no such similar concern.³⁶

A study prepared for the Organization for International Investment, titled “Insourcing Survey: A CEO-Level Survey of U.S. Subsidiaries of Foreign Companies,” listed the legal system as a drawback regarding investment in the United States. Top concerns from high-level executives of major U.S. subsidiaries of foreign companies included class action lawsuits, cost of legal representation, and business-to-business litigation.³⁷

Similarly, *Sustaining New York’s and the U.S.’ Global Financial Services Leadership*, a McKinsey and Company study of the financial-sector that was prepared for New York City Mayor Michael Bloomberg and New York Senator Charles Schumer, noted the concern with high legal costs connected with doing business in the United States.³⁸ The study also noted a perceived lack of predictability and fairness concerning litigation. Respondents expressed a strong preference for United Kingdom law as the governing law for international contracts.³⁹

Specific Areas of Concern

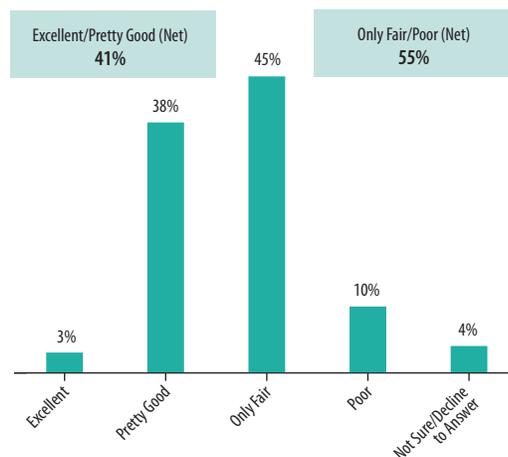
International investors and others view several parts of the U.S. legal system as problematic.⁴⁰ The following four areas merit examination.

Punitive Damages

Most private litigation is aimed at getting *compensatory* damages (that is, monetary damages that compensate an aggrieved party for harm suffered); however, in most States,⁴¹ plaintiffs may also seek *punitive* damages when malice or reckless disregard is found in connection with a defendant’s conduct.⁴² When awarded, punitive damages are designed to punish the defendant and to deter future bad conduct. Because punitive damages may be adjusted on the basis of the wealth of a particular defendant, juries sometimes award damages that are many times the amount awarded for compensation.⁴³

Many outside the U.S. view punitive damages as objectionable in general, and consider the way such damages operate in the U.S. system to be particularly troubling.⁴⁴ Juries play an important

Figure 3. Overall Rating of State Court Liability Systems in the United States



Source: Harris Interactive, “2008 U.S. Chamber of Commerce State Liability Systems Ranking Study,” study conducted for the Institute for Legal Reform, U.S. Chamber of Commerce, Washington, D.C., April 15, 2008.

and constitutionally sanctioned role in the common law-based U.S. legal system. In that context, however, juries are sometimes seen as not having the needed expertise and as being improperly subject to emotional or populist appeals.⁴⁵ In addition, most other countries object to imposing punishment in civil litigation, believing that the criminal justice system—or, at least, a government agency—is better suited to the fair administration of punishment.⁴⁶ Further, in some situations there is the possibility of vicarious liability (i.e., liability for the acts of others), for punitive damages as well as a public policy-based prohibition on allowing insurance to cover punitive damages.⁴⁷

When combined with certain other aspects of the U.S. legal system (for example, class action litigation, high legal costs, joint and several liability, and contingency fee structures), the potential for a significant award—even if it is perceived as unlikely and unmerited—can create a strong incentive to settle an actual or threatened case. This incentive exists even though it is recognized that actual punitive damages awards are unusual and that, even when punitive damages are awarded by a jury, they can subsequently be reduced by a court decision.⁴⁸

The view from abroad is described well in a recent *New York Times* article: “Most of the rest of the world views the idea of punitive damages with alarm.” The article reports that when asked to enforce a U.S. punitive award against an Italian company, a court in Italy found the punitive damages “so offensive to Italian notions of justice” that

it would not enforce the judgment.⁴⁹ Given that reaction, the possibility of being subject to punitive damages in the United States may also be deterring companies from investing in the United States.

Class Action Lawsuits

Although most civil litigation in the United States and elsewhere is between a small number of parties, U.S. law allows for cases in which large numbers of similarly situated plaintiffs sue together as a class. In such class action lawsuits, thousands (or potentially even millions) of plaintiffs may each claim damages individually in a relatively small amount. When taken together, those damages can create the potential for a significant judgment. Such lawsuits are justified because they allow efficient redress in situations where going to court would not be worthwhile to an individual, but the total damage to everyone who has been wronged is large. In addition to potential damages, class action lawsuits tend to involve significant expenses for legal services and for producing information requested by the plaintiffs’ attorneys before trial (the “discovery process”). These expenses and the management and employee time dedicated to the cases can go on for years before any decision is reached and can create their own incentives for settlement unrelated to the merits of a case.⁵⁰ The advantage of class action lawsuits is that they take advantage of economies of scale and thus may allow for a more efficient and less costly consolidation of the discovery process in which multiple lawsuits involving the same basic issues are likely.⁵¹

Class action lawsuits are largely unfamiliar to those outside the United States.⁵² They are faulted for addressing wrongs that might more appro-

priately be left to a government agency. Foreign citizens doing business in the United States are troubled because the suits are sometimes created by lawyers themselves.⁵³ Unlike cases in which the individual plaintiffs each allege that they have suffered damage and have individually sought out legal representation, lawyers who prepare possible class action cases often seek to certify certain people as co-plaintiffs. Many times, co-plaintiffs might be a class of people who do not necessarily know of the alleged harm or rights are being asserted on their behalf. Plaintiffs’ lawyers contact them once a judge has certified that a class exists. Once a class is certified, these cases can become quite profitable for the law firms involved. A plaintiff’s law firm might receive millions of dollars in fees as part of a settlement, while each member of the class receives a relatively small cash amount or coupons for future goods or services.⁵⁴ The idea of lawyers manufacturing lawsuits against businesses with deep pockets is not an unfamiliar one to foreign investors. The idea of such a practice being sanctioned by the courts in an advanced economy, however, is unfamiliar and might reasonably be factored into a decision of whether to invest in the United States.

Forum Shopping

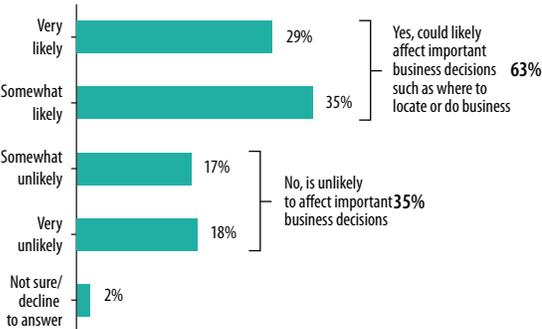
When a plaintiff or multiple plaintiffs together decide to bring a lawsuit, the action might be brought to one of several possible courts, each with a potentially legitimate nexus to the dispute. This issue occurs as a consequence of the unique federal structure of the U.S. courts system. In the United States, lawyers spend substantial time and effort trying to identify which court might be most sympathetic to their client’s case, a practice known as “forum shopping.”⁵⁵ The plaintiff who brings the lawsuit chooses the initial court, and the options available might include several State courts and, in some cases, U.S. Federal district courts. Once a plaintiff brings a case in the chosen court, the defendant may challenge the choice. But making that determination can sometimes provide an important advantage.⁵⁶

The U.S. legal system has had a problem with forum shopping.⁵⁷ Most tort cases are brought in State courts, and there are specific courts within even well-regarded State legal systems that are seen as being favorable to plaintiffs. Such courts have sometimes been described as “jackpot jurisdictions”⁵⁸ and are characterized by rulings

“Survey respondents said that a fair and predictable legal environment was the second most important criterion determining a financial center’s competitiveness. In this regard, they felt that the United States was at a competitive disadvantage to the United Kingdom. They attribute this US disadvantage to a propensity toward litigation and concerns that the US legal environment is less fair and less predictable than the UK environment.”

—McKinsey & Company, *Sustaining New York’s and the US’ Global Financial Services Leadership*, p.16

Figure 4. Impact of Litigation Environment on Important Business Decisions, Such as Where to Locate or Do Business



Source: Harris Interactive, “2008 U.S. Chamber of Commerce State Liability Systems Ranking Study,” study conducted for the Institute for Legal Reform, U.S. Chamber of Commerce, Washington, D.C., April 15, 2008.

that generally favor plaintiffs, plaintiff-oriented juries, and high-damage awards.⁵⁹ Furthermore, particularly in class action litigation, plaintiffs' lawyers have been known to shape their cases (and classes) with an eye for what will bring them before these specific courts.⁶⁰

Although foreign investors typically see the U.S. legal system as fair in the larger sense, practices such as forum shopping have contributed to their fear of litigation (and liability) and are seen as a source of significant investor uncertainty.⁶¹ However, international investors are not alone in that concern. It is a concern that is shared by U.S. businesses in general.⁶²

Litigation Culture

To domestic critics, perhaps the most dysfunctional aspect of the U.S. legal system is the increasing public prominence of lawsuits and the potential the average person feels for being sued and having to deal with the court system. While most Americans understand that extreme verdicts are the exception and are unlikely to touch their lives directly, their concern still affects their behavior.⁶³ Businesses are more regularly affected by lawsuits. The possibility of an extreme verdict, while still the exception, is an important factor in how businesses handle a more regular flow of actual and potential litigation. Added to that factor are some of the more controversial practices that have been associated with tort litigation. Practices recently confirmed, including perjury, bribery, fraud, and obstruction of justice involving the manufacturing of tort claims in high-profile cases,⁶⁴ have added to the sense that important aspects of the U.S. tort system need to be changed.⁶⁵ High litigation costs and extreme verdicts, even if unlikely, raise the expected cost of operating a business in the United States for both existing firms and potential entrants.

What Is Being Done to Address These Concerns

Several important recent developments are aimed at correcting some of the most troubling aspects of the U.S. legal system:

- **U.S. Supreme Court decisions limiting punitive damages.** In *State Farm v. Campbell*⁶⁶ in 2003, the U.S. Supreme Court, which had previously held that judges should decide the upper limits of damages as a matter of law,⁶⁷ generally limited the amount of punitive damages that should be awarded. The Court stated that punitive damage

awards of more than nine times the compensatory damages awarded (and normally a multiple of not more than four times that amount) would be unlikely to satisfy due process requirements. In his opinion for the Court, Justice Anthony Kennedy wrote, "Elementary notions of fairness enshrined in our constitutional jurisprudence dictate that a person receive fair notice not only of the conduct that will subject him to punishment, but also of the severity of the penalty that a State may impose."⁶⁸ While potential punitive damages may still end up being significant, particularly in class action cases where the aggregate compensatory damages claim may be a large amount, the value of having an overall absolute upper limit on punitive damages in a given case should significantly reduce the perceived level of uncertainty facing an investor.⁶⁹

- **Class Action Fairness Act.** Congress enacted and the President signed the Class Action Fairness Act of 2005 to address the issue of forum shopping in class action cases.⁷⁰ The act now gives the U.S. Federal (as opposed to State) courts jurisdiction in class action cases when the amount claimed exceeds \$5 million and when any member of the plaintiff class is a citizen of a State different from that of any defendant (unless at least two-thirds of the class members and the primary defendants are citizens of the State where the lawsuit is filed).⁷¹ Forum shopping is still possible between Federal district courts under the act, and Federal courts are required to use applicable State law in such cases. Even so, this change makes a significant contribution by getting class action cases away from the State courts known for being unduly favorable to plaintiffs. Even though damages claimed in a class action lawsuit can still represent a significant potential legal risk, the new law still represents a noteworthy improvement in the way forum shopping is addressed in class action cases in the U.S. legal system.⁷²
- **Tort reform in the States.** The States have also recognized the importance of tort reform and its connection to economic development and attracting FDI. More than half the States now limit damages.⁷³ States such as Mississippi (see Box 2) have made tort reform a centerpiece of their efforts to improve their business climates.⁷⁴ Investors seek legal regimes that are favorable for investment, and recognition is

Box 2. Case Study: Mississippi Tort Reform

While several States have undertaken tort reform initiatives in the past several years, Mississippi's achievements are particularly noteworthy.

Before 2004, Mississippi was referred to in some quarters as the "jackpot justice capital of America. Juries in certain Mississippi counties were known for returning large verdicts favoring plaintiffs and trial lawyers from elsewhere in the United States to bring mass tort cases in the state. The result was a series of multi-million dollar verdicts in several industries, including environmental, pharmaceutical, banking and insurance. Some insurance companies stopped doing business in the state."⁷⁵

Although the need for change was debated for several years, matters finally came to a head in 2003, when Haley Barbour ran for governor and made the need for tort reform a central issue in his election campaign, tying it to economic development and job growth in the state. Barbour was elected in November 2003.

The State's tort reform law, which was passed by the Mississippi legislature and signed by Barbour in 2004, is considered model legislation in some circles. It includes venue reform, which limits the practice of forum shopping

within the State court system, product liability relief for innocent retailers; limits on joint and several liability; and caps on non-economic damages, such as pain and suffering.

The effect of those changes is just beginning to be felt, but is already viewed as significant. The new law has reportedly virtually eliminated the "mass tort" industry in Mississippi.⁷⁶ Some insurance companies have reportedly returned to Mississippi, and insurance rates have begun to fall. Since 2004, several important investments have been announced, including a \$1.8 billion expansion investment by FedEx Ground and a new \$1.3 billion manufacturing facility by Toyota. When Toyota made its announcement, Barbour observed, "Toyota would not have located in Mississippi if we hadn't passed tort reform."⁷⁷

The extent to which such changes may eventually be imitated in other States is an open question. Mississippi's experience (and the extent of the changes undertaken) illustrates a growing recognition both of the importance of litigation reforms for economic growth and the competitive significance of such reforms with regard to attracting investment.

growing throughout the States that tort reform is an important part of that equation.

Additional Legal System Features Relevant to FDI

There are other topics discussed in the context of FDI and the U.S. legal system that represent potential policy issues. Many of the topics highlight differences between the U.S. legal system and the systems in other countries. Typically, they involve choices between different functional approaches that may affect the perception of a legal system's favorability to FDI.

The topics include (a) the effect of allowing contingency fees;⁷⁸ (b) the advisability of adopting a "loser pays" rule covering a lawsuit's legal costs;⁷⁹ (c) the effect of joint and several liability among defendants to a lawsuit;⁸⁰ (d) the advisability of compensating successful plaintiffs for non-economic damages;⁸¹ (e) the advisability of allowing immediate appeals of decisions on pre-trial motions to dismiss a lawsuit;⁸² (f) the nature, extent, and costs of pre-trial discovery;⁸³ (g) the use of specialized tribunals instead of courtroom trials;⁸⁴ and (h) the extent to which compliance with regulatory standards should provide a safe harbor from tort liability.⁸⁵

Addressing the issues individually is beyond the scope of this paper. However, at a recent conference,⁸⁶ Peter Chaffetz, global head of litigation and dispute resolution at Clifford Chance, an international law firm, made an important observation

concerning the issues as a whole. After mentioning several of the listed differences, he said, "When you look around the world, it's a striking fact that most other countries don't have any of these features. I'm personally not aware of any that has more than one or two. But acting in combination, it is these elements that have embedded civil litigation as a major American industry."⁸⁷

Ultimately, there may be a legitimate policy debate about the merits of different aspects of some of the different approaches. Many of the features of the U.S. legal system have positive benefits as well as costs. Contingency fees and the lack of a "loser pays" rule, for example, have their origins in American values of fairness. Many believe that such features significantly strengthen the legal process for economically disadvantaged individuals. The effect those choices have on FDI and U.S. business, however, is also an important part of that debate.

Areas Where Additional Attention Is Needed

The Supreme Court's limitations on punitive damages and the implications of the Class Action Fairness Act of 2005 in particular may have a significant effect. Additional steps might be considered to address other areas where problems have been identified.

- **Support and encourage State efforts on tort reform.** There are real limits on what can be

Box 3. Asbestos and the Tort System

The tort system's treatment of asbestos cases demonstrates how the system can fall short of its purported objectives of deterring harmful behavior and funding compensation. Beginning in the 1970s, increased public awareness and concern about the health effects of asbestos led to regulations limiting exposure to asbestos. By 1989, all new uses were banned, and strict regulations have limited remaining asbestos use. Between 1973 and 2001, asbestos use in the United States fell by 98 percent. With extensive regulations in place and minimal use, the tort system's role in deterring harmful behavior has been substantially reduced simply because there is little activity to deter.

Yet even as the use of asbestos declined, the number of claims rose substantially. The total number of claimants is estimated to have grown from 21,000 in 1982 to over 600,000 by the end of 2000. To be sure, some additional claims are warranted because cancers caused by asbestos can take years to develop. An estimated 90 percent of the new claims, however, are by people who have no cancers and may never develop cancer. Claims by individuals without a diagnosed asbestos-related cancer account for almost all of

the growth in asbestos case loads during the 1990s, and most of the compensation received by claimants goes to those without malignant cancers. Only 43 percent of the money spent on asbestos litigation is recovered by claimants—the rest goes to lawyers and administrative costs. In short, the current system neither achieves deterrence in the use of this dangerous substance nor directs appropriate compensation to its victims.

Instead, asbestos litigation has imposed costs on workers, shareholders, and those who in the future will become ill from their previous exposure to asbestos. Estimates suggest that roughly 60 companies entangled in asbestos litigation have gone bankrupt primarily because of asbestos liabilities, with most of the bankruptcies occurring since 1990. One study estimated that between 52,000 and 60,000 workers were displaced because of these bankruptcies. Moreover, bankruptcy results in a shrinking pool of money to be divided up among future claimants. The growing number of bankruptcies raises concerns that those who become ill in the future will receive little or no compensation.

—Excerpt from Council of Economic Advisers, "The Tort System," in 2004 Economic Report of the President, chapter 11.

done to address some issues at the national level because of the shared sovereignty and responsibility inherent in the Federal system. States should be appropriately encouraged in their efforts to address these issues within their own jurisdictions. The aspects of punitive damages and forum shopping within a State court system seem particularly suited to such efforts. Also, details of their efforts should be shared, and the successes associated with such efforts should be explained and recognized.

- **Encourage judges to make this area a priority.** Judges in Federal and State judiciaries should be appropriately encouraged to enforce existing legal standards. Judges often have authority to assign costs in cases in which the action is deemed frivolous. They should similarly be encouraged to address issues of apparent tort fraud: "[J]udges have a responsibility on behalf of a free society to assert standards of reasonable behavior and to prevent the power of justice from being used by private parties as a form of extortion. That's their role in our constitutional system."⁸⁸
- **Lower tort-related expenses as a share of GDP.** The high tort-related costs associated with doing business in the United States are a competitiveness issue and merit sustained attention. The U.S.-based Council on Competitiveness suggests that the United States should set a goal to reduce the costs associated with tort litigation from the current level of 2 percent of GDP to a level half that size.⁸⁹ Such a reduction would

bring U.S. tort-related costs more in line with other advanced countries that compete with the United States for global FDI flows.

Need for Additional Economic Research and Analysis

This policy debate needs to be engaged for several reasons. The current mix of policy choices and existing practices has caused uncertainty among international investors and has led to the United States becoming a high-cost environment with respect to several legal issues.

That said, people need to recognize that this area is a new one, and that there is a strong need for significant additional economic research and analysis. While it is clear that the U.S. legal environment is costly in some respects and that there is a negative perception of the litigation environment, not enough evidence or research currently exists to determine the litigation environment's actual effects on FDI in the United States. It remains unknown whether the litigation environment indeed has a material effect on FDI; what the size of that effect might be; whether the effect differs depending on factors such as type of investment, industry, or size of firm; and what aspects of the litigation environment are the most important deterrents to foreign investment.

Although there is no shortage of anecdotal information, additional quantitative data is needed to guide policymakers. Surveys clearly indicate negative perceptions of the American

litigation environment and show that litigation is a concern for companies operating in the United States. However, this information does not prove that the litigation environment is an important factor in whether firms decide to invest in the United States.

Some counterevidence indicates that litigation has not been a major factor. Tort costs as a percentage of GDP were at their peak in the mid- to late 1980s, when FDI was surging into the United States. Some have put forward a hypothesis that the size of the U.S. market makes it a place where large international companies have concluded they need to be, and the high costs of litigation, while prompting complaints, has simply been treated as a cost of doing business.⁹⁰ Alternatively, the general certainty of the rule of law in the U.S. legal system may provide the United States with a comparative advantage in attracting FDI.

Most of the evidence regarding negative perceptions of the U.S. litigation environment is focused on firms already operating in the United States. Research that looks at factors considered by firms thinking of investing in the United States or the reasons firms choose to invest elsewhere would shed light on how perceptions of the litigation system affect investment decisions. Similarly, if perceptions of the litigation environment play a significant role, they should be reflected in firm behavior that could potentially be measured with hard data.⁹¹ In addition to looking at how perceptions of the litigation

environment affect investment decisions, research that looks more specifically at how litigation affects the costs of foreign-owned businesses and the different types of foreign investment would be of interest.⁹² Further research might also address how litigation costs affect different types of foreign investment in the United States. Another important question is what particular aspects of the litigation environment are especially costly and deter foreign investment. A better understanding of those aspects could help inform efforts to make the U.S. litigation environment less of a barrier to investment.

Further analysis could also look at what aspects of the legal system may be costly and a cause for concern to some firms but may be beneficial for others.⁹³ Other areas of the litigation environment may be costly but very difficult to remedy, such as litigation culture.

Lastly, once areas of the litigation environment that are most harmful and least beneficial have been identified, work should focus on identifying possible solutions. Depending on what areas of the system are identified as priorities for improvement, solutions could come in a variety of forms: tort reform legislation (such as limits on damages), coordination efforts (such as states working to limit forum shopping), market solutions (such as increased use of insurance), or even technology (for example, to decrease cost of the pretrial discovery).

Notes

¹ World Bank, *Doing Business 2009: Comparing Regulation in 181 Economies* (Washington, D.C.: Palgrave Macmillan and World Bank, 2008).

² See the survey Eurochambres and U.S. Chamber of Commerce, "Obstacles to Transatlantic Trade and Investment" U.S. Chamber of Commerce, Washington, D.C., June 2005, pp. 11–12.

³ Robert E. Litan, "Through Their Eyes: How Foreign Investors View and React to the U.S. Legal System," Institute for Legal Reform, U.S. Chamber of Commerce, Washington, D.C., August 2007, www.instituteforlegalreform.com/issues/docload.cfm?docId=1059.

⁴ See American Association for Justice (formerly the Association of Trial Lawyers of America) Web site at www.justice.org.

⁵ Tillinghast Insurance Consulting, "2007 Update on U.S.

Tort Cost Trends," Towers Perrin, Stamford, Conn., p. 5, www.towersperrin.com/tp/getwebcachedoc?webc=TILL/USA/2007/200712/tort_2007_1242007.pdf.

⁶ Tillinghast Insurance Consulting, "2005 Update on U.S. Tort Cost Trends," Towers Perrin, Stamford, Conn., p. 12.

⁷ George W. Bush, "President Bush's Statement on Open Economies," News release, Office of the Press Secretary, White House, Washington, D.C., May 10, 2007, www.whitehouse.gov/news/releases/2007/05/20070510-3.html; George H. W. Bush, "Statement on Foreign Direct Investment Policy," American Presidency Project, University of California at Santa Barbara, December 26, 1991, www.presidency.ucsb.edu/ws/print.php?pid=20394; and Ronald Reagan, "Statement on International Investment Policy," American Presidency Project, University of California at Santa Barbara, September 9, 1983, www.presidency.ucsb.edu/ws/index.php?pid=41814.

See also William Clinton, "Remarks at American University Centennial Celebration," Office of the Press Secretary, White House, Washington, D.C., February 26, 1993, p. 6.

⁸ See Bill Marriott, letter to the president on civil justice reform, August 23, 2007, President's Export Council, Washington, D.C., www.ita.doc.gov/td/pec/Civil_Justice_Reform.pdf.

⁹ Eurochambres and U.S. Chamber of Commerce, "Obstacles to Transatlantic Trade and Investment," pp. 11–12.

¹⁰ *Ibid.*, pp. 10–11.

¹¹ McKinsey & Company, *Sustaining New York's and the U.S.' Global Financial Services Leadership*, Report for New York City Mayor Michael Bloomberg and New York Senator Charles Schumer (New York: McKinsey & Company, 2006), pp. 75, 77.

¹² World Bank, *Doing Business 2009*.

¹³ The U.S. Bureau of Economic Analysis defines FDI in the United States as "ownership or control, directly or indirectly, by one foreign person, or entity, of 10 percent or more of the voting securities of an incorporated U.S. business enterprise or an equivalent interest in an unincorporated U.S. business enterprise." Bureau of Economic Analysis, "Glossary," U.S. Department of Commerce, Washington, D.C., November 2007, www.bea.gov/glossary/glossary.cfm?letter=F.

¹⁴ Eurochambres and U.S. Chamber of Commerce, "Obstacles to Transatlantic Trade and Investment."

¹⁵ United Nations Conference on Trade and Development, "Foreign Direct Investment Database," United Nations Conference on Trade and Development, Geneva, www.unctad.org/Templates/Page.asp?intItemID=1923&lang=1; Bureau of Economic Analysis, "International Economic Accounts: Balance of Payments (International Transactions)," U.S. Department of Commerce, Washington, D.C., www.bea.gov/international/index.htm#bop.

¹⁶ Thomas Anderson, "U.S. Affiliates of Foreign Companies: Operations in 2006," *Survey of Current Business* 88, no. 8 (August 2008): 186–203, www.bea.gov/scb/pdf/2008/08%20August/0808_affiliate.pdf.

¹⁷ *Ibid.*

¹⁸ Information is compiled and analyzed from data provided by the Bureau of Economic Analysis at www.bea.gov.

¹⁹ See Bush, "President Bush's Statement on Open Economies."

²⁰ World Bank, *Doing Business 2009*.

²¹ *Ibid.*, p. 143. The World Bank metric on protecting investors relates primarily to concerns involving portfolio investment. Although not irrelevant to FDI, portfolio investment does not directly address many of the concerns that arise in connection with the U.S. domestic litigation environment.

²² Bush, "President Bush's Statement on Open Economies." In his statement, President Bush said, "The United

States provides foreign investors fair, equitable, and non-discriminatory treatment as a matter of both law and practice. While there are exceptions, generally related to national security, such exceptions are few: they limit foreign investment only in certain sectors, such as atomic energy, air and water transport, and telecommunications. These exceptions are consistent with our international obligations."

²³ Tillinghast Insurance Consulting, "2007 Update on U.S. Tort Cost Trends."

²⁴ "The methodology used to develop estimates of tort costs in this study... incorporates three cost components: benefits paid or expected to be paid to third parties (hereafter referred to as 'losses'); defense costs; administrative expenses." *Ibid.*, p. 7. See section title "Methodology and Approach" for a more complete discussion of this topic.

²⁵ "Commercial" reflects torts alleged against business, including all medical malpractice. "Personal" tort costs include torts alleged against individuals, excluding medical malpractice." *Ibid.*, pp. 5–6.

²⁶ *Ibid.*, p. 6 and note at p. 5: "Throughout this report, unadjusted, or nominal GDP is used. Most news releases on GDP rely on inflation-adjusted, or real, GDP." The calculation of real average annual growth uses a GDP deflator rather than the consumer price index because of the index's tendency to overstate inflation in the long run.

²⁷ Tillinghast Insurance Consulting, "2005 Update on U.S. Tort Cost Trends," p. 12. Current information on this topic was not included in the "2007 Update on U.S. Tort Cost Trends." Towers Perrin's contribution to the comparative aspects of this issue is unique and highlights the need for additional quantitative research.

²⁸ Philip K. Howard, "Making Civil Justice Sane," *City Journal* 16, no. 2 (Spring 2006): 64.

²⁹ These figures stand in interesting contrast to the World Bank's findings that the United States has among the lowest costs for enforcing contracts (9.4 percent of claim). World Bank, *Doing Business 2009*, p. 143. This finding compares with 14.4 percent for Germany (p. 105), 17.4 percent for France (p. 104), 22.7 percent for Japan (p. 112), 23.4 percent for the United Kingdom (p. 142), and 24.0 percent for Switzerland (p. 137).

³⁰ Harris Interactive, "Lawsuit Climate 2008: Where Does Your State Rank," report conducted for the Institute for Legal Reform, U.S. Chamber of Commerce, Washington, D.C., 2008. Respondents were asked to grade the individual States in each of the following areas: (1) having and enforcing meaningful venue requirements, (2) overall treatment of tort and contract litigation, (3) treatment of class action suits and mass consolidation suits, (4) punitive damages, (5) timeliness of summary judgment or dismissal, (6) discovery, (7) scientific and technical evidence, (8) non-economic damages, (9) judges' impartiality and competence, and (10) juries' predictability and fairness (p. 6).

³¹ Ibid., p. 10. Individual states reported scores ranging (out of a possible 100) from 71.5 for the top state to a low of 42.4, with an average state rating of 59.4 (p. 15).

³² Ibid., p. 9.

³³ See Philip K. Howard, *The Collapse of the Common Good: How America's Lawsuit Culture Undermines Our Freedom* (New York: Ballantine Books, 2007).

³⁴ Ibid. The negative publicity surrounding fraudulent conduct involving leading plaintiff's attorneys is also relevant to understanding how a negative view of the U.S. tort system has developed. See Julie Creswell, "Milberg Weiss Is Charged with Bribery and Fraud," *New York Times*, May 18, 2006, www.nytimes.com/2006/05/18/us/18cnd-legal.html.

³⁵ Henry M. Paulson, "Remarks by Treasury Secretary Henry M. Paulson on the Competitiveness of U.S. Capital Markets," Economic Club of New York, November 20, 2006.

³⁶ Eurochambres and U.S. Chamber of Commerce, "Obstacles to Transatlantic Trade and Investment," pp. 10–12.

³⁷ Neil Newhouse Public Opinion Strategies, "Insourcing Survey: A CEO-Level Survey of U.S. Subsidiaries of Foreign Companies," survey conducted for the Organization for International Investment, Washington, D.C., May 2007.

³⁸ McKinsey & Company, *Sustaining New York's and the US' Global Financial Services Leadership*, p. 75.

³⁹ Ibid., p. 77.

⁴⁰ FDI-related problems are likely to be ones that (a) could affect anyone competing in the market; (b) strike the international investor as capricious or materially unfair; (c) have the potential to significantly affect the investment or broader reputation of the investor; and (d) lack clarity with respect to how they should be handled, even with strong management or good professional advice.

⁴¹ Five States (Louisiana, Massachusetts, Nebraska, New Hampshire, and Washington) reportedly do not have punitive damages. Harris Interactive, "2008 U.S. Chamber of Commerce State Liability Systems Ranking Study," study conducted for the Institute for Legal Reform, U.S. Chamber of Commerce, Washington, D.C., April 15, 2008, p. 7.

⁴² John L. Diamond, Lawrence C. Levine, and M. Stuart Madden, *Understanding Torts*, 2nd ed. (New York: Matthew Bender, 2000), pp. 249–53, section 14.05.

⁴³ Ibid. A U.S. Department of Justice study involving civil trial cases in the 75 largest counties in the United States is reported to have found that punitive damages were awarded in 4.5 percent of cases where plaintiffs won (2.3 percent of all cases), but represented 21 percent of all damages awarded to plaintiffs. Council of Economic Advisers, *2004 Economic Report of the President*, 108th Congress, 2nd sess., H. Doc. 108-145, p. 211.

⁴⁴ Adam Liptak, "Courts Wary of U.S. Punitive Damages," *New York Times*, March 26, 2008, p. 1.

⁴⁵ See Phillip K. Howard, "Making Civil Justice Sane," pp. 66–68. See also Litan, "Through Their Eyes," pp. 15–16. But see also Council of Economic Advisers, *2004 Economic Report of the President*, p. 216: "Empirical evidence suggest that U.S. judges and juries decide cases in approximately the same way."

⁴⁶ Liptak, "Courts Wary of U.S. Punitive Damages."

⁴⁷ Diamond, Levine, and Madden, *Understanding Torts*, p. 253, section 14.05.

⁴⁸ Plaintiffs often seek punitive damages when a case is filed. "[O]nce a prayer for punitive damages is on the table ... defendants are truly on the defensive. Foreign investors cannot help but take notice." Litan, "Through Their Eyes," pp. 14–15.

⁴⁹ Liptak, "Courts Wary of U.S. Punitive Damages."

⁵⁰ Litan, "Through Their Eyes," pp. 12–13.

⁵¹ Ibid.

⁵² Ibid. But see articles indicating that France is a recent exception, albeit on a limited basis. "French Class-Action Lawsuits Back on the Agenda," Expatica.com, July 13, 2007, www.expatica.com/fr/articles/news/french-class-action-lawsuits-back-on-the-agenda-41863.html. In 2006, the French government is reported to have enacted a consumer protection law that, among other things, would introduce a modified version of class action lawsuits. The law reportedly created a two-phase process in which judges would hear class action complaints filed by government-approved consumer organizations covering consumer goods linked to a contract. Damages are capped at €2,000. "The law would not introduce lawyer contingency fees, punitive damages, or civil trials with juries into France. Class actions would not be allowed for medical complaints, transportation accidents, or other non-commercial disputes." Rick Mitchell, "French Ministers Rubber Stamp Class-Action Bill," *Business Insurance*, November 10, 2006, www.businessinsurance.com/cgi-bin/news.pl?newsId=8786.

⁵³ Eurochambres and U.S. Chamber of Commerce, "Obstacles to Transatlantic Trade and Investment," p. 12.

⁵⁴ See Office of the Press Secretary, "President Participates in Class-Action Lawsuit Reform Conversation," News release, White House, Washington, D.C., February 9, 2005, www.whitehouse.gov/news/releases/2005/02/20050209-15.html. The conversation was held at the Department of Commerce and included remarks from Alita Ditowsky, who received a \$50 rebate coupon (for any purchase of \$100 or more) in connection with a class action settlement that involved a television set she had purchased. The lawyer who brought the suit reportedly received \$22 million.

⁵⁵ "Forum shopping: The process by which a plaintiff chooses among two or more courts that have the power—technically, the correct jurisdiction and venue—to consider [the] case. This decision is based on which court is likely to consider the case most favorably. In

some instances, a case can properly be filed in two or more federal district courts as well as in the trial courts of several states—and this makes forum shopping a complicated business. It often involves weighing a number of factors, including proximity to the court, the reputation of the judge in the particular legal area, the likely type of available jurors, and subtle differences in governing law and procedure.” Nolo, “Glossary: forum shopping,” www.nolo.com/definition.cfm/Term/6A51B5C1-469D-4D5E-BBFB579BBFB0496C/alpha/F/.

⁵⁶ In a perfect world, neither the plaintiff nor the defendant in a lawsuit would expect this choice between courts to matter. The result would be dictated by the law and the facts of the case and not by the court’s location. Although probably impossible in the real world, such neutrality between venues is, however, an important aspiration of any rule-based legal system.

⁵⁷ Litan, “Through Their Eyes,” p. 14.

⁵⁸ Lisa A. Rickard, “New Report Shows Need to Curb Lawsuit Abuse in Jackpot Jurisdictions,” statement of Institute for Legal Reform, U.S. Chamber of Commerce, Washington, D.C., December 13, 2006, www.uschamber.com/press/releases/2006/december/06-191.htm.

⁵⁹ See Harris Interactive, “Lawsuit Climate 2008.” An important contributing factor is that some state judges are elected to their positions (and may need to run for re-election from time to time) is seen by critics as an important contributing factor. See Council of Economic Advisers, *2004 Economic Report of the President*, p. 217.

⁶⁰ See Harris Interactive, “Lawsuit Climate 2008.”

⁶¹ Litan, “Through Their Eyes,” pp. 13–14.

⁶² See Harris Interactive, “Lawsuit Climate 2008.”

⁶³ “It is hard to remember, but until a few decades ago, people didn’t go through the day worrying about suing or being sued.... Society wasn’t perfect, but people felt free to make daily judgments based on what they believed was right.” Howard, *The Collapse of the Common Good*, p. 24. A Harris Interactive survey taken in 2005 found that only 16 percent of Americans trust the legal system to defend them against a baseless claim. Harris Interactive, “Public Trust of Civil Justice, 2005,” www.instituteforlegalreform.com/issues/docload.cfm?docId=990.

⁶⁴ Peter Eklind, “Milberg Weiss Faces the Music,” *Fortune*, October 3, 2007, www.money.cnn.com/2007/10/01/news/companies/Melvyn_weiss.fortune/index.htm. See also Richard Fausset, Jenny Jarvie, and Henry Weinstein, “Bribery Case Brings Down Legal Legend,” *Los Angeles Times*, March 15, 2008, p. A-1, <http://articles.latimes.com/2008/mar/15/nation/na-scruggs15>.

⁶⁵ The U.S. Chamber of Commerce’s Institute for Legal Reform has created a Web site, www.iamlawsuitabuse.org, that contains stories and interviews (using Internet video) about the experiences of several individuals and small business owners who believe that they have been subject to abusive use of the legal system. The

institute has performed an important service in making the accounts available to a broader audience. The accounts are not necessarily typical of what businesses in the United States face every day, but they stand as an example of the kinds of experiences that can occur.

⁶⁶ *State Farm v. Campbell*, 538 U.S. 408 (2003).

⁶⁷ *Cooper v. Leatherman*, 532 U.S. 424 (2001).

⁶⁸ *State Farm v. Campbell*, 538 U.S. at 417.

⁶⁹ See Litan, “Through Their Eyes,” p. 15.

⁷⁰ Class Action Fairness Act of 2005, 109 P.L. 2 (2005).

⁷¹ Id. at section 4(a). See Litan, “Through Their Eyes,” pp. 13–14.

⁷² See discussion in Litan, “Through Their Eyes,” pp. 13–14.

⁷³ Howard, “Making Civil Justice Sane,” p. 64.

⁷⁴ Civil Justice Reform Act of 2004, Mississippi Laws, 1st Executive Sess., Ch. 1 (House Bill 13).

⁷⁵ Charlie Ross, “Jackson Action: In Mississippi, Tort Reform Works,” *The Wall Street Journal*, September 15, 2005, www.opinionjournal.com/cc/?id=110007260.

⁷⁶ Ibid.

⁷⁷ Haley Barbour, “Prepared Remarks of Governor Haley Barbour at the Neshoba County Fair,” Jackson, Miss., July 26, 2007, www.governorbarbour.com/speeches/ncf07.htm.

⁷⁸ Contingency fees are available to finance plaintiffs’ lawsuits in the United States, and they are generally thought to increase the likelihood of litigation. They also make it possible for legitimate complaints to be pursued when a plaintiff would otherwise be unable to afford legal services. In other countries, contingency fees are typically limited or prohibited on public policy grounds. Litan, “Through Their Eyes,” p. 12.

⁷⁹ Much is often made of the difference between the U.S. system in which the parties to a lawsuit each pay their own legal costs, and the “loser pays” rule of the United Kingdom. The U.S. rule emphasizes that plaintiffs should not be deterred from asserting a potentially legitimate claim, whereas the United Kingdom’s rule takes the view that the loser should pay the legal fees of the party who prevails, as a matter of fairness and as a deterrent to frivolous litigation on both sides.

⁸⁰ When multiple defendants are named in a civil lawsuit in the United States, the defendants—as a group—are jointly and severally liable. Each defendant is responsible for the full amount if one or more of the other defendants cannot pay. Litan, “Through Their Eyes,” p. 13.

⁸¹ The U.S. legal system differs from that of many other countries in that it allows plaintiffs to recover both economic losses (for example, medical costs, present and future lost wages), and non-economic losses (for example, pain and suffering). Non-economic losses are viewed as harder to quantify and add substantially to tort system costs. According to a 2004 report prepared by the U.S. Council of Economic Advisers, the amount of non-economic damages spent in the tort system that

goes to plaintiffs is greater than the damages received for economic losses. “Of the 46 cents of each dollar spent in the tort system that goes to plaintiffs, 22 cents compensates them for economic losses and 24 cents compensates them for noneconomic damages.” Council of Economic Advisers, *2004 Economic Report of the President*, p. 209.

⁸² A pretrial motion to dismiss, when granted, typically stops the lawsuit and is immediately appealable. When a pretrial motion to dismiss is denied, the decision typically cannot be appealed immediately and must await the completion of both the pretrial process and the trial itself. See Judiciary and Judicial Procedure, 28 U.S.C §§ 1291, 1292 (2008), and related case law.

⁸³ The U.S. legal system differs from that of many other countries in that it requires developing an extensive written record before trial by means of a pretrial discovery process. The discovery process makes decisions in legal disputes more fact-based and contributes to more accurate trial decisions. See U.S. Chamber of Commerce, “Transcript of Lawsuits and Global Competitiveness: Is the U.S. Litigation System a Beacon or a Barrier to Foreign Investment?” U.S. Chamber of Commerce, Washington, D.C., August 1, 2007, p. 10–12, panel 2 (unpublished transcript, on file with author; Webcast available at www.uschamber.com/webcasts/2007/default). The discovery process has been criticized, however, as being expensive, in terms of actual cost and lost management and employee time, and as a source of delay. Litan, “Through Their Eyes,” p. 13. That said, discovery is a natural corollary to the common law legal tradition in the United States, which makes distinctions on the basis of factual differences. Factual discovery also assists in “leveling the playing field” against an opponent whose records may contain information necessary to resolve issues in a case.

⁸⁴ U.S. courts work well when the disputed matters in a case are reasonably understandable to the judge or jury and when the outcome primarily affects the specific parties in a given lawsuit. When that is not the case, however, there is an argument to be made for using a specialized tribunal to resolve the dispute. The asbestos litigation (see Box 3) that has been occupying U.S. courts for more than 40 years has often been criticized as a larger industry and societal issue that is inappropriate for resolution in what often seems to be an endless series of lawsuits that each take years and that, in some cases, have bankrupted companies only tangentially involved with asbestos products. By comparison, seven years ago, when the United States was faced with the tragic consequences of the September 11 attacks, it was determined that matters would not be left to the court system but would instead be handled by a specialized tribunal so that compensation would be provided promptly and fairly to those who suffered. See the Air Transportation Safety and System Stabilization Act of 2001, Title IV of Pub. L. 107-42, 115 Stat. 237, 49 U.S.C.

§ 40101 (2001). New Zealand has chosen to prohibit personal injury damage actions and has substituted a government-run compensation system that covers virtually all accidental injuries. Injury Prevention, Rehabilitation, and Compensation Act (2001 No. 49). See Peter H. Schuck, “Tort Reform, Kiwi-Style,” *Yale Law and Policy Review* 27, no. 1 (forthcoming).

⁸⁵ As Robert Litan, senior fellow at the Brookings Institution, puts it, “This aspect of the U.S. legal system seems unfair and inefficient, since presumably the main reason for administrative agencies to exist is to issue interpretations of legislative mandates that can help better guide the behavior of private actors. If juries nonetheless can hold particular defendants to different standards of behavior—with 20/20 hindsight, well after the fact, in a lawsuit—then why issue the regulations in the first place?” Litan, “Through Their Eyes,” p. 14.

⁸⁶ U.S. Chamber of Commerce, “Transcript of Lawsuits and Global Competitiveness.”

⁸⁷ *Ibid.*, p. 10, panel 2.

⁸⁸ Howard, *The Collapse of the Common Good*, p. 62.

⁸⁹ “The country should set a goal to reduce the costs of tort litigation from the current level of two percent of GDP—some \$200 billion—down to one percent.” Council on Competitiveness, *Innovate America: National Innovation Summit and Report* (Washington, D.C.: Council on Competitiveness, 2005), p. 65.

⁹⁰ See Litan, “Through Their Eyes,” p. 24.

⁹¹ For example, investment trends might change following changes in tort law, new precedents, and high-profile cases, or investment trends might vary by state—with states with better litigation environments receiving more investment. Countries similar to the United States but with better litigation environments would be expected to see an uptick in foreign investment as the U.S. environment grows more costly.

⁹² It would be useful to determine whether those aspects of the litigation environment that are perceived as most harmful are indeed those that are most costly for business that are operating here. In addition, the effects of the litigation environment may differ by type of investment. Costs of litigation may differ by the size of a company or by industry. If so, the litigation environment could affect not only how much foreign investment comes to the United States, but what kinds of investment—and what kinds of jobs—the United States attracts.

⁹³ Business-to-business litigation is listed as a top concern of executives at multinational companies, but it is beneficial for a company that is looking for redress as the plaintiff. In another example, strong intellectual property laws may encourage more litigation, but they may attract firms interested in investing in research and development in the United States.

This paper was prepared by Charles G. Schott, Senior Advisor
Invest in America, Market Access and Compliance, International Trade Administration



1401 Constitution Ave., NW
Washington, DC 20230

Carlos M. Gutierrez
Secretary of Commerce
www.commerce.gov