SMALL BUSINESS LIABILITY REFORM (H.R. 2813)

HEARING

BEFORE THE

SUBCOMMITTEE ON REGULATORY REFORM AND OVERSIGHT

OF THE

COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

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THURSDAY, JULY 22, 2004

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON REGULATORY REFORM AND OVERSIGHT,
COMMITTEE ON SMALL BUSINESS
Washington, D.C.

The Subcommittee met, pursuant to call, at 2:05 p.m. in Room 311, Cannon House Office Building, Hon. Edward L. Schrock [chairman of the Subcommittee] presiding.

Present: Representatives Schrock, Kelly, Velazquez and Christensen.

Chairman SCHROCK. Let us go ahead and begin our hearing. We are glad to have Congressman Chabot here.

Our hearing today addresses the cost of tort liability to the small business community. Tort liability has become a cost of doing business in the United States that makes us less competitive. One study puts the cost at 4.5 percent of manufacturing output. That is four times as much as those in Canada, the United Kingdom and Japan.

It has been as much as eight times as high as those in Mexico, Taiwan, South Korea or China. Other nations have far better and less costly tort systems. A study sponsored by the U.S. Chamber shows the cost of tort liability for small businesses in America is $88 billion a year. Small business bear a disproportionate share of the total tort liability burden. Although taking in only 25 percent of business revenue, they face 68 percent of the tort costs. The average liability cost for small businesses is $15 per $1,000 of revenue, while large corporations average $5.39 per $1,000 of revenue.

Reducing the cost of tort liability is clearly an issue of great importance to small businesses. The president has made ending lawsuit abuse a cornerstone of his plan for economic recovery. In a speech in Mississippi he said, and I quote, "Junk and frivolous lawsuits can ruin an honest business. Listen," he said, "small businesses are the backbone of our society. Most new jobs are created by small businesses. And when you have junk and frivolous lawsuits that could completely wipe out a small business hanging over the heads of small business people it doesn't help. It hurts economic vitality and economic growth."

The president clearly sees the threat of frivolous lawsuits and our current tort system to the strength of the American economy. It is incumbent upon Congress to vigorously reform the system.

We are fortunate today to have Ohio Congressman Steve Chabot with us. I can say without question there are few members of this chamber, this Congress, who could rival his commitment to restoring common sense to our legal system and protecting small business. We are anxious to hear from him today and lucky that he could be here with us.

It is important to remember that small businesses generate nearly 80 percent of the new jobs each year in this country and account for 50 percent of its total payroll—total private payroll, and recently they have been critical to our economy. From 2000 to 2001 small businesses created 100 percent of the net new jobs. Every effort should be made to protect and encourage small business development.

I would like to thank the congressman for being here as well as those who will follow him. I feel we have two exceptional panels of witnesses before us and I look forward to all their testimony.

Before we go to Congressman Chabot I would like to yield to Ms. Velazquez for any comments she might have.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Today we will examine the liability costs of small businesses. Congressman Chabot, I appreciate your taking the time to be here to discuss the Small Business Liability Reform Act which you introduced last year. Given that you have taken a lead on this issue I look forward to hearing your observations on this matter.

We have all heared the arguments on the need for tort reform, the costs to taxpayers and the costs of rising premiums. We need to work in a bipartisan manner to get the heart of this program and formulate solutions that meet the needs of our nation's small businesses and consumers. Any wholesale changes to our legal system must be based on independent empirical data, not just the emotion of the issue. In my time on the Committee, I have heard many compelling stories but have seen little compelling data. In fact, my review of the Bureau of Justice statistics and National Center for State Courts concerns an across-the-board 10-year decline in tort filings and awards.

When addressing policy changes, Members of Congress have the responsibility to ensure that decisions are based on unbiased information and evidence. I hope today's hearing will provide an opportunity to separate the hard facts from perceptions. In order to move forwards, we must first pinpoint the systematic problems that are hurting our nation's small businesses. Armed with this knowledge we can then cross-target solutions and ensure that we do not create unintended, long-term consequences that will harm small businesses.

I am concerned that if we do not have a better handle on what our small businesses need, we will end up with policies that offer them no help. In the zeal to help our nation's entrepreneurs, we have seen several bills move through this body that were represented as small business relief. In reality the lion's share of benefits went to large corporations, and small businesses received just a fraction.

The consequences for small businesses and consumers are far too serious to repeat this pattern with liability reform. NFIB's own sur-

veys and independent polls all show tort reform is not a high priority for small businesses. So let us slow down and figure out what is really going on. Once the liability needs of our nation's small businesses are adequately assessed, balanced policy reforms can be pursued.

In the meantime we should focus on health insurance, tax reform, work force issues and regulatory relief. These are the issues that consistently rank as the top concerns for U.S. small companies and are where we can have the most impact in supporting the growth of our nation's small business owners.

With that I thank the Chairman and I look forward to the testimony of our witnesses.

Chairman SCHROCK. Thank you, Ms. Velazquez. Would Dr. Christensen like to have an opening statement?

Ms. CHRISTENSEN. Thank you, Chairman Schrock. I am really glad that the Subcommittee is holding this hearing to look at the merits of H.R. 2813, the Small Business Liability Reform Act. Reportedly, small businesses bear significant share of the costs of U.S. tort liability, $88 billion annually. But what I would like to also find out is what percentage is that when one considers all businesses and how much of that is due to personal injury suits. Also, what kinds of businesses are included in that report?

For example, if health-related businesses are included and we consider them small businesses I think that would significantly skew the results of the study. But whatever the costs and the make-up of the businesses, if small businesses do bear a disproportionate burden of liability costs or if liability costs are significantly burdening them, regardless of the proportion of the costs or relationship to the larger corporations, it is something that this Committee needs to look at, examine thoroughly and fashion a remedy for. But caps have not proven to be an effective approach.

I really want to commend Representative Chabot for his effort to provide tort reform for small businesses. But the bill does raise several concerns, including what is the definition of small business, its caps on punitive damages, limits on non-economic awards, and preemption in some cases of state law.

Other portions of the legislation really provide no protection for the injured. In fact, the injured party under this bill appears to be less protected.

It in fact reminds me a lot of what we went through on malpractice reform. And I would wonder since there is no clear definition of which small business needs are covered, if this is not another approach to achieving malpractice tort reform without really calling it that. But as a physician I do share—I would not want to say that malpractice reform is not needed. I think I share the same concern in that case that I share, that I have for small business where relief is needed. But I really do not think that caps are the answer. What we really need to do in both cases is to really take a comprehensive approach that includes the assessments of what the causes are for the increasing premiums and the increasing costs that are incurred by small businesses in this case and really

do a bill that addresses each one of those issues, look at the cause and craft some remedies that really get to the bottom of it.

But I am interested to hear the testimony today and to hear from our colleagues and see if this bill can in some fashion address some of the issues that small businesses are facing.

Chairman SCHROCK. Thank you, Doctor.

Congressman Chabot is the chairman of the Subcommittee on the Constitution, also a member of the Small Business Committee. And as soon as he does his testimony he has to return to the Floor. He is speaking on legislation and he has to get back.

So with that, the floor is yours, Steve.

STATEMENT OF THE HONORABLE STEVE CHABOT, U.S. HOUSE OF REPRESENTATIVES (OH-1)

Mr. CHABOT. Thank you very much, Mr. Chairman. It is certainly a pleasure to be here this afternoon. And as you mentioned, I am not going to be able to stick around after my testimony because I am going to have to get to the floor. We are involved in fairly non-controversial issues, gay marriage. So obviously it is a very involved issue and they are debating it as I speak. So I am going to try to keep my testimony fairly concise. And I appreciate the members here and I appreciate the remarks that I did hear. And thank you for giving me the opportunity to appear before the Subcommittee this afternoon on behalf of H.R. 2813, the Small Business Liability Reform Act.

This legislation was first introduced back in the 106th Congress—this, by the way, is the 108th Congress that we are in now—by our former colleague, Congressman Jim Rogan of California and was passed in the House on February 16 of the year 2000 by a 221 to 193 margin. It was not considered in the last Congress, the 107th. I reintroduced the bill in this Congress, the 108th, along with my democratic colleague Ken Lucas from across the Ohio River. Ken, of course, is Kentucky and I am Ohio. So we introduced this together. So it is a bipartisan piece of legislation.

The frequency and high cost of litigation is a matter of growing concern to small businesses across the country. Today's civil justice system presents a significant disincentive to business start-ups and to continued operations of existing businesses already in existence. The litigation costs and excessive judgments affecting small businesses have escalated out of control, destroying lives and businesses and affecting communities both in and out-of-state.

Small business employ after all nearly 60 percent of the American workforce. Further, more than 60 percent of small business owners make less than $50,000. A lot of the public thinks that you are the owner of a business, you are a wealthy individual. That is clearly not the case. It is in some circumstances but in more than half it is not.

Small business owners know that if they are sued they will have to choose between a long and costly trial or an oftentimes expensive settlement. Either choice significantly impacts the operations of a business and the livelihood of its employees. And I think that is something that oftentimes gets lost in these, especially by some

of my, I think some of my folks that may disagree philosophically with tort reform and some other things that when a business goes down the drain because of a lawsuit it is the employees, the little guys and the little gals that are oftentimes hurt the most when that business goes under. Most business decisions today are made with this new reality in mind. These decisions ultimately affect the hiring of new employees, improving existing products or introducing new ones. And they also involve long-term planning.

H.R. 2813, this bill, helps remedy this situation. It is not the solution to it but it is I think a first step.

The Small Business Liability Reform Act is after all, as I mentioned, a bipartisan bill that would make the necessary reforms that have been at the forefront of the small business community's agenda for a number of years now.

Under Title I, the bill would limit punitive damages to $250,000, a quarter of a million dollars, or three times the amount awarded to a claimant for economic and non-economic losses, in other words what lawyers refer to as compensatory damages. It would also eliminate joint and several liability for non-economic losses, instead making defendants responsible for an amount consistent with the harm contributed. And it would also preserve a state's right to legislate intrastate, in other words within the state, disputes by allowing a state to elect out of the statute if all the parties to the lawsuit are citizens of that particular state.

These changes protect small businesses from being unnecessarily punished unless it is established that the conduct that has occurred warrants such a penalty. And it protects small businesses and individual defendants from being liable for non-economic damages that they did not cause. In addition, this bill would make certain reforms for product sellers and distributors other than manufacturers. The chain of distribution of a product provides plaintiffs with wide choice of defendants, including sellers and distributors, who may never have physical control over a product from which to join in a product liability lawsuit.

Under Title II, product sellers and distributors would be held liable for injuries caused by defective products only if, number one, the seller was negligent; two, the seller breached an express warranty or; three, the manufacturer was judgment proof. These reforms would reduce the exposure that sellers and distributors face in the product's so called "chain of distribution."

Mr. Chairman, reform is needed to protect small businesses, promote the flow of goods across state boundaries, and inject fairness into a legal system that is escalating out of control. While pursuing these reforms, we must be cognizant of and protect the rights of those plaintiffs with legitimate claims. And I believe that this bill accomplishes both.

Mr. Chairman, I want to thank you again for holding today's hearing. And I thank my colleagues on the Subcommittee for giving me the opportunity to speak on this important issue. And I want to once again thank my colleague Ken Lucas for his leadership in co-sponsoring this bill along with me. And thank you for your time.[Congressman Chabot's statement may be found in the appendix.]

Chairman SCHROCK. Thank you, Congressman. Thank you very much for being here.

Ms. Kelly has to go to a meeting here shortly. I must vote. I am going to put this Subcommittee in recess until 2:45 until I get back. I assure you I will run down there and I will run right back. I will not dilly-dally, I will be back as quick as I can. The second panel could be sitting and getting set up in the meantime.

So we will recess for a few minutes.

[Recess.]

Chairman SCHROCK. I will call the hearing back to order. Thank you again for your indulgence.

We are happy to have the second panel with us today. Let me first introduce our first witness who is Lisa Rickard who is the President of the U.S. Chamber Institute for Legal Reform. Ms. Rickard is a graduate of the Lafayette College in Easton, Pennsylvania, and received her law degree from American University.

Before we begin I would just ask you all if you could help us with the five minute rule. On the front of the table is a box that lets you know when your time is up. It will turn yellow and then red, then the trap door opens and away you go.

So, Ms. Rickard, the floor is yours. Thank you for being here.

STATEMENT OF LISA A. RICKARD, INSTITUTE FOR LEGAL REFORM, U.S. CHAMBER OF COMMERCE

Ms. RICKARD. Lisa Rickard, President of the U.S. Chamber Institute for Legal Reform. The U.S. Chamber is the world's largest business federation, representing more than three million businesses and professional organizations of every size, in every business sector, and in every region of the country. The U.S. Chamber founded the Institute for Legal Reform in 1998 with the mission of making America's legal system simpler, fairer and faster for everyone. On behalf of the Chamber and ILR, I appreciate the opportunity to testify before the Subcommittee today on the effect of lawsuit abuse on small business. I would also request that a copy of my testimony and the full ILR study, "Tort Liability Costs for Small Business," be included for the record.

Chairman SCHROCK. Without objection.

Ms. RICKARD. No sector of the economy is hit harder by lawsuit abuse than America's small business owners. In our most recent survey of our small business members, over 90 percent of those surveys ranked legal reform as a high or extremely high priority.

Last month ILR released the results of a groundbreaking study that shows the devastating effect of litigation on America's small businesses. Last December, world-renowned actuarial firm Tillinghast Towers-Perrin released its annual report showing that in 2002 the tort system drained our economy to the tune of $233 billion, or $809 per person.

We wanted to go a step further, to find out exactly how the tort system is threatening American small businesses, which create approximately 75 percent of the new jobs in our country. We con-

tracted with NERA Economic Consulting to analyze the numbers. NERA is affiliated with Marsh, Inc., one of the largest commercial insurance brokers in the world. NERA was able to use data on actual purchases by Marsh customers. NERA also analyzed data from A.M. Best, an insurance information service, Market Stance, a market research firm in insurance, and U.S. Economic Census.

What we found in our study is quite troubling. The total cost of the tort system to all U.S. businesses, both large and small, is an astounding $129 billion. NERA's study found that small businesses with $10 million or less in annual revenue, and one or more employees, bear 68 percent of that cost, paying $88 billion a year. That translates into about $150,000 per year, money that could be put into much more productive uses.

Very small businesses, those that we define with less than $1 million in annual revenues, pay $33 billion of that $88 billion per year. What is even more astonishing is that these very small businesses pay $15 billion of their liability costs out of pocket, not through insurance coverage.

What does that all really mean?

To us it means that America's small businesses are paying a high price for our legal crisis in the form of lost opportunities to expand their businesses.

It means that significant small business capital is being diverted to the bank accounts of trial lawyers rather than being invested in tens of thousands of new American jobs.

And it means that American consumers are forced to pay more for everything they purchase, including consumer goods and health care because businesses are forced to raise prices to stay afloat.

I.L.R.'s study highlights why we need comprehensive legal reforms at the federal and state levels that will rein in the excessive influence of trial lawyers and restore fairness and balance to our legal system.

We strongly urge Congress to enact bills that cut back on frivolous litigation, such as the Class Action Fairness Act and the Fairness in Asbestos Injury Resolution Act.

We also support the recently introduced Lawsuit Abuse Reduction Act, medical malpractice reform legislation, the Commonsense Consumption Act, and the host of pending legislation providing liability protection for manufacturers of lawful goods and services.

We also support the Small Business Liability Reform Act, which would place reasonable limits on punitive damages awarded to plaintiffs in liability cases against small businesses, abolish joint liability so that defendants are only liable for their proportionate share of damages, and protect innocent product sellers from liability when the manufacturer is directly responsible for the harm.

Unfortunately, not one of these legal reform bills I just mentioned have been enacted, even as we watch lawsuit abuse stifle economic development in America's states, cities and towns.

In closing, I would like to make clear that ILR strongly believes that those who have been truly injured should receive just compensation through our legal system. That is what America's civil justice system was originally designed to do. It was not, however, intended to become a lottery that bestows jackpot awards on behalf

of random plaintiffs at the expense of unsuspecting, hard-working small businessmen and women.

It is time for all of us Americans to jettison our lawsuit-happy culture and take some personal responsibility for ending the litigation lottery in this country.

On behalf of the U.S. Chamber Institute for Legal Reform and the U.S. Chamber, thank you for the opportunity to appear before you today.[Ms. Rickard's statement may be found in the appendix.]

Chairman SCHROCK. Thank you, Ms. Rickard. We appreciate it.

Next we will hear from Chris who is an insurance agent with Nationwide Insurance Company and the owner of Cavey Insurance Agency in Hampstead, Maryland. Welcome, Mr. Cavey, and the floor is yours.

STATEMENT OF CHRIS CAVEY, NATIONWIDE INSURANCE

Mr. CAVEY. Thank you, Mr. Chairman and members of the Small—

Chairman SCHROCK. Could you please turn on your mike?

Mr. CAVEY. Thank you, Mr. Chairman—

Chairman SCHROCK. Thank you.

Mr. CAVEY. —and members of the Small Business Committee. My name is Chris Cavey. I am an insurance agent for Nationwide Insurance Company and the owner of Cavey Insurance Agency in Hampstead, Maryland. I am here on behalf of the National Federation of Independent Business whose 600,000 members strongly support restoring common sense in our civil justice system.

The frequency and the high cost of our litigation in the country's current civil justice system is a matter of growing concern to small businesses like mine. Liability reform would inject a measure of fairness into a legal system that preys on business, often without regard to legal merit. Liability reform also would help reduce the number of frivolous lawsuits and exorbitant costs of defending a frivolous lawsuit that can drive a business into financial ruin.

The NFIB supports H.R. 2813, the Small Business Liability Reform Act, because it would significantly improve the legal climate in which small businesses operate. The bill covers the smallest of the nation's small businesses, like me, with fewer than 25 employees, who operate in fear that they will be put out of business.

I would like to share with you a couple of examples where my clients, who are business owners of small businesses, were nearly destroyed by lawsuits. In both cases Nationwide Insurance Company informed the business owner that the amount of the lawsuit was greater than the liability limit of their current policy. And that is, a very scary letter for a business owner to get.

In both cases the business owner was covered by a policy in excess of $1 million and in both cases the business owner would have been pushed out of business had the full amount of damages in excess of the insurance policy been awarded.

The first example involves the case of a local family that operates a grain farm. The current owners are third generation in farming and have won numerous agricultural awards for production and conservation. In 1997, they were sued for $5 million for incorrectly planting their corn. In September of that year a lady approached an intersection with a stop sign. She proceeded to "roll through" the stop sign, claiming her vision was impaired by corn planted to close to the edge of the roadway and was struck by oncoming traffic.

She sued the owner of the property, the local county and state jurisdictions, and my client, the farmer, who rented the ground and planted the corn. This suit was investigated thoroughly by all parties, however, the corn was harvested prior to the filing of the lawsuit so there were only eyewitness accounts of the manner the corn was planted.

My policyholder received that scary letter from Nationwide stating that they were only insured up to $3 million. This letter was devastating to the client. We spoke by phone and in person and they were afraid that they would have to liquidate the family farm if the trial went against them. The Circuit Court found for all the defendants and the charges were dismissed. Within weeks, the plaintiff's attorney filed in the Appellate Court and the farmer had to worry again about losing the family farm in court. During the preparation work for the Appellate Court, Nationwide Insurance Company decided to settle out of court for $600,000. This decision was based on the prior opinions of that court and the fact that the full settlement would have forced complete liquidation of the farm.

Another client of mine owns and operates a local farm roadside market. He grows a limited amount of his own produce but buys thousands of dollars of locally produced grown produce, bedding and nursery crops. He has been in business for about 25 years at this location. One day in early spring at the farm stand, a woman fell in the parking lot. The owner witnessed the accident, gave her first aid, which included two band aids to her knee and promoted some good will and gave her some freebies to apologize.

A year later Nationwide Insurance Company notified him that the woman and her husband we suing for $1.7 million each. The woman involved was claiming soft tissue damage in her back and neck from the fall. She even appeared in court for discovery in a neck brace.

However, the insurance company did the proper investigation prior to trial, found that the woman making the claim was part of a winning foursome at a local golf course and was still maintaining her three handicap. She had not missed any of her club tournaments the summer of her alleged injury, nor the following summer while waiting for trial. She was looking for the "big payoff" on the back of a kind small business owner, and thankfully she was caught.

The scary part of this ordeal was when the business owner received the notice that he was being sued for $3.4 million. He also received a letter from Nationwide which was scary that indicated he needed to hire outside counsel. This man has run his small farm market for 25 years, but a frivolous lawsuit would have put him out of business.

Legitimate claims should be heard. If someone's behavior is negligent then they should be held responsible. But frivolous lawsuits like the ones I have just described serve only to enrich plaintiff's lawyers at the expense of small business who oftentimes lack the resource to fight back in court. Without action by Congress, these meritless claims will cause small businesses to close their doors forever and their employees will lose their jobs. The Small Business Liability Reform Act would help ensure that small business can survive in this increasingly litigious environment. I hope H.R. 2813 will be enacted without delay.

Thank you very much for this opportunity, Mr. Chairman.[Mr. Cavey's statement may be found in the appendix.]

Chairman SCHROCK. Thank you very much, Mr. Cavey.

Our next witness this afternoon is the President of CTO, Incorporated, a commercial contractor in Harlingen, Texas. Her firm has just celebrated its 31st year of business, completing over 200 various projects over the past decade. Ms. Jo Rae Wagner is also a leading member of the Plumbing-Heating-Cooling Contractors National Association. And we are delighted to have you here from Texas. The floor is yours.

STATEMENT OF JO WAGNER, CTO, INC.

Ms. WAGNER. Thank you, Chairman Schrock, Ranking Member Gonzalez, and members of the Subcommittee and other distinguished guests. It is a thrill for me to be here in Washington and I applaud the Committee's scheduling of a hearing to discuss tort reform, a matter of primary importance to my industry, the plumbing-heating-cooling contractor industry, and my company.

My name, as you said, is Jo Rae Wagner, President of CTO, Incorporated, a commercial plumbing, heating and cooling contractor in Harlingen, Texas. I am a woman in a male-dominated industry, so most of my correspondence has a Mr. instead of a Ms. and an "E" on the end of Jo. My firm is celebrating its 31st year in business, which proves that women can and will continue to be a force in the construction industry. Not to toot my own horn, but I have worked hard to show that women can also be very good plumbers.

During 29 of those 31 years my company has pursued the American dream of being a family-owned small business. I have focused on growing my business through investment in the real strength of my company, its employees, and in developing a skilled workforce to ensure increased profitability by professionally and efficiently completing over 250 projects over the past decade. We take pride in our work; in fact, our association motto is that "plumbers protect the health of the nation."

However, over the past two years, I find that I am spending more time preparing for mediations and court appearances than on exploring new business opportunities to keep my company profitable. I wish to return to a time when our industry focused on what we do best, build America, without the stress of wondering if we are going to get sued on any given project.

Mr. Chairman, we are in desperate need of tort reform for the construction industry. The current system is jeopardizing the secu-

rity not only of my company, but it is my opinion that the legal sector is sucking resources out of the construction of schools, hospitals and other valuable assets that enrich our nation. We need to put an end to the frivolous litigation that pervades the construction sector; such litigation is jeopardizing the future of America's small businesses.

Lawsuits threaten profitability and my company's ability to compete in this sector. Many of my fellow contractors are responding to the potential for legal action by reducing their workforce; simply, many firms cannot afford triple-digit increases in their general liability premiums, that is, if they are lucky enough to find coverage. Often these increases come to companies that have not had a claim; it is simply the nature of the industry. Until we see some return to normalcy, our firm has chosen to remove itself from performing work in high risk trades, including air conditioning, as we cannot continue to operate under a veil of potential litigation.

Our industry is highly supportive of H.R. 2813, legislation sponsored by Representatives Steve Chabot from Ohio and Ken Lucas from Kentucky. It is a great first start in reversing a trend that is tearing away at the very foundation of an industry that is known as the finest in the world. Key for our industry are the provisions in Section 104 which would limit non-economic liabilities to those liable or negligent for the action's occurrence. An anecdote should help explain why it is so essential for those that are negligent to be assigned their proportionate share of the damages.

Several years ago, my company performed work on a large school project. Due to some mold and construction defect claims, the school board sought legal action against all 26 contractors involved in the project. The school board sought $30 million for a project that cost $14 million to build. Let me repeat: the cost to build the building was $14 million, yet the cost to sue was $30 million. Through the process of taking depositions, several contractors were told they were not negligent for the mold or construction defect claims. I was prepared to rejoice when I learned that my company was one of them.

Meanwhile, as the matter appeared headed toward litigation, a construction remediator was hired to remedy the mold and defect claims. The court system appointed a mediator to assign liability amongst the 26 contractors involved, but instead, the mediator focused on identifying enough insurance to cover the costs for those remediating the mold problem, which had nearly approached $20 million. All 26 of the "involved"—and I use that term generously—were assessed and contributed to cover the costs of the remediator. Even though various depositions cleared us of any negligence and liability, we were still found "guilty" and were forced, through insurance, to assist in covering the costs. I cannot begin to describe the anger and frustration I felt on hearing this news. Of course, it made no difference that we performed quality work on this school project and never had any call-backs to replace any of the plumbing fixtures, appliances or piping.

Mr. Chairman, this story is not the exception, it is the daily experience for those participants in the plumbing, heating and cooling industry.

My company has been named in another lawsuit that involves 32 construction companies. And like before, we have no apparent liability. Counsel informs me we should be able to get out of this one for $1.5 million. I already know that my insurance next year will be considerably higher. Those are costs that simply cannot be passed on to the consumer.

The court system in south Texas will be considering over $2 billion in construction-related lawsuits. In an effort to cover the costs of possible litigation, the bidding for new schools have exceeded estimates by 40 percent. Why should the taxpayer be expected to fund such an increase?

I thank you again, Mr. Chairman, for the opportunity to appear before this Committee. In a few short minutes I have tried to address my concerns and capture why our industry so desperately needs tort reform legislation. My colleagues and I plead with you to start putting an end to this travesty of justice that serves to destroy the fabric of what makes our country great. It has been a most gratifying experience for me to be here representing my company, CTO, Inc., and my trade association, the Plumbing-Heating-Cooling Contractors National Association. Thank you.[Ms. Wagner's statement may be found in the appendix.]

Chairman SCHROCK. Thank you, Ms. Wagner. The next time I need plumbing or HVAC done I am calling you.

Ms. WAGNER. Thank you very much.

Chairman SCHROCK. Thank you very much.

Next we will hear from Joanne Doroshow who is the Executive Director for the Center for Justice and Democracy. And I hope I did not mess your name up too bad.

Ms. DOROSHOW. No. You said it perfectly.

Chairman SCHROCK. Great, thank you. The floor is yours. Thank you.

STATEMENT OF JOANNE DOROSHOW, CENTER FOR JUSTICE AND DEMOCRACY

Ms. DOROSHOW. Thank you, Mr. Chairman. I have a fairly extensive written statement which I would like to submit for the record and just make a few points to highlight that statement.

Chairman SCHROCK. Without objection.

Ms. DOROSHOW. A few years ago I attended a large conference in Albany, New York, my state capital, and it was a small business conference. And the governor and all the major political leaders of the state spoke to the small business community in New York, including the chairman of the Small Business Committee in New York who was the primary sponsor of a very broad tort reform bill. And I went there in order to hear the various political leaders talk

about this very important issue supposedly to small business, that is tort reform.

And as I sat there, what struck me as I sat there minutes and minutes going by is that not a single mention of this issue was made by any of these political leaders. And as a result of that we did our—decided to do our own survey of various small business trade associations and organizations of their members to see whether or not lawsuits and liability issues were really such an incredible concern as we were hearing from the lobbyists in Albany.

And what we found is that in study after study, survey after survey it wasn't even mentioned as an issue. Liability and lawsuits if they are mentioned at all are very, very far down on the list, whereas other issues like workforce and health care costs and traffic and so forth, other kinds of labor issues were much more important.

And then we saw the NFIB's most recent poll of small businesses and saw that, well, lo and behold, lawsuits and liability ranked number 64 out of 75 of a list of issues of concern. Higher than lawsuits were issues like traffic and parking, anti-competitiveness practices like price fixing, in other words, which the insurance industry engages in, business growth and labor and so forth. And so we really have not seen much change in terms of the importance of liability and lawsuits as an issue for small businesses.

Of course, what we have seen is an increase in concern about insurance premiums. Well, there is no wonder for that, we have been in a hard insurance market since 2001, characterized by skyrocketing rates and reduced coverage for many businesses and for doctors and for many, many policyholders. The causes of that problem have nothing to do with the legal system, they have to do with the investment cycle of the insurance industry. And we are coming out of that hard market now.

In my testimony I indicate new statistics that show that rates are actually starting to come down for all businesses, including small businesses, as we come out of the hard insurance market.

But I do want to at least address the issue of tort reform liability as it comes up in this particular piece of legislation because it is a fairly massive intrusion into state law and into the power and authority of juries and judges in this country. And if you are going to do something like that you really need to base it on some data. So what do the data really say about the liability system?

Well, they say that lawsuits in this country are actually dropping. They have, tort filings have dropped for the last ten years. Jury verdicts are down. Claims are down. But the insurance industry is making a lot of money. In fact, their profits were up almost 1,000 percent last year from 2002.

So there is tremendous amount to be concerned about about what the insurance industry is doing. However, none of that is being driven by the lawsuits or the legal system.

If you take a look at the Tillinghast study that the Chamber of Commerce bases its report on, again the data in that is about liability insurance premiums. There is nothing whatsoever in that study that deals with the legal system or the tort system or juries. It is not even remotely connected to the legal system. You have expenses in there that concern overhead and salaries by insurance

executives, all kinds of unverifiable statistics. You even have in there no fault costs dealing with commercial auto accidents when there is no lawsuit involved at all. So that is in terms of a study to rely on in order to pursue this massive overhaul of the legal system it is just wrong.

The specifics of this legislation are also extremely damaging to innocent consumers but will also do nothing to even solve this problem of frivolous lawsuits. You have a cap on punitive damages in this piece of legislation which would only affect the most egregious kinds of cases where clearly the case is not frivolous.

I will wrap up here because I know I am out of time, but I would just caution that there is nothing in this legislation that is going to assist small businesses with their insurance problems, with the issue of frivolous lawsuits. Half the bill does not even deal with the issue of small businesses but deals with product sellers.

So thank you, Mr. Chairman.[Ms. Doroshow's statement may be found in the appendix.]

Chairman SCHROCK. Our last and most patient witness today is Victor Schwartz. Mr. Schwartz has served as both a professor of law and the Dean of the University of Cincinnati's College of Law as well as served the U.S. Department of Commerce under both Presidents Ford and Carter.

In addition, he is also the co-author of one of the most widely used tort casebooks called Prosser, Wade & Schwartz's Torts.

With that you are recognized. Welcome.

STATEMENT OF VICTOR SCHWARTZ, AMERICAN TORT REFORM ASSOCIATION

Mr. SCHWARTZ. Thank you, Mr. Chairman and Ms. Velazquez. I appreciate your being here today and discussing a topic that is very, very important. I also served as general counsel to the American Tort Reform Association. And at least with our members, they feel liability is a very major problem, and our members include small businesses, school boards, doctors' groups, across the board really almost all of society.

The bill that Mr. Chabot discussed is very important. In fact, part of it dealing with wholesalers and product sellers I would be pleased to take questions on because we helped develop that idea in the Commerce Department many years ago. Wholesalers and product sellers should not be dragged into every lawsuit, they should be there if they have done something wrong.

But I am going to discuss today what I see from my 50 trips last year is the number one problems that small businesses face. Everywhere you go if you ask them, the number one thing they talk about is frivolous lawsuits.

And what do they mean by that?

Well, there is a rule that defines them. Frivolous lawsuits are cases that have no basis in fact or they are not based on existing law or any reasonable extension of the law. The law moves forward. And there was weaponry to help businesses against frivolous claims, and that weaponry was in Rule 11 of the Federal Rules of Civil Procedure. And that said if the judge finds a claim is frivo-

lous, the plaintiff who brought that case has to pay the costs of the other side. Plain and simple.

But in 1993 that rule was severely weakened. And as a result people—and I think of my smallest client who runs a little restaurant in Atlantic City—they do not have weaponry to fight. She had a case where a police report showed that the person was never in her restaurant. He named a whole bunch of other places. And because the rule is so weak and because it is so ineffective she could not recover her legal costs.

Now, plaintiffs' lawyers in general do a very good job. But there are a few who survive on these suits, and they sue school boards, they sue small business, they sue more the defendless type of people. And they know if they make an offer to settle that is under the defense costs the insurer is really on the hook. If they do not settle the case and they go to court a case could come in above claim limits, or they will have to pay more to litigate then to settle. And it is a death of a thousand cuts.

Mr. Smith of the Judiciary Committee has introduced a bill 4571, and I hope all of you will consider co-sponsoring his bill because it restores the power to Rule 11, which is a federal rule, but states tend to follow the federal rules. So if a federal rule is changed state rules will change. And it is a good bill, it is solid. In fact, one of the most experienced trial lawyers in North Carolina, a very experienced man, said that this is the exact type of reform that is needed. We need mandatory sanctions against frivolous claims. That trial lawyer is currently running for vice president of the United States, sir.

So this is not a partisan kind of thing, it is a bipartisan kind of thing. And I think it should be supported by every member of this Committee. It is small business's really number one problem.

I will mention something else that Mr. Smith's bill does. We have a new type of tourist in America, and I call them the litigation tourist. The litigation tourist travels around the country to what the American Tort Reform Association calls and is defined as "judicial hellholes." These are places where you just do not want to be sued. And I ask our "Judicial Hellholes" report be made part of the record, sir.

Chairman SCHROCK. Without objection, it will be.

Mr. SCHWARTZ. Now, common sense says you should be able to sue where you live, you should be able to live where you have been hurt, you should be able to sue where you work or in the defendant's principal place of business. And that is what Mr. Smith's law says. It is a problem of interstate commerce that people are suing where there is none of these things. That is the litigation tourist. They go to a place like Madison County. They have never been there before. They did not work there before. They were not hurt there. There is only one reason they go there, because it is known that the judges will find for plaintiffs.

Plaintiffs' lawyers acknowledge this. There are famous plaintiffs' lawyers who say, Victor, I agree with you except for one thing, I do not call them "judicial hellholes," I call them "magic jurisdic-

tions." So we agree really on the nature of the place, we just have a difference as to the title.

So I suggest that this Committee as it approaches a variety of remedies that come forward, those are two that are very practical embodied in Mr. Smith's bill, dealing with frivolous claims, putting sanctions on those who agree with them—who bring them, excuse me—and also clamp down on litigation tourism. We do not need that in this country.

Thank you very much.[Mr. Schwartz's statement may be found in the appendix.]

Chairman SCHROCK. Thank you very much.

Let me start the questioning. We are going to have votes here in a few minutes, so when that happens we will ask a few questions, we will get over there and vote and we will get back as quick as we can.

Mr. Schwartz, I was interested in your comments about the rule, the change of Rule 11. Do you have any sort of list of states that have altered their own state rules to conform to the national model? And I am curious, is my home state of Virginia one of them?

Mr. SCHWARTZ. No. But many have and we will submit that information to this Committee.

Chairman SCHROCK. No, Virginia is not?

Mr. SCHWARTZ. Virginia has not. But there is a trip wire in many, many states. What happens is the way the rule is set up, if the federal rule changes it is automatic. There are not hearings, there is no legislative action, it just happened. And there are quite a few states that have done that. And we will submit that information to you, sir.

Chairman SCHROCK. Great, thank you.

Do you think that the Bar will undertake to rewrite or correct the problem with Rule 11?

Mr. SCHWARTZ. No. They have shown no inclination to do that. And it has been 11 years. We have had over a decade of a weakening of a rule that was the one weapon that a small business owner had to stop a frivolous claim. There has been absolutely no movement on the part of the Bar.

I think, you know, the rule applies to frivolous defenses too. And so sometimes defense attorneys might not want those sanctions brought against them. It cuts both ways. So the Bar has not policed its own house on this issue.

Chairman SCHROCK. How do these frivolous lawsuits affect the dockets and the case loads of our courts, courts generally?

Mr. SCHWARTZ. Well, they are going to add to it because there is not a vacuum cleaner to get rid of them. Most of them I have to say are settled, they virtually never go to trial because it is too

expensive for the plaintiff's lawyer and the defense lawyer to go to trial. That is why some of the data about the reduction in the number of lawsuits has some meaning, but it also has to be put in the context that more and more cases today are settled.

Chairman SCHROCK. Can you give me or share with us any instance where civil justice reform has made a difference in jobs or the economy?

Mr. SCHWARTZ. Sure. In the interest of time I will just mention one. This body passed in 1994 the General Aviation Recovery Act. It was an 18-year statute of repose for general aviation. And I was right at these tables and told the bill would do no good and it would produce aircraft that would be falling out of the sky. One witness said "tissue paper" airlines or "balsam wood" airplanes.

That bill, and I will submit to this Committee an article that documents this, has restored an industry. Cessna, Piper are back. Twenty-five thousand jobs—and these are not hamburger flipper jobs—and the planes are safer than ever.

And I was with Mr. Glickman the other night, a former member of this body, Secretary of Agriculture, and he had the lead on this bill. And he took a lot of flack from some of his colleagues about it. But the president of the United States signed the bill and it has been very effective.

I can give you other examples. We will submit them to you after the hearing.

Chairman SCHROCK. Great. Thank you.

Ms. Rickard, in your testimony you mentioned that small businesses pay a disproportionate share of the overall costs of tort claims. What impact do you think that is having on job creation in this country?

Ms. RICKARD. The U.S. Chamber has a small business council. The chairwoman of that council, Mora Donahue, runs Fabric Contractors in New Orleans, Louisiana. We convened here when we released this study, the members of that small business council. There were over 60 people from small businesses here and the stories from different regions of the country, one after the other, with regard to lawsuits being filed against these companies and the number of whether it is regular personal injury suits being dragged in and joint and several liability cases, they have gone on and on about the impact for them and the increase in insurance rates as well, which resulted in them having to scale back in jobs.

There is a woman who runs a home health care agency in Richmond, Virginia who was also up here and talked about the impact of her costs and frivolous litigation which has required her to scale back on her jobs. So we see this nationwide in both rural and urban areas.

Chairman SCHROCK. So the very small businesses seem to be really hit the hardest because they find it difficult to pass on those costs. Can you explain why it is that they do not have access to

insurance companies for these claims as many of the larger businesses have?

Ms. RICKARD. I am sorry, why they?

Chairman SCHROCK. Why they, explain why smaller companies do not have access to the insurance coverage for some of these things that large businesses seem to have.

Ms. RICKARD. They do have access to insurance in a number of circumstances. Some of them choose not to take insurance because of the cost.

However, in our study, because we did rely on insurance coverage, we found that we looked at employers, small businesses that have one employee. And there is not a lot of data with regard to single proprietorships, and they do not generally take insurance. And it is the cost generally.

Chairman SCHROCK. Thank you.

Ms. Velazquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Ms. Doroshow, there have been discussions that the specter of litigations has hindered small business growth. What evidence have you seen that indicates that small businesses' economic growth have been hindered by litigation fears?

Ms. DOROSHOW. Well, we have never seen any evidence of that. And, in fact, as I have mentioned in my testimony, in survey after survey of small businesses that are done internally by trade associations, the NFIB, the Chamber and other state associations as to the issues that are most important to them in terms of business growth, in terms of where they will locate a business, liability, litigation, lawsuits have absolutely nothing to do with it. These issues rank very, very low of issues to concern of small businesses.

Ms. VELAZQUEZ. Thank you.

Mr. Chairman, I would like to ask unanimous consent to enter into the record a survey conducted by the National Small Business United in conjunction with Arthur Andersen basically that mentions when asked to name the three most significant challenges to the future of growth and survival of their businesses the top three factors were finding and retaining qualified employees, state and federal regulations and economic uncertainty. Neither lawsuits nor liability law made the list.

Chairman SCHROCK. Without objection.

Ms. VELAZQUEZ. Ms. Doroshow, what will H.R. 2813 do with regard to stopping the filing of all frivolous litigation?

Ms. DOROSHOW. This bill has absolutely nothing to do with the issue of frivolous litigation. The major provisions are capping punitive damages which are only awarded in a very, very tiny number

of cases, in the most egregious kinds of cases, limiting joint and several liability for non-economic damages which are the kinds of damages that affect particularly women who do not work outside the home, the poor, children and senior citizens. And then the other whole half of the bill affects the issue of product sellers. We are talking about major retailers like Wal-Mart and Toys-R-Us that this bill would change state laws around the country, eliminate the ability of states to have strict liability for product sellers, to make sure that products that reach the consumer are safe.

And this part of the bill would do a tremendous amount to encourage putting unsafe products on the market. That is what it would do.

Ms. VELAZQUEZ. Thank you.

Mr. Cavey, NFIB's 2002 National Small Business poll on liability makes the case that there has been no explosion in lawsuits filed against small businesses. And I quote from their own survey and summary, "11 percent of small business owners were defendants in a liability suit during the past five years. The incidence is virtually identical to that reported by a similar sample of owners in 1995. There effectively has been no change in the frequency of liability suits filed against small businesses at least in the last decade."

Would you care to comment on that?

And I would like unanimous consent to enter into the record this NFIB National Small Business poll.

Chairman SCHROCK. Without objection.

Mr. CAVEY. The statistics that you have I cannot personally verify from sitting where I am. I can, however, verify what has passed through my agency and in front of my business association at home. And the fact of the matter is perhaps the percentages have not increased dramatically one way or the other. Maybe they have, maybe they have not. I cannot answer that. But I do know that the fear of liability suit is constantly there on the small business owner.

I also know that the cost of the liability insurance and the cost to protect the policy holder who is the small business owner is continually going up.

Ms. VELAZQUEZ. Thank you.

Mr. Cavey, are you here in what capacity, representing NFIB?

Mr. CAVEY. I am here as a member of NFIB, yes, ma'am.

Ms. VELAZQUEZ. Okay. This is their survey.

Ms. Wagner, you mentioned in your testimony that you were sued by a school board?

Ms. WAGNER. Yes. Actually it is the whole district. The school district informs the school board which initiates the lawsuits.

Ms. VELAZQUEZ. Okay. In the case that read about in The Valley Star involving faulty prison construction it says that you were sued

by a county. Since H.R. 2813 applies to cases where individuals sue businesses it will not impact the type of cases that you have experienced; is that correct?

Ms. WAGNER. In a sense, yes. All we are looking for is some legislation that would draw a line in the sand somewhere to stop the rampant and needless lawsuits that attack for no reason at all for large groups of contractors.

Ms. VELAZQUEZ. But what I am trying to say is this type of legislation does not apply?

Ms. WAGNER. Well, it will in one sense, in the sense of mold damages and construction defects occasionally you have eight to nine hundred individuals suing the contractor on an individual basis for health reasons. And that would apply.

Ms. VELAZQUEZ. Thank you.
Okay, Mr. Chairman.

Chairman SCHROCK. Ms. Rickard, let me ask you how important is tort reform to small business? I want to ask everybody that.

Ms. RICKARD. In our survey, and I did mention this in my testimony, we do survey our members, small business members. And in that survey over 90 percent of those surveyed—and I believe there were over 1,000 respondents to that survey representative of small, representative of small business across the nation reported that 90 percent that legal reform was rated important or very important among those members.

Again, our small business council, representative of a large crosssection of small business in this nation, meets two or three times a year. They consistently talk with me. I spoke with them last December at their board meeting. And when I got to the issue and went on about legal reform they were just rabid about the problem and essentially gave me a cheering ovation at the end of my presentation talking about the need for us to really pursue this issue for them.

Chairman SCHROCK. Mr. Cavey and Ms. Wager, please.

Mr. CAVEY. Can I answer that question?

Chairman SCHROCK. Absolutely you can.

Mr. CAVEY. Well, I will tell you how the best way to answer that question is. And it crosses partisan lines every single way you can get it, the fact is that it is needed in small business. I challenge the members of this Committee, regardless of their political affiliation, to go home, get out your "A list" of donors to your campaign contributions who are small business owners, just call them up and ask. Do not take my word for it, pick the people that are putting you here to represent them and giving you money to do it.

Chairman SCHROCK. Would you believe it if I told you I have?

Mr. CAVEY. God bless you.

Chairman SCHROCK. You are welcome.
Ms. Wagner?

Ms. WAGNER. Last week when PHCC put a notice out that I would be testifying today, when I went home for the weekend I never realized what I was going to run into Monday morning. My e-mail was totally jammed with people, contractors from California, Nevada, Arizona, name it, from everywhere in this nation that actually plugged up my e-mail just to tell me to please get the word across today that this was a dire situation in our industry and we desperately need some help.

Chairman SCHROCK. Good. Ms. Doroshow, Mr. Schwartz?

Ms. DOROSHOW. Survey after survey for years has shown that it is not as high a priority as many, many, many other issues that affect small business. In fact, NFIB's most recent poll it ranked 64th out of 75 issues. So I am just going by what I see in terms of the surveys and the data and the facts. And when you compare it to other issues that are affecting small businesses today it ranks very, very low if it is mentioned at all.

Now, the issue of insurance is another thing. It is number two for small businesses in the NFIB survey. But as we consumer groups have been saying for years over and over again, the causes and solutions to these insurance problems lie with the insurance industry. We are in a hard insurance market right now. It is ending. The insurance industry has made enormous amounts of money off the back of policy holders which has not been driven by any increased losses. The solutions to that problem lie with the insurance industry. And what Congress ought to be doing, the first thing they should be doing is remove the antitrust exemption that the insurance industry currently enjoys in this country. It allows them to price fix, it allows them to burden small businesses and other policy holders with enormous kinds of rate hikes without any accountability.

Chairman SCHROCK. Mr. Schwartz, I think I know what your answer is to that, so let me ask you another question. Ms. Doroshow has suggested that product sellers should face liability for products they do not manufacture. What do you think about that?

Mr. SCHWARTZ. Well, I think product sellers should be responsible when they have done something wrong. And I agree with the concept that Ms. Doroshow has in her testimony, and that is there should be pressure on a product seller to deal with responsible manufacturers.

And if you read Mr. Chabot's bill what it says is that if a manufacturer is not in business or unavailable to be sued, then the product seller has to bear full and complete liability. Now, you are a businessman and if you were in business and you knew that if you

did not deal with a responsible manufacturer you would have full and complete liability, you would have a motive to do it.

So I think you get to the goal that you want which is to have product sellers act in a responsible way with that provision.

Right now let us go for very brief with the litigation tourist. What happens with the litigation tourist is, and this is where it hurts small business, they go into another state and the plaintiff's lawyer when he goes into that state wants to get into the state court. That is the hellhole. He does not want to be in a federal court. So they will name some local seller, a retailer, a small pharmacy, a little stationery store so that that person is from the same state and they will not have the case in federal courts, it will have to be in the state court. And that is not good.

If the law was that the local seller only was liable for fault and wrong it would be much harder to drag that innocent seller into a case. Again, the consumer is still left with a responsible defendant.

I was not involved in many of these things, I read them and I learn them—learn about them. But we did help develop the product seller provision under President Carter a long time ago. And it is law in about 16 states. But people deal in interstate commerce and it would be better to have it as a national law.

Chairman SCHROCK. Ms. Velazquez?

Ms. VELAZQUEZ. Mr. Schwartz, I know that you are here representing the American Tort Reform Association.

Mr. SCHWARTZ. That is correct.

Ms. VELAZQUEZ. And given that members of this association are predominantly large corporations I really find it interesting that you are here testifying on their behalf at a small business hearing. Could you please tell me how the American Tort Association Members such as Boeing, Johnson and Johnson, Exxon-Mobil, Chrysler will benefit from passage of H.R. 2813? I have the list here of the members of the American Tort Reform Association.

Mr. SCHWARTZ. Well, there are many, many small business members. I would invite you to attend one of our meetings. I will extend the invitation now that I hope you can accept so you will see our small business members. But I also want to address your question.

Ms. VELAZQUEZ. Okay. But excuse me one second. I will strongly recommend you to tell them to add all those small businesses that are members of the American Tort Association because when you go down this list you do not have any small business represented in this list. So it is a matter of perception. I am sorry for that.

Mr. SCHWARTZ. Representative, first of all, you made a very, very good suggestion. And I will take it back. I always learn something from hearings and often it is from folks who are not that comfortable with tort reform. So I appreciate your statement.

Let me just say in terms of the bill how some of the larger businesses might benefit from this small business bill—and remember,

I was not testifying about that bill but a bill that dealt with frivolous claims. When product sellers are sued and if product sellers can be brought into cases even though they are totally innocent it allows some plaintiffs' lawyers, some, to manipulate the system. And then the larger businesses find that their cases are in state courts and some of these state courts do not have a very fair way of handling things. So the provision that deals with product sellers avoids needless lawsuits but it also helps a case be in a federal court when it should be in a federal court, and that helps some of the larger businesses.

Ms. VELAZQUEZ. Ms. Doroshow, would you care to comment as to how large corporations will benefit from this bill?

Ms. DOROSHOW. Well, I think half the bill does deal with large corporations. We are dealing with large product sellers here, major companies. It is not a small business bill at all when you look at that part of the bill. So I would say that those that are involved in selling consumer products would benefit tremendously from the liability restrictions that are in this legislation.

Ms. VELAZQUEZ. Ms. Wagner, how many employees do you have in your company?

Ms. WAGNER. I have 65.

Ms. VELAZQUEZ. Sixty-five. So this legislation also defines a small business as having 25 or fewer employees?

Ms. WAGNER. Yes. And I would truly hope that when this bill is discussed further that that would then be increased to 100 since that would be a sensible amount for a small business.

Chairman SCHROCK. We have a vote. Let me ask a couple of questions before I leave.

Mr. Cavey, what is going to happen to your clients or other small businesses if we do not pass some sort of tort reform?

Mr. CAVEY. Well, tort reform is definitely needed. My estimation based on what I have seen through my agency is that two things will happen: number one—well, three really—there will be a lot more fear within the—dealing with the public; number two, I see that it will inhibit the amount of jobs that are out in the market because employers need to feel competent and they need to keep their expenses in line; and number three, I think the other thing it will do is it will cause consumer prices to go up because the small florist who has an increase in liability insurance is not going to take it out of the pocket, they are going to pass that right back on to the consumer in the neighborhood.

Chairman SCHROCK. Does litigation drive insurance premiums obviously?

Mr. CAVEY. Oh definitely.

Chairman SCHROCK. Okay.

Mr. CAVEY. Absolutely.

Chairman SCHROCK. Ms. Wagner, I was impressed by your testimony about being forced to settle claims for which your company bore absolutely no responsibility. Do you think these kind of claims hurt your ability to get other contracts and particularly government contracts? I would think this is not the kind of publicity any company would want to get?

Ms. WAGNER. Well, this is true. And truly this has affected the way we feel about projects that we should take. First of all, we stopped bidding schools entirely because of the litigation in schools. But when you are looking at any given project having $100 million to $200 million worth of collective insurance you are looking at a lot of targets there for any litigation. So frivolous lawsuits on construction projects hurt everybody involved with them. And it certainly does not do reputations any good.

Chairman SCHROCK. So you think the lawsuit culture in the construction industry discourages some people from going into business in your industry?

Ms. WAGNER. Absolutely. And it certainly right now is discouraging growth, which should be a part of the construction industry right now.

Chairman SCHROCK. Absolutely.

Well, we have a vote, folks. And I am not going to hold you here. I really do, I really do appreciate your testimony here. I appreciate the input you have. It has given me a lot to think about. And I am delighted to think that Mr. Schwartz learned something from us. That is so unusual here. So I really appreciate that.

I appreciate your taking the time to come. And I assure you this is a subject that will not die. This is a subject we are going to hear about for a long time until something is done about it.

So, again, I thank you all very much. And this hearing is adjourned.

[Whereupon, at 3:30 p.m., the Subcommittee was adjourned.]

Statement of Congressman Steve Chabot
Committee on Small Business
Subcommittee on Regulatory Reform and Oversight
July 22, 2004

Mr. Chairman, thank you for giving me the opportunity to appear before the Subcommittee this morning on behalf of H.R. 2813, the Small Business Liability Reform Act.

This legislation was first introduced in the 106th Congress by our former colleague, Congressman Jim Rogan and was passed in the House on February 16, 2000 by a 221-193 margin. It was not considered during the 107th Congress. I appreciate, Mr. Chairman, your willingness to hold this hearing today.

The frequency and high cost of litigation is a matter of growing concern to small businesses across the country. Today's civil justice system presents a significant disincentive to business start-ups and continued operations. The litigation costs and excessive judgments affecting small businesses have escalated out of control, destroying lives and businesses and affecting communities both in and out-of-state.

Small businesses employ nearly 60% of the American workforce. Further, more than 60% of small business owners make less than $50,000 a year. Small business owners know that if they are sued they will have to choose between a long and costly trial or an expensive settlement. Either choice significantly impacts the operations of a business and the livelihood of its employees. Most business decisions today are made with this new reality in mind. These decisions ultimately affect the hiring of new employees, expanding existing or introducing new products, and planning long term.

H.R. 2813 helps remedy this situation.

The Small Business Liability Reform Act is a bipartisan bill that would make the necessary reforms that have been at the forefront of the small business community's agenda for the last several years.

Under Title I, the bill would limit punitive damages to $250,000 or three times the amount awarded to a claimant for economic and non-economic losses; would eliminate joint and several liability for non-economic losses, instead making defendants responsible for an amount consistent with the harm contributed; and would allow states to elect out of the subsection by enacting a new statute.

These changes protect small businesses from being unnecessarily punished unless it is established that the conduct that has occurred warrants such a penalty; protects small businesses and individual defendants from being liable for non-economic damages that they did not cause; and provides states with the ability to opt out of the subsection when parties are all citizens of the state.

In addition, this bill would make certain reforms for product sellers and distributors other than manufacturers. The chain of distribution of a product provides plaintiffs with wide choice of defendants, including sellers and distributors who may never have had physical control over a product, from which to join in a product liability lawsuit.

Under title II, product sellers and distributors would be held liable for injuries caused by defective products only if (1) the seller was negligent; (2) the seller breached an express warranty; or (3) the manufacturer was judgment proof. These reforms would

reduce the exposure that sellers and distributors face in the product's so called "chain of distribution."

Mr. Chairman, reform is needed to protect small businesses, promote the flow of goods across state boundaries, and inject fairness into a legal system that is escalating out of control. While pursuing these reforms, we must be cognizant of and protect the rights of those plaintiffs with legitimate claims. This bill accomplishes both.

Mr. Chairman, I want to thank you again for holding today's hearing. And I thank my colleagues on the Subcommittee for giving me the opportunity to speak on this important issue.

STATEMENT ON AMERICA'S LEGAL CRISIS
SUBMITTED
BY
LISA RICKARD, PRESIDENT OF
THE U.S. CHAMBER INSTITUTE FOR LEGAL REFORM
TO
THE COMMITTEE ON SMALL BUSINESS
SUBCOMMITTEE ON REGULATORY REFORM AND OVERSIGHT
UNITED STATES HOUSE OF REPRESENTATIVES
JULY 22, 2004

Good afternoon. I am Lisa Rickard, president of the U.S. Chamber Institute for Legal Reform. The U.S. Chamber of Commerce is the world's largest business federation, representing more than three million businesses and professional organizations of every size, in every business sector, and in every region of the country. The U.S. Chamber of Commerce founded the Institute for Legal Reform (ILR) in 1998 with the mission of making America's legal system simpler, fairer and faster for everyone. On behalf of the Chamber and ILR, I appreciate the opportunity to testify before the Subcommittee on the effect of lawsuit abuse on small business. I would also request that a copy of my full testimony and the ILR study, "Tort Liability Costs for Small Business," be included for the record.

America's legal crisis is raising prices for hard-working Americans, crippling companies, eliminating jobs, and clogging our courts with frivolous lawsuits.

Unfortunately, our efforts to reform the legal system are met with stiff opposition by those who seek personal financial gain at the expense of creating more jobs and providing better access to health care.

No sector of the economy is hit harder by lawsuit abuse than America's small business owners. Last month, ILR released the results of a groundbreaking study that shows the devastating effect of litigation on America's small businesses.

In December, world-renowned actuarial firm Tillinghast Towers-Perrin released its annual report showing that in 2002 the tort system drained our economy to the tune of $233 billion, or $809 per person.

We wanted to go a step further – to find out exactly how the tort system is threatening American small businesses, which create 75% of the new jobs in this country. We contracted with NERA Economic Consulting to analyze the numbers – and what we found was quite troubling.

The total cost of the tort system to all U.S. businesses (i.e., both large and small businesses) is an astounding $129 billion. NERA's study found that small businesses with $10 million or less in annual revenue bear 68% of that cost, paying $88 billion a year. For a small business with $10 million in annual revenue, that translates into about $150,000 a year – money that could be put to much more productive use.

Very small businesses – those with less than $1 million in annual revenues – pay $33 billion of the $88 billion per year. That works out to about $17,000 each per year.

What's even more astonishing is that these very small businesses pay 44%, or $15 billion, of their liability costs out-of-pocket -- not through insurance coverage.

What does all this really mean?

It means America's small businesses are paying a high price for our legal crisis in the form of lost opportunities to expand their businesses.

It means that significant small business capital is being diverted to the bank accounts of trial lawyers – rather than being invested in tens of thousands of new American jobs.

And it means that American consumers are forced to pay more for everything they purchase, including consumer goods and health care, because businesses are forced to raise prices to stay afloat.

Real people and real businesses are suffering under the burden of our current lawsuit-happy culture. The sad truth is that America's small business owners are being bombarded on all sides by lawsuit abuse.

One recent news story from Champaign, Illinois detailed how the local airfield spent $600,000 in legal defense costs for a lawsuit in which the airfield was found *not liable*. The airfield was eventually forced out of business due to excessive liability

costs. The story went on to detail how lawsuit abuse is forcing the closure of many small flight schools across the country. These are small businesses that employ numerous hard-working men and women throughout America's heartland.

One member of the U.S. Chamber's Small Business Advisory Council – a registered nurse and owner of a home health services agency in Richmond, Virginia – recently explained how her professional liability coverage insurance costs rose from $5,000 in 2000 to $27,000 in 2003 – an increase of over 400% in only three years. As if that wasn't bad enough, her worker's compensation insurance coverage costs rose from $5,000 to $35,000 during that same period.

Even more frightening is the fact that her company is taking a major hit from these skyrocketing liability costs, even though she has never been sued. This shows firsthand the negative effect that frivolous lawsuits against employers can have on small businesses across the country.

I could go on and on with story after story of small business owners who have been victimized by lawsuit abuse, but perhaps nobody put it better than Maura Donahue, a small business owner from Louisiana and chair of the U.S. Chamber's Small Business Advisory Council, who said recently, "lawsuit abuse is like a stone around the necks of America's small employers, threatening our livelihoods and casting a black cloud over the spirit of entrepreneurship and innovation."

ILR's study highlights why we need comprehensive legal reforms at the federal and state levels that will rein in the excessive influence of unscrupulous trial lawyers and restore fairness and balance to our legal system.

We strongly urge Congress to enact bills that cut back on frivolous litigation, such as the Class Action Fairness Act and the Fairness in Asbestos Injury Resolution Act.

We also support the recently introduced Lawsuit Abuse Reduction Act, medical malpractice reform legislation, the Commonsense Consumption Act, and the host of pending legislation providing liability protection for manufacturers of lawful goods and services.

ILR also supports the Small Business Liability Reform Act, which would place reasonable limits on the amount of punitive damages awarded to plaintiffs in liability cases against small businesses, abolish joint liability so that defendants are only liable for their proportionate share of damages, and protect innocent product-sellers from liability when the manufacturer is directly responsible for the harm.

Unfortunately, none of the legal reform bills I just mentioned have been enacted – even as we watch lawsuit abuse stifle economic development in America's states, cities and towns.

The problem is even worse in a few dozen places around the country. Places such as Madison County, Illinois are "jackpot jurisdictions," bankrupting U.S. employers while enriching a select group of already-wealthy plaintiffs' attorneys. Meanwhile, doctors are fleeing the state, employers are avoiding the area, job growth is stagnant, and economic development is all but nonexistent.

Jurisdictions such as Madison County have started to pop up across the country, as plaintiffs' attorneys shop around for friendly courts in which to file frivolous lawsuits.

Our most recent ILR/Harris State Liability Systems Rankings Study illustrates how this practice of "forum-shopping" is drastically impacting the economies of states with poor legal climates. This study was conducted by the Harris Poll for the U.S. Chamber Institute for Legal Reform among a national sample of in-house general counsel or other senior litigators. The survey quantifies the perceived fairness of each state's legal system when it comes to civil litigation.

An overwhelming 80% of those surveyed in this year's poll reported that the litigation environment in a state could affect important business decisions at their company, such as where to locate or do business. That statistic does not bode well for poorly ranked states looking to attract new jobs and improve economic development.

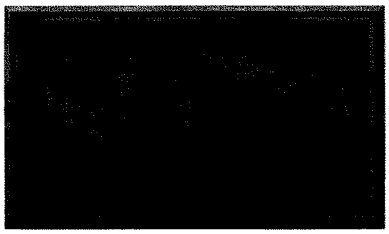
Your constituents are also feeling the effect of lawsuit abuse. According to the Tillinghast study I mentioned earlier, each American family of four is paying an extra $3,200 because of our costly tort system – that's over $800 per person. I am certain that America's working families could put that money to use in more productive ways.

In closing, I would like to make clear that ILR strongly believes that those who have been truly injured should receive just compensation through our legal system. That is what America's civil justice system was originally designed to do. It was not, however, intended to become a lottery that bestows jackpot awards on random plaintiffs at the expense of unsuspecting, hard-working small businessmen and women.

Frivolous lawsuits are hitting the pocketbooks of hard-working Americans, threatening our jobs and raising prices. It's time for all Americans to jettison our lawsuit-happy culture and take some personal responsibility for ending the litigation lottery in this country.

On behalf of the U.S. Chamber Institute for Legal Reform and the U.S. Chamber, thank you for the opportunity to appear before you today.

I am happy to answer any questions you may have. Thank you.



STATEMENT OF

CHRIS CAVEY

INSURANCE AGENT, NATIONWIDE INSURANCE AGENCY

ON BEHALF OF:

THE NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Subject:	"Protecting America's Small Businesses from Frivolous Lawsuits"
Before:	House Committee on Small Business, Subcommittee on Regulatory Reform and Oversight
Date:	July 22, 2004

Chris Cavey
P.O. Box 430
838 Main St.
Hampstead, MD 21074

Mr. Chairman and members of the Small Business Committee, my name is Chris Cavey, and I am an insurance agent for Nationwide Insurance Company and the owner of Cavey Insurance Agency in Hampstead, Maryland. I am here on behalf of the National Federation of Independent Business (NFIB), whose 600,000 members strongly support restoring common sense to our civil justice system and have endorsed H.R. 2813, the Small Business Liability Reform Act of 2003.

The frequency and high cost of litigation in our country's current civil justice system is a matter of growing concern to small businesses. Liability reform would inject a measure of fairness into a legal system that preys on business, often without regard to legal merit. Liability reform also would help reduce the number of frivolous lawsuits and the exorbitant costs of defending a frivolous lawsuit that can drive a business to financial ruin.

Civil litigation was once a last-resort remedy to settle limited disputes and quarrels, but recent years have brought a litigation explosion. The number of civil lawsuits has tripled since the 1960's. Litigation has become big business, and it is putting small companies out of business. When the typical cost of a lawsuit that goes to trial is at least $100,000, the economic pressures to settle are enormous. NFIB members say that being sued is one of the most threatening experiences for a small-business owner. It is even more frightening for the smallest of the small, which can be put out of business by one lawsuit.

NFIB supports the Small Business Liability Reform Act (H.R. 2813) because it would significantly improve the legal climate in which small businesses operate. The bill covers the smallest of the nation's small businesses; those with fewer than 25 employees, who operate in fear that they will be named as a defendant in a frivolous lawsuit. Most importantly, the bill caps punitive damages at $250,000. This cap is needed because while compensatory damages, referred to as economic and non-economic damages, are usually covered by liability insurance, punitive damages are not – defendants must pay them in full. Because of the fear of unlimited punitive damages, many business owners settle out of court, even if the claim is unwarranted. Capping punitive damages would protect small businesses by limiting this fear.

The bill also abolishes joint and several liability for non-economic damages, and this important reform is long overdue. This sensible reform will provide protection to those that may be as little as one percent at fault, but because they have "deep pockets," can

find themselves liable for 100% of the damages. This provision would return our civil justice system to one that is truly based on degree of fault.

I would like to share with you two examples where my clients, who are owners of small businesses, were nearly destroyed by lawsuits. In both cases Nationwide Insurance Company informed the business owner that the amount of the suit was greater than the liability limit of their current policy. In both cases, the business owner was covered by a policy in excess of one million dollars and, in both cases, the business owner would have been forced out of business had the full amount of damages in excess of the insurance policy been awarded.

The first example is a case involving a local family that operates a grain farm. The current owners are third generation in farming and have won numerous agricultural awards for production and conservation. In 1997, they were sued for $5 million dollars for incorrectly planting their corn. In September of that year a lady approached an intersection with a stop sign. She proceeded to "roll through" the stop sign, claiming her vision was impaired by corn planted to the edge of the roadway, and was struck by oncoming traffic. She sued the owner of the property, the local county and state jurisdictions, and my client, the farmer, who rented the ground and planted the corn. This suit was investigated thoroughly by all parties, however, the corn was harvested prior to the filing of the lawsuit, so there was only eyewitness accounting of the manner the corn was planted. My policyholder received a letter from Nationwide stating that the amount of suit was greater than the $3 million liability coverage they currently carried and that they should seek outside counsel. This letter was devastating to my client. We spoke by phone and in person and they were afraid that they would have to liquidate the family farm if the trial went against them. The Circuit Court found for all the defendants and all charges were dismissed. Within weeks, the plaintiff's attorney filed in the Appellate Court and the farmer had to again worry about losing the family farm in court. During the preparation work for the Appellate Court, Nationwide decided to settle out-of-court for $600,000. This decision was based on the prior opinions of the court and the fact that full settlement would have forced liquidation of the farm.

Another client of mine owns and operates a local farm roadside market. He grows a limited amount of his own produce and buys thousands of dollars of locally grown produce, nursery and bedding crops. He has been in business for 25 years at this location. One day in the early spring at the farm stand, a woman fell in the parking lot. The owner witnessed the accident, gave her first aid (2 band aids to her knee was all it took) and to promote good will, gave her some freebies to apologize. A year later, Nationwide Insurance Company notified him that the woman and her husband were suing him for $1.7 million each. The woman involved was claiming soft tissue damage in her back and neck from the fall. She even appeared in court in a neck brace! However, the insurance company did the proper investigation prior to trial and found that the woman making the claim was part of a winning foursome at a local golf course and was still maintaining her 3 handicap. She had not missed any of her club tournaments the summer of her alleged injury, nor the following summer while waiting for a trial date. She was

looking for the "big payoff" on the back of a kind small-business owner, and thankfully she was caught.

The scary part of this ordeal was that when the business owner received the notice that he was being sued for $3.4 million, he also received a letter from Nationwide Insurance Company indicating that he needed to hire outside counsel because he only had $500,000 of liability coverage. This man has run his small farm market business for 25 years, but a frivolous lawsuit threatened to put his family-owned business out of business and threatened the jobs of 18 employees.

Legitimate legal claims should be heard – if someone's behavior is negligent, then they should be held responsible. But frivolous lawsuits like those I've just described serve only to enrich plaintiff's lawyers at the expense of small businesses who oftentimes lack the resources to fight back in court. Without action by Congress, these meritless claims will cause small businesses to close their doors forever and their employees to lose their jobs. The Small Business Liability Reform Act would help ensure that small businesses can survive in this increasingly litigious environment. I hope H.R. 2813 will be enacted without delay.

Thank you Mr. Chairman for the opportunity to testify today.

Plumbing-Heating-Cooling Contractors–National Association

Pride In Our Past–Faith In Our Future

WRITTEN TESTIMONY

OF

MS. JO RAE WAGNER
President
CTO, Inc.
Harlingen, Texas

and a member of the
Plumbing-Heating-Cooling Contractors--National Association

BEFORE THE
SUBCOMMITTEE ON REGULATORY REFORM
AND OVERSIGHT,
COMMITTEE ON SMALL BUSINESS
U.S. HOUSE OF REPRESENTATIVES

July 22, 2004
311 Cannon Office Building
House Committee on Small Business

Thank you Chairman Shrock, Ranking Member Gonzalez, members of the subcommittee and other distinguished guests. It is a thrill for me to be here in Washington and I applaud the Committee's scheduling of a hearing to discuss tort reform, a matter of primary importance to my industry, the plumbing-heating-cooling contractor industry, and my company.

My name is Jo Rae Wagner, President of CTO, Inc., a commercial plumbing-heating-cooling contractor in Harlingen, Texas. I'm a woman in a male dominated industry, so most correspondence to me has a Mr. instead of a Ms. and an "E" at the end of Jo. My firm recently celebrated its 31st year in business, which proves that women can and will continue to be a force in the construction industry. Not to toot my own horn, but I've worked hard to show that women can also be very good plumbers.

During 29 of those 31 years, my company has pursued the American dream of being a family-owned small business. I have focused on growing my business through investment in the real strength of my company, its employees, and in developing a skilled workforce to ensure increased profitability through professionally and efficiently completing over 250 projects over the past decade. We take pride in our work; in fact, our association's motto is that "plumbers protect the health of the nation."

However, over the past two years, I find that I am spending more time on preparing for mediations and court appearances than on exploring new business opportunities to keep my company profitable. I wish to return to a time when our industry focused on what we do best – Build America, without the stress of wondering if we're going to get sued on a given project.

Mr. Chairman, we are in desperate need of tort reform for the construction industry. The current system is jeopardizing the security not only of my company, but it is my opinion that the legal sector is sucking resources out of the construction of schools, hospitals and other valuable assets that enrich our nation. We need to put an end to the frivolous litigation that pervades the construction sector; such litigation is jeopardizing the future of America's small businesses. Lawsuits threaten profitability and my company's ability to compete in this sector. Many of my fellow contractors are responding to the potential for legal action by reducing their workforce; simply, many contracting firms can't afford triple-digit increases in their general liability premiums, that is, if they're lucky enough to find coverage. Often these increases come to companies that have not even had a claim; it's simply the nature of the industry. Until we see some return to normalcy, our firm has chosen to remove itself from performing work in the high risk trades, including air conditioning, as we cannot continue to operate under a veil of potential litigation.

Our industry is highly supportive of H.R. 2813, legislation sponsored by Reps. Steve Chabot (R-OH) and Ken Lucas (D-KY). It is a great first start in reversing a trend that is tearing away at the very foundation of an industry that is known as the finest in the world. Key for our industry are the provisions in Section 104 which would limit noneconomic liabilities to those liable or negligent for the action's occurrence. An anecdote should help explain why it is so essential for those that are negligent to be assigned their proportionate share of the damages.

Several years ago, my company performed work on a large school project. Due to some mold and construction defect claims, the school board sought legal action against all 26 contractors

involved in the project. The school board sought $30 million for a project that cost $14 million to build. Let me repeat that: the cost of the building to construct was $14 million, yet the cost to sue was $30 million. Through the process of taking depositions, several contractors were told that they were not negligent for the mold or construction defect claims. I was prepared to rejoice when I learned that my company was one of them. Meanwhile, as the matter appeared headed toward litigation, a construction remediator was hired to remedy the mold and defect claims. The court system appointed a mediator to assign liability among the 26 contractors involved, but instead, the mediator focused on identifying enough insurance to cover the costs for those remediating the mold problem, which had nearly approached $20 million. All 26 of the "involved" and I use that term generously, were assessed and contributed to cover the costs of the remediator. Even though various depositions cleared us of any negligence and liability, we were still found "guilty" and were forced, through insurance, to assist in covering the costs. I can't begin to describe the anger and frustration I felt on hearing this news. Of course it made no difference that we performed quality work on this school project as we never had any call backs to replace any of the plumbing fixtures or appliances.

Mr. Chairman, this story is not the exception; this is a daily experience for those participants in the plumbing-heating-cooling industry and others in the construction community. (I've attached a couple of other horror stories and anecdotes from other industry partners regarding their litigation experiences.) In order for us to go back to doing what we do best, it is critical for us to get some real common sense tort reform legislation passed in this country. We need to secure passage of legislation like H.R. 2813 and assign liabilities in direct proportion to the percentage of responsibility of those negligent.

My company has been named again in another lawsuit that involves 32 construction companies, and, like before, we have no apparent liability. Counsel informs me that we should be able to "get out of this one" for $1.5 million. I already know that my insurance next year will be considerably higher; I see another triple-digit increase on the horizon. These are costs that simply cannot be passed on to the consumer.

I've heard that the court system in south Texas will be considering over $2 billion in construction-related lawsuits. In an effort to cover the costs of possible litigation, the bidding for some of these new school projects have exceeded estimates by 40%. Why should the taxpayer be expected to fund such an increase?

Mr. Chairman, I again thank you for the opportunity to appear before this Committee. In a few short minutes, I've tried to address my concerns and capture why our industry so desperately needs tort reform legislation. My colleagues and I plead with you to start putting an end to this travesty of justice that serves to destroy the fabric of what makes our country great. It has been a most gratifying experience for me to be here representing my company, CTO, Inc., and my trade association, the Plumbing-Heating-Cooling Contractors--National Association.

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STATEMENT OF JOANNE DOROSHOW
EXECUTIVE DIRECTOR, CENTER FOR JUSTICE & DEMOCRACY

BEFORE THE HOUSE COMMITTEE ON SMALL BUSINESS

HEARING ON SMALL BUSINESS LITIGATION REFORM

July 22, 2004

Mr. Chairman, members of the Committee, I am Joanne Doroshow, President and Executive Director of the Center for Justice & Democracy, a national public interest organization (and a small business) that is dedicated to educating the public about the importance of the civil justice system. I appreciate the opportunity to address the issue of small businesses liability, although half the bill under consideration by this committee, H.R. 2813, has nothing whatsoever to do with small businesses.

SMALL BUSINESSES - INTRODUCTION

On March 30, 1999, the Business Council of New York State held a conference for hundreds of small business owners at which some of New York's top political leaders spoke, including New York's Governor, Senate Majority Leader, and Assembly Speaker, and the principal sponsor of broad tort reform legislation then being considered by the New York State legislature. "Tort reform" was a hot issue in my state, New York, being touted by corporate lobbyists as critical for the small business community and crucial to improving New York's upstate economy. So one might expect some discussion about it from politicians trying to assist the small business community. Yet not a single speaker even mentioned the issue of "tort reform" at that conference.

In May 1999, following passage of severe "tort reform" legislation in Florida, Enterprise Florida, a private-public partnership that works to bring out-of-state companies to Florida, told the Miami Daily Business Review, "tort reform was never a big priority for the group.... The litigation environment isn't an issue that companies look at 'on a day-to-day basis' in deciding whether to relocate. If it were a frequent question, we would have been more active on this bill."

If you listen to some of the lobbyists here today, they will tell you that lawsuits by consumers are creating economic "crises" that are wiping out small businesses. They tell Congress that "tort reform" legislation is needed for small businesses to survive. But as the two examples above illustrate, the notion that lawmakers must restrict the rights of injured consumers in order for small businesses to grow or even survive in this country is one of the most sensationalized fictions driving the "tort reform" movement today.

The actions of those savvy New York politicians and the folks at Enterprise Florida reflected exactly what internal business surveys have consistently shown for years: when it comes to this country's business climate, liability issues rank far below other matters of greater importance, like workforce, healthcare and a range of tax and regulatory issues. In fact, in the National Federation of Independent Businesses (NFIB)'s most recent poll, the issue "Cost and Frequency of Lawsuits" is ranked 64th (out of 75) of issues that are important to small businesses. (1) Some problems that businesses considered to be of greater concern were:

> Traffic, Parking, Highways (61st)
> Anti-Competitive Practices, e.g. Price Fixing (54th)
> Handling Business Growth (47th)
> Using Computer(s), the Internet or New Technology Effectively (45th)
> Locating Business Help When Needed (39th)

Whereas groups like the NFIB and the U.S. Chamber of Commerce have all made "tort reform" one of their top legislative priorities at the federal and state level, survey after survey shows that their members believe other issues are far more pressing for their own survival and growth. Businesses virtually always put "lawsuits" or "liability" toward the bottom of their list of concerns, if they mention it at all. (Some of these surveys are mentioned at the end of this testimony, Appendix A.) Moreover, while NFIB lobbyists are telling you one thing, their own research says another, to wit:

> Job creation plans continue to exceed the high points of expansions in the 1980s and early-to-mid 1990s. Job openings are high, profit trends are favorable and capital spending is solid.... "Sales were strong, so inventory was taken off the shelves as fast as owners put it out,"' said NFIB chief Economist William Dunkelberg.... [R]eports of favorable profit trends remain the best since 2000. (2)

THE FLAWED U.S. CHAMBER OF COMMERCE REPORT: LIABILITY COSTS FOR SMALL BUSINESSES

Every year, an insurance industry-consulting firm, Tillinghast–Towers Perrin, (3) estimates what it calls the overall annual "cost" of the U.S. tort system. In its 2003 report, Tillinghast put this cost at $129 billion for "Commercial Lines." This year, the U.S. Chamber of Commerce issued a report entitled "Liability Costs for Small Businesses" that claimed to breakdown Tillinghast's estimate among businesses of varying sizes and finding that "the tort liability price tag for small businesses in America is $88 billion a year." This figure is fallacious.

First, the basic methodology behind this number is severely flawed. Tillinghast's numbers do not examine jury verdicts, settlements, lawyers' fees or any actual costs of what might generally be considered the legal system. Rather, Tillinghast's numbers were calculated from total liability insurance premiums, primarily as reported by the insurance reporting firm, A.M. Best, as well as Tillinghast's own "internal" sources.(3)

Each year, consumer groups and many academics have criticized this methodology. (4) In January 2004, Americans for Insurance Reform, a coalition of over 100 public interest groups from around the country, provided a detailed analysis of why Tillinghast's numbers are wrong, and are inappropriate for demonstrating either total costs of the U.S. tort system, or cost trends over time. (5)

The Chamber's report is based entirely on Tillinghast's figures. (6) In fact, it appears that any figures that they found differing from Tillinghast's numbers were then "scaled" so they would equal Tillinghast's. (7) Here are just some of the problems:

The definition of "tort liability costs" is incorrect. The "tort system costs" identified by the Chamber and Tillinghast are calculated by including the immense costs of operating the wasteful and inefficient insurance industry. Fully 21 percent of so-called "liability" costs are what Tillinghast calls insurance industry "overhead" (e.g. salaries of executives, rent and utilities for insurance company headquarters, commission paid to agents, advertising and other acquisition costs). (8) And on top of that, it also includes costs like commercial auto insurance liability claims for fender benders, for which policyholders pay insurance premiums, the vast majority of which are settled without any attorneys being hired or anyone being sued. Thus, the Chamber's analysis is of a system it calls the "tort" system, but which is, in fact, vastly larger that the actual tort system.

The Chamber uses Tillinghast's distorted facts. Throughout its report, Tillinghast makes unfounded assumptions, adjusts figures without any basis, and fails to provide explanations or sources. On the rare occasion when it does provide "sources," they include such impossible-to verify citations as "internal Tillinghast Reviews,"9 "internal Tillinghast study,"10 "Tillinghast-Towers Perrin's internal database,"11 "various studies published by Tillinghast and Conning & Company,"12 and "our best estimate."(13)

For example, it attributes 21 percent of so-called "tort" costs to "administration," or insurance industry "overhead." As explained above, it is wrong to call this a "tort" cost, but also, the number itself is not verifiable.14 As another example, Tillinghast simply adds into its "estimate" of total tort costs an additional 32 percent (in 2002) of the expense of the entire liability insurance industry, to cover what it guesses to be "self- (un) insured" costs. While it is true that self-insurance is a growing percentage of the entire system, Tillinghast neither explains the basis of its estimates nor makes any adjustment to reflect the greater efficiencies of self-insurance programs. Tillinghast apparently assumes that the self-insurance system requires the same inefficient delivery system as the insurance industry, which is untrue. By using this device, Tillinghast overstates the costs of the tort system significantly.

The Chamber and Tillinghast do not measure the countervailing costs saved by the tort system; nor do they place any value on the rights granted to all Americans by the tort system itself. Any analysis of tort system costs must consider the countervailing benefits of the legal system, which pays people for real damages that must be repaid in some way. If someone is brain damaged, burned, or rendered paraplegic as a result of the misconduct of another but cannot obtain compensation from the culpable party through the tort system, he or she may be forced to turn elsewhere for compensation, such as to taxpayer-funded health and disability programs. In other words, the costs of injuries are not eliminated, but merely shifted onto someone else, such as the taxpayer.

Moreover, the tort system provides the financial incentive for companies and institutions to act more safely. The Chamber entirely ignores this point, failing to take into account the amount of money that the tort system saves the economy in terms of injuries and deaths that are prevented due to safer products and practices, wages not lost, health care expenses not incurred, and so on.

Finally, the right of injured people to sue and collect compensation from the perpetrators of their harm is one of the great achievements of American democracy. In our system, the poorest and most vulnerable, including those in need of medical care, the disrupted families of injured children or people who have suffered violations of their fundamental rights, can hold the largest wrongdoer accountable for causing harm. This is a precious and priceless right, the value of which the Chamber and Tillinghast entirely overlook in their reports.

Small businesses are being price-gouged by the profiteering insurance industry. In the NFIB's most recent survey poll, the issue "Cost and Availability of Liability Insurance" ranked as number 2 in importance by small business owners. Its ranking increased from 13th in the 2000 survey. More than 30 percent of owners regard it as a critical issue, compared with 11 percent in 2000—a three-fold increase. (15)

Well, no wonder. This country has been in a "hard" insurance market since 2001. It is remarkable that the Chamber would issue a report on tort costs for small businesses without even mentioning the well-known insurance cycle, which results in cost increases having nothing to do with the tort system – and cannot be solved by restricting victims' rights.

Insurance is a cyclical business. Its costs are cyclical as well. Three times in the last 30 years, insurance policyholders have experienced particularly large and sudden rate hikes. This is typical of what policyholders experience during the so-called "hard market" part of the insurance industry's cycle. The cause of the hard market is always the same: a drop in investment income for insurers compounded by underpricing in prior years. When investment income drops, insurers always respond the same way: by reducing coverage, canceling polices and/or raising premiums, often dramatically. Since 2001, we have been in a "hard market" period, but it is ending now.

In conducting any evaluation of insurance industry costs, it is critical to take into consideration the insurance cycle and insurer accounting practices, particularly over-reserving, during the hard market. Yet in this report, the Chamber, relying on Tillinghast, fails to mention it or even take note of the insurance cycle at all, even though it is the best explanation for many of the findings

Tillinghast seeks to blame on rising tort costs. (16) This omission seems particularly conspicuous because in other Tillinghast publications, the company not only acknowledges the cycle, but also advises insurers on how to "ride" the cycle to maximize profit. (17)

Today, the situation for businesses has changed dramatically from even last year.
Property/casualty insurance company profits are soaring and the "hard market" is over.

Skyrocketing Profits. According to the Property Casualty Insurers Association of America and Insurance Services Office, Inc., the property-casualty insurance industry's after-tax net income skyrocketed an astounding 997 percent between 2002 and 2003, to $29.9 billion. (18) Those huge profits were boosted thanks to a 10 percent increase in premiums even though losses rose just 2 percent, according to that report. Weiss Ratings similarly found that property/casualty insurers made a profit of over $32 billion in 2003. As they put it: "Escalating premiums have caused profits to soar." (19) While small businesses have been hit with rising health insurance premiums, those insurers have also enjoyed huge profits: up 311 percent in 2003, when they enjoyed a $30 billion profit. (20)

Here's a new "poll" idea for NFIB: Ask small businesses for their reaction to these skyrocketing insurance industry profits.

The industry's economic cycle has turned. The Council of Insurance Agents & Brokers reports that commercial property/casualty premium increases have eased greatly and are now returning to the levels they were at the end of 1999. As of the first quarter of 2004, small businesses saw their rates rise only 3 percent from the prior quarter.

	2001	4Q 2002	4Q 2003	1Q 2004
OVERALL RESULTS				
Small Comm. Accounts	21%	8%	4%	3%
Mid-size Comm. Accounts	32%	19%	5%	1%
Large Comm. Accounts	36%	21%	4%	-3%
SPECIFIC LINES				
Business Interruption	30%	13%	2%	-1%
Construction	46%	34%	13%	8%
Commercial Cars	28%	18%	7%	3%
Property	47%	21%	5%	-5%
General Liability	27%	19%	6%	3%
Umbrella Liability	56%	34%	11%	4%
Workers' Compensation	24%	21%	9%	4%
D&O		32%	13%	7%
Employment Practices		32%	10%	5%

Moreover, the most recent renewals survey by the Risk Insurance Management Society shows a "march to a soft market": "Insurance buyers are seeing flat renewals or price breaks as the market continues to soften, a recently released survey concludes. Price declines in the second quarter were more common than increases in every major category of coverage except workers compensation, according to the benchmark survey by the New York-based Risk & Insurance Management Society Inc." (21)

WHERE'S THE CRISIS?

During past and current liability insurance crises, the insurance industry has tried to cover up its pricing errors by blaming juries, lawyers and the legal system for liability insurance price jumps. Lobbyists pushing for this legislation argue about the alleged need for such legislation to limit lawsuits by consumers, including arguments that the litigation system is "out of control" or "broken." There is no basis for this view.

According to the National Center for State Courts, tort filings have dropped approximately 4 percent in the last 10 years, while contract filings, which are not covered by this legislation, rose 21 percent. (22) Adjusting tort filings for population growth would show that the drop in tort cases was even more dramatic, since total population in the states studied rose 13 percent during that time. "Tort filings ... peaked in 1990 and have actually shown a generally downward movement since that time." (23)

Moreover, according to the Bureau of Justice Statistics, in 2001, median awards to plaintiff winners (in the 75 most populous counties), was $27,000 (24): That's down from $31,000 in 1996. (25) Median punitive damage awards to plaintiff winners (awarded to only 3 to 5 percent of prevailing plaintiffs) was $25,000 in 2001, (26) down from $38,000 in 1996. (27)

Moreover, while the casualty count in the workplace and marketplace runs into the billions of dollars annually, overall, only 10 percent of injured Americans ever file a claim for compensation, including informal demands and insurance claims. Only two percent file lawsuits. The Rand Institute concludes that these statistics are at odds with any notion that we live in an overly litigious society. (28)

In sum, all insurance industry sectors are now enjoying astronomical profits on the backs of policyholders. Insurance rates are starting to drop due to predictable market conditions. And new data proves, once again, that jury verdicts and lawsuit filings are dropping in the United States. As in the past, the proponents of federal tort legislation continue to rely on myths about litigation and its impact on businesses to support disrupting state authority and protecting wrongdoers. There is no need for such an extraordinary federal measure as H.R. 2813.

H.R. 2813: A DEEPLY FLAWED BILL

The proposed Small Business Liability Reform Act of 2003 would be a significant preemption of state law, dictating federal products liability standards to the courts in all 50 states. Each of these standards would weaken the rights of innocent consumers who are wrongfully injured. It offers

nothing for consumers. Rather, it is a carefully crafted bill to provide relief and protections for the businesses and trade associations lobbying for it.

Moreover, while the bill limits consumers' ability to recover damages if they are injured from defective products, this part of the bill leaves corporations completely unhampered to sue if they suffer injury, i.e. commercial loss, from defective products. This is entirely unfair. Further, it does not touch corporate actions under contract or property law, even though contract case filings outnumber tort filings. (29)

Tort cases represent only about 10 percent of civil case filings in state courts in 1993 (the most recent year available), and only 5 percent of tort cases are based on product liability (including toxic substances) – about 5 out of every 1000 cases filed.30 On the other hand, contract cases – more than two-thirds of which were filed by businesses31 – represent about 11 percent of civil case filings.32 It is not credible to argue that the 5-per-thousand product liability case filings are clogging the courts, when business-plaintiff contract cases are filed 15 times as frequently.

TITLE I- SMALL BUSINESS LIABILITY RESTRICTIONS

Many businesses with fewer than 25 employees produce products that threaten the public's health and safety. They should not be entitled to the blanket liability protections H.R. 2813 provides.
For example, several years ago the Consumer Federation of America conducted a review of recent Consumer Product Safety Commission press releases and found that several companies with fewer than 25 employees had been fined or cited for failing to conform with federal mandatory safety standards or because a product was alleged to contain a product defect. Many of these products were toys, fireworks or baby products -- underscoring the impact this bill will have on the health and safety of children.

Moreover, according to the Violence Policy Center, small companies that would be covered by this bill include "many manufacturers of assault weapons, Saturday Night Special handguns, and even 50 caliber sniper rifles. Many of these companies have experienced safety-related problems with their products or have been defendants in product liability lawsuits. The legislation would protect Intratec, the manufacturer of the TEC-DC9 assault pistol, and Hi-Point, maker of the Carbine used in the April 1999 Columbine massacre in Littleton, Colorado." (33)

Punitive Damages Cap – Protecting the Worst Wrongdoers: The bill establishes a punitive damages cap of $250,000 or three times compensatory damages, whichever is less. This provision effectively would punish wrongdoing based on the harm done to the victim, not the culpability of the conduct.

Punitive damages are imposed by judges and juries to punish egregious misconduct and to hold companies accountable for their most reckless or deliberately harmful acts. The size of the punitive award should be based on the egregiousness of the actions, the extent to which the company acted with malice and awareness of the harm that would result, and the financial size of the company, and in any event, should be up to a judge and jury to decide. As the Rand Institute for Civil Justice, funded in part by insurance companies, has noted, "Punitive damages are

designed to punish a defendant for grossly inappropriate action and, in so doing, to deter further such actions by signaling that their consequences can be severe."(34) Arbitrary limits on punitive damages severely undercut this deterrent value.

Complete Abolition of Joint and Several Liability for Non-Economic Damages: The bill would overturn many state laws, burdening the most seriously injured consumers. The doctrine of joint and several liability has been part of the common law for centuries. It is a rule that applies to allocating damages when more than one defendant is found fully responsible for causing an entire injury. If one of them is insolvent or cannot pay compensation, the other defendants must pick up the tab so the innocent victim is fully compensated. Courts have always held that joint and several liability applies only to injuries for which the defendant is fully responsible. That means that the defendant's negligent or reckless behavior must be an "actual and proximate" cause of the entire injury. This is a high standard. (35)

Moreover, by limiting this provision to non-economic damages, women who work inside the home, children, seniors and the poor, who are more likely to receive a greater percentage of their compensation in the form of non-economic damages if they are injured, are disproportionately hurt. Non-economic damages compensate injured consumers for intangible but real injuries, like infertility, permanent disability, disfigurement, pain and suffering, loss of a limb or other physical impairment. The human suffering accompanying injuries caused by wrongful conduct deserves full compensation.

TITLE II: PRODUCT LIABILITY RESTRICTIONS

Elimination of Strict Liability for Product Sellers. H.R. 2813 eliminates strict liability and replaces it with a negligence standard -- which requires the consumer to prove that the seller failed to use reasonable care with regards to the product. It protects sellers where there was no reasonable opportunity for the consumer to inspect the product, or if inspection would not have revealed the aspect responsible for the harm. Seller liability is maintained for violations of an express warranty, or for intentional wrongdoing.

Strict liability for product sellers is the standard developed by courts because they recognized that stores are often in the best position to spot a product defect and to notify consumers about the dangers. Under this new standard, retailers would no longer have a duty to warn their customers about known product defects nor would they even have an incentive to stop selling products they know are unsafe. In addition, by holding every defendant in a product's chain of distribution -- including product sellers -- strictly liable, the tort system can alleviate the need for the injured consumer to discover and use complex and often difficult-to-obtain evidence about which defendant was responsible for a particular product defect and the resulting injury. The negligence standard under this bill can be very difficult and very expensive to prove.

Negligent Gun Sales. The bill exempts from its provisions three types of liability theories for negligent gun sales: negligent entrustment, negligence per se and dram shop action. The intent of this section is to exempt from the bill actions brought by consumers injured as a result of negligent gun sales. However, the bill fails to accomplish this purpose. According to the Violence Policy Center, there are additional liability theories that have been used successfully

against firearm retailers and proprietors of gun clubs or target ranges, that would be covered by the bill's extremely broad "product seller" and "product liability action" definitions. For example, theories of nuisance and trespass have been used successfully by plaintiffs harmed by bullets fired at gun clubs. To use these other theories, an injured consumer would now have to show that the seller was negligent, breached an express warranty or engaged in intentional wrongdoing. A nuisance action, increasingly used in firearm litigation, would not fall within any of these categories. Thus, the bill would provide great benefits for these gun companies at the expense of consumers.

Restricting Vicarious Liability. The bill protects renters and leasers from liability of damages caused by the people who rent or lease their products. This provision would specifically overturn the automobile rental and insurance laws of many states, including that of my state, New York, and generally overturn the common law of vicarious liability in a majority of states. This is extremely dangerous, as this doctrine is the best way to protect injured victims of products rented or leased to uninsured and under-insured people in their states. California, Florida, New York, and the District of Columbia -- states with the largest tourism businesses and, therefore, the most active rental car markets -- have applied vicarious liability to automobile rental companies, and as someone who frequently rents cars, I rely on this protection. Repealing this provision of New York law would leave some victims uncompensated, especially when the driver in an accident had only the legal minimum auto insurance coverage or no insurance at all, which is common in New York City where many individuals do not own cars.

This bill preempts the judgment of these states like my own, which have had unique experiences in dealing with the problem of uninsured and under-insured renters. Vicarious liability encourages rental companies to monitor their goods and customers more carefully, ensuring safer usage of their products in the marketplace. By making automobile rental companies accountable, they have incentives to make sure that their renters are qualified, safe, and use their products properly.

CONCLUSION

From the mid-1980s until today, the nation's business communities -- large and small – have been advancing a legislative agenda to limit their liability for causing injuries. One of the principal arguments on which they rely is that laws that make it more difficult for injured people to go to court (i.e., "tort reform") are economically necessary for small businesses and for a state's economy. This argument is utterly groundless. Surveys show that issues such as workforce development, healthcare and taxes are the issues businesses believe challenge their growth and viability, not civil lawsuits.

Moreover, not a single aspect of H.R. 2813 has anything at all to do with so-called "frivolous litigation." The only impact of this bill will be to take away the rights of most people who live in this country, while letting a handful of companies escape accountability for reckless misconduct that causes injury and death.

APPENDIX A

THE REAL CONCERNS OF BUSINESSES- NATIONAL SURVEYS

NATIONAL SMALL BUSINESS UNITED (NSBU) (CONDUCTED IN PARTNERSHIP WITH ARTHUR ANDERSEN ENTERPRISE GROUP); SURVEY OF SMALL AND MID-SIZED BUSINESSES, TRENDS FOR 2000. (36)

NSBU describes itself as "the nation's oldest bipartisan small business advocate for small American businesses."

Survey: Nationwide survey of small and mid-size businesses; 10,000 mailed, 557 responses.

Findings:

- When asked to name the "three most significant challenges to the future growth and survival of their business," the top three factors were: 1. Finding and retaining qualified employees (61 percent of respondents named this as one of their top three challenges); 2. State and federal regulations (35 percent); and 3. Economic uncertainty (29 percent).
- Other areas of concern cited were: keeping up with technology, access to adequate capital, taxes, labor costs, healthcare insurance benefits and conducting business on the Internet.
- Neither lawsuits nor liability laws made the list.
- Those results were consistent with earlier NSBU/Arthur Andersen surveys, which have never deemed lawsuits a top concern. (37)
- Even with regard to "legislative concerns" from which respondents could choose from a pre-defined list, healthcare reform, tax reform, capital gains tax incentives, social security reform, estate tax repeal and payroll tax reform all outpolled "product liability/tort reform."
- Similarly, in 1999, 2000 and 2001, litigation was not mentioned in a list of top 10 concerns facing the small business community cited by the NSBU Small Business Congress. While tax reform, healthcare reform, pension reform and bankruptcy reform were placed on its legislative agenda, "lawsuit reform" was not. (38)

AMERICAN EXPRESS, VOICES FROM MAINSTREET SURVEY.39

Survey: July 2000 poll of small business owners; sent to 1,000 small businesses, nearly 800 responded.

Findings:

- The survey results list the top 10 issues that are "very important" to small businesses. Neither lawsuits nor liability laws made the list.
- Employee health care insurance ranked number one.

- Other concerns that made this list were: tax cuts/reform, improving the quality of the workforce, reducing government regulations, availability of capital, crime, social security reform, reducing the budget deficit, Internet security, reducing estate taxes and minimum wage guidelines.
- These results are consistent with an earlier American Express survey, where small businesses listed "improving schools/training young people for work" and "healthcare" as the most important priorities, but never mentioned litigation. (40)

NATIONAL FEDERATION OF INDEPENDENT BUSINESSES (NFIB) EDUCATION FOUNDATION. 2000 SMALL BUSINESS PROBLEMS AND PRIORITIES. (41)

Survey: 75 potential problem areas were listed, and NFIB members were asked to assess how much each actually affected their operations.

Findings:

- Interestingly, NFIB chose not to even list "lawsuits" or "liability laws" as problem areas from which members could choose.
- The only category remotely connected to general liability was called "cost and availability of liability insurance," a problem for which insurance industry practices are far more responsible than lawsuits. This issue ranked #13.
- Nearly half of all respondents rated the cost of health care insurance a critical concern.
- Federal taxes on business income and finding qualified workers ranked second and third, respectively. Three of the six most important concerns involved taxes.
- Such findings were consistent with the issues discussed in the 2000 Congressional Small Business Summit, which focused on short-term tax relief, health care, social security, government regulations, worker shortages and the tax code. (42)

NATIONAL FEDERATION OF INDEPENDENT BUSINESSES (NFIB). 2000 SURVEY (RELEASED FEBRUARY 6, 2001). (43)

Survey: Survey of small business members of New York NFIB.

Findings:

- 63 percent of respondents selected rising health care costs as one of the top three most serious problems they face, followed by high taxes and an uncertain economy. Workers compensation insurance costs were also mentioned.
- Neither liability laws nor lawsuits were mentioned in any materials accompanying release of the survey.

CENTER FOR GOVERNMENT RESEARCH (CGR) (RELEASED BY BUSINESS COUNCIL OF NEW YORK STATE). BARRIERS TO SMALL BUSINESS GROWTH IN NEW YORK STATE – A BAROMETER OF OPINIONS, NOVEMBER 1998. (44)

Survey: Mailed to 3,600 small-to-medium sized businesses across state. About a 10 percent response rate.

Findings:

- Local property taxes were considered the most significant barrier to growth of their business. Health care costs came second, followed by the state personal income tax, energy costs and wage/salary costs, federal taxes, finding qualified workers, declining population and the state sales tax. All of these outpolled liability laws, which ranked 10th.
- Nearly half the respondents claimed state taxes affected growth.(45) Those firms who considered it harder to do business in New York than in any other state listed barriers to growth as follows: 1. Health care costs, 2. Local property taxes, 3. The state personal income tax, 4. Energy costs and 5. Federal taxes.(46)

NEW JERSEY

NATIONAL FEDERATION OF INDEPENDENT BUSINESSES (NFIB). 1999 NFIB/NEW JERSEY SURVEY ON THE STATE BUSINESS CLIMATE. (47)

Survey: Survey of small business members of New Jersey NFIB. Respondents were asked, "[W]hat is the number one problem facing your business today?" from the following list: over-regulation, access to capital/loans, health insurance costs, lack of qualified workers, property taxes, litigation/lawsuits, other insurance costs, business taxes, other.

Findings:

- Litigation/lawsuits tied with property taxes and "other insurance costs" for last place in this survey. More important concerns were: lack of qualified workers (24 percent), overregulation (23 percent), health insurance costs (16 percent), business taxes (12 percent) and access to capital/loans (5 percent).
- In 1998, litigation/lawsuits again tied with "property taxes" for last place in the rankings.

OTHER STATE NFIB SURVEYS

Quality workers and regulatory reform were the two biggest worries for Washington's small business owners, according to a 1999 survey of the 17,000 state NFIB members. (48) A 2000 survey of Oregon NFIB members found that health care costs and taxes, including the personal income tax, capital gains tax, personal property tax and unemployment insurance tax, were the most pressing issues for Oregon small business owners.49 In a 1999 NFIB Pennsylvania study, most business owners placed affordability of employee group health insurance and implementing state unemployment insurance on the top of their "worry" list.50 That same year, the local director of NFIB's Hawaii chapter reported that 77 percent of small business owners in Hawaii viewed taxes and fees as their greatest problems.51 When asked to weigh in on issues of concern in 1997, Illinois NFIB members cited prevailing wages, educational funding and quality of graduates and health insurance. (52)

NOTES

(1) NFIB, "Small Business Problems and Priorities." June 2004. at 7-8.
(2) NFIB, "Small Businesses Signal Best Economy in 20 Years," July 13, 2004.
(3) In nearly every Tillinghast publication, except this one, Tillinghast describes itself as "a premier independent actuarial advisor to the insurance and financial services industry; our major clients include most of the world's top insurers," yet that description is conspicuously missing from the "U.S. Tort Costs" report. See, e.g., Tillinghast, Enterprise Risk Management in the Insurance Industry: 2003 Benchmarking Survey Report; Tillinghast, 2003 Stop Loss Survey, at 7; Tillinghast, Riding the Insurance Cycle, Part 2, at 4; Tillinghast, Update U.S.: Focus on Variable Annuity Market, Sept. 2003, at 16.
(4) E.g., in a January 29, 1999 independent study prepared for the New York State Bar Association, Daniel Capra, Philip Reed Professor of Civil Justice Reform at Fordham University School of Law, called these figures "vastly over inclusive." Ralph Nader noted in 1991 congressional testimony, "If consumer advocates came to Congress asking for a complete overhaul of the nation's regulatory laws based on made up and mischaracterized numbers like these, we would rightfully be laughed out the door." Committee on Commerce, Science and Transportation, Sept. 19, 1991.
(5) See, Tillinghast's "Tort Cost" Figures Vastly Overstate the Cost of the American Legal System, http://www.insurance-reform.org/pr/Tillinghast_Overstates.pdf
(6) See U.S. Chamber Institute for Legal Reform, Liability Costs for Small Business, 7-8 ("The most recent Tillinghast study estimates the total costs of the tort liability system to be $233 billion.... Of the $233 billion overall tort liability costs, Tillinghast estimated that $129 billion falls on businesses.... The U.S. Chamber Institute for Legal Reform sought to understand how these costs affect different segments of the business community.")
(7) U.S. Chamber Institute for Legal Reform, Liability Costs for Small Business, Table 1 notes 2, 3, Table 2 notes 2, 3.
(8) Tillinghast, U.S. Tort Costs: 2003 Update, 14, 17.
(9) Tillinghast, U.S. Tort Costs: 2003 Update, App. 4 note 3.
(10) Ibid. App. 5 notes 2, 3, and 4.
(11) Ibid. at 16.
(12) Ibid. App. 4 note 6.
(13) Ibid. at 17 (The report states that "[n]o consistent historical database exists," and "studies . . . typically have been limited to a particular state, coverage or exposure," before stating the authors' "best estimate.")
(14) See ibid. at 14 (The report provides no source, no basis for the figure, and no definition, but rather just states that "these costs are consistently defined and measurable over time.")
(15) NFIB, "Small Business Problems and Priorities," June 2004, at 7-8.
(16) For example, the report notes "tort cost growth experienced in 2001 and 2002 . . . akin to what was last experienced in the 1970s and 1980s," but never points out that these are the three hard markets of the last 30 years, which explains the sharply rising premiums. Instead, the report goes on to list various alleged causes for the 2001-02 growth without any mention of the cycle. Tillinghast, U.S. Tort Costs: 2003 Update, at 3.
(17) Tillinghast, Riding the Insurance Cycle, Parts 1 and 2, available at http://www.tillinghast.com/tillinghast/publications/asp/regionpubs.asp?region=NA.

(18) Insurance Services Office, Inc., & Property Casualty Insurers Association of America, "Sharp Increase in P/C Industry's Net Income Propels Surplus Upward in 2003," April 2004. http://www.iso.com/press_releases/2004/04_14_04.html
(19) Weiss Ratings, "Property and Casualty Insurers Earn $32.3 Billion in 2003; Industry Reports $48 Billion Investment Gain," July 14, 2004, http://www.weissratings.com/News/Ins_General/20040714general.htm.
(20) Weiss Ratings, "Life and Health Insurers' Profits Climb 311% in 2003; $6.9 billion gain in individual annuity business," July 6, 2004, http://www.weissratings.com/News/Ins_General/20040706general.htm.
(21) Michael Bradford, "RIMS renewals survey shows 'march to a soft market,'" Business Insurance Online, posted July 15, 2004.
(22) National Center for State Courts, "Examining the Work of State Courts, 2003" at 23.
(23) Ibid.
(24) Bureau of Justice Statistics, "Civil Trial Cases and Verdicts in Large Counties, 2001," April 2004, at 5.
(25) Ibid, at 7.
(26) Ibid, at 5, 6.
(27) Bureau of Justice Statistics, "Civil Trial Cases and Verdicts in Large Counties, 1996," Sept. 1999, at 9.
(28) Compensation for Accidental Injuries in the United States, Rand Institute for Civil Justice (1991).
(29) See National Center for State Courts, "Examining the Work of State Courts, 2003" at 26.
(30) Bureau of Justice Statistics, "Tort Cases in Large Counties," April 1995, at 2.
(31) Bureau of Justice Statistics, "Contract Cases in Large Counties," Feb. 1996, at 2, 3.
(32) Bureau of Justice Statistics, "Tort Cases in Large Counties," April 1995, at 2.
(33) Violence Policy Center, Deadly Exceptions: Gun Manufacturers That Would be Protected by the "Small Business" Cap on Punitive Damages, February 2000.
(34) Erik Moller, Nicholas M. Pace, Stephen J. Carroll, Punitive Damages in Financial Injury Jury Verdicts, Rand Institute for Civil Justice 10 (1997).
(35) (See, e.g., Richard Wright, "The Logic and Fairness of Joint and Several Liability," 23 Memphis State Law Review 45 (1992).
(36) "Survey of small and mid-sized businesses: Trends for 2000." Conducted by Arthur Andersen and National Small Business United.
(37) See, e.g., "Survey of Small and Mid-Size Businesses: Trends for 1998," found at http://www.nsbu.org/survey/7th/index.html; "Highlights of the 1997 NSBU/Arthur Andersen Survey of Small and Mid-Sized Businesses," found at http://www.nsbu.org/survey.htm; "1996 NSBU/AA Survey Highlights," NSBU News Release, June 27, 1996, found at http://www.nsbu.org/survey96.htm.
(38) "The Voice of Small Business Is Shaped: Final Results from Small Business Congress 2001," February 14, 2001, found at http://www.nsbu.org/media_center/pr021401.htm; "Final Results From Small Business Congress 2000," February 7, 2000, found at http://www.nsbu.org/pr/pr020700.htm; "Final Results From The 1999 Small Business Congress," February 9, 1999, found at http://www.nsbu.org/pr/pr020999.htm.
(39) "Small Business Says Affordable Healthcare Is Their Highest Priority on the National Agenda; High Costs Prevent One Out of Two Small Firms from Offering Employees Healthcare Insurance," Business Wire, July 10, 2000.

(40) "Small Business Owners Want Improvements In Education And Affordable Healthcare – Top Concerns Ahead Of Tax Cuts And Reductions In Regulatory Burdens," March 16, 2000, found at http://www.nsbu.org/pr/pr031600amex.htm.
(41) NFIB Education Foundation, "2000 Small Business Problems & Priorities," found at http://www.google.com/search?q=cache:www.nfib.com/media/releases/sbet_prob.htm+NFIB+Education+Foundation&hl=en.
(42) "2000 Congressional Small Business Summit Referendum Summary," found at http://www.google.com/search?q=cache:www.nfib.com/2000summit/referendum.html+NFIB+Small+Business+Problems+Priorities&hl=en.
(43) "Health care mandates threaten New York small businesses, new NFIB survey finds," February 6, 2001. On file with CJ&D.
(44) "Barriers to Small Business Growth in New York State," Center for Governmental Research Inc. (November 1998).
(45) "Study: Property taxes, health-care costs hurt small businesses" (March 1999), on file with CJ&D. A 2000 survey of New York Business Council members echoes such concerns over taxes. See, "Survey: Business Council Members See Improvement—And Room For More—In New York's Business Climate, Taxes," October 17, 2000 found at http://www.bcnys.org/whatsnew/2000/1017srvy.htm.
(46) "Study: Property taxes, health-care costs hurt small businesses" (March 1999), on file with CJ&D.
(47) "Results of the 1999 NFIB/New Jersey Survey on the State Business Climate," on file with CJ&D.
(48) Sleeth, Amy, "Quality workers, regulatory reform top NFIB survey," Puget Sound Business Journal, February 5, 1999.
(49) Brown, Craig, "Insurance, Taxes Top Issues For Small Businesses, Report Says," The Oregonian, February 9, 2001.
(50) Miller, Michael, "Benefit costs are a top concern for Pennsylvania small business," Pittsburgh Business Times, April 9, 1999.
(51) "NFIB calls for tax/fee reductions," Pacific Business News, February 5, 1999.
(52) Janecke, Ron, "Illinois small-business owners weigh in on issues," St. Louis Business Journal, February 3, 1997.

TESTIMONY OF

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Before

THE REGULATORY REFORM AND OVERSIGHT SUBCOMMITTEE

THE HOUSE SMALL BUSINESS COMMITTEE

UNITED STATES HOUSE OF REPRESENTATIVES

Regarding

H.R. 2813
"THE SMALL BUSINESS LIABILITY REFORM ACT"

JULY 22, 2004

Mr. Chairman, thank you for inviting me today to share my views regarding H.R. 2813, "The Small Business Liability Reform Act," and how our liability system adversely affects small business.

By way of background, I have been an active participant in the development of personal injury or tort law since I served as law clerk to a federal judge in 1965. I was a professor of law and dean at the University of Cincinnati College of Law. I practiced law on behalf of injured persons for fourteen years. I also served at the U.S. Department of Commerce under both Presidents Ford and Carter, and chaired the Federal Inter-Agency Task Force on Insurance and Accident Compensation. For the past 25 years, I have been a defense lawyer. I have co-authored the most widely used torts casebook in the United States, *Prosser, Wade & Schwartz's Torts* (10th ed., 2002).

I have had a deep interest in improving our civil justice system and currently serve as General Counsel to the American Tort Reform Association, on whose behalf I am testifying today. I wish to make clear that the views I am expressing today are my own.

The Problem of Frivolous Lawsuits – A Major Problem for Small Business

Other witnesses will discuss the helpful principles contained in H.R. 2813, the Small Business Liability Reform Act. In order to avoid duplication, I would like to focus on a problem not addressed in this excellent bill, namely, frivolous claims and forum shopping.

The expression, "Death by a Thousand Cuts," fits the problem of frivolous lawsuits. Most frivolous lawsuits are not high-ticket items, but relatively modest. They are brought against small businesses including mom and pop stores, restaurants, schools, dry cleaners and hotels. Let's take an example that occurred to one of my

clients over a decade ago. The client, who runs a successful Irish pub, called me because a barrage of frivolous claims threatened her business. For example, an individual who alleged that he had been served alcoholic beverages when he was already inebriated brought a claim against the pub. The individual drove while intoxicated, and was involved in an automobile accident. He sued the pub. Police records showed, however, that he had visited numerous bars. Omitted from the list was my client's place of business.

Working with the pub's own lawyer, we were able to get the claim dismissed and have the plaintiff's lawyer pay the legal costs generated by the frivolous claim brought by his client. Those costs were several thousand dollars. Unfortunately, that would not be likely to occur today because, as I will show, the rules against frivolous lawsuits have been materially weakened.

This is what occurs today when a small business is hit with a frivolous claim. The defendant contacts a lawyer, usually one supplied by his insurer. The defendant's lawyer would call the plaintiff's lawyer, and suggest that there is proof that the plaintiff was never at the client's establishment. The plaintiff's lawyer could respond, "Well, I know there is a dispute about this, and I have asked for $50,000, but I think we can settle this for about $10,000." The plaintiff's lawyer realizes that the cost to the insurer of defending the case will be more than $10,000.

The defendant's insurer is then placed in a dilemma – if it fights the case and a judge allows the case to go to a jury, and the jury renders a verdict above policy limits, the insurer could be subject to a claim by its insured for wrongful failure to settle. On the other hand, if the insurer settles such a case, over time such action will cause the defendant's insurance costs to increase exponentially. Because there is currently no

swift and sound sanction against frivolous claims, the "death by a thousand cuts" will continue. It can destroy a small business.

The scenario just outlined makes clear why the alleged "screening effect" of the contingency fee does not work. In debates, some plaintiffs' lawyers often say that the contingency fee screens out frivolous claims. As plaintiffs' lawyers have said, "Why would a personal injury lawyer bring a claim on a contingency fee, when he knows it is baseless; he will not recover any money." In the real world, this is not true. It costs little more than a $100 filing fee and often takes little more time than generating a form complaint to begin a lawsuit. Additional defendants, who may have nothing to do with the case, can be named at no charge, as in the case of my client. It costs much more for a small business to defend against it. The system is rigged to allow, in effect, legal extortion.

The Weakening of Rule 11:
Unsound Policy Falling Between the Cracks of Correction

Slightly more than ten years ago, the Federal Rules Advisory Committee, an extension of the federal judiciary which has the primary responsibility to formulate the Federal Rules of Civil Procedure, announced an amended and weakened Rule 11. That rule is the main bulwark in federal courts and the analogous rule in state courts that helps stop frivolous claims. Before it was amended, it allowed a defendant to obtain reimbursement from the plaintiff for legal costs that it had to bear as a result of a frivolous claim. The Advisory Committee recommended weakening the rule despite the result of a survey it conducted of federal court judges, those who deal with the problem of lawsuit abuse on a day-to-day basis. That survey found that 95% of judges believed

that the now abandoned version of Rule 11 had not impeded development of the law.[1] Eighty percent found that the prior rule had an overall positive effect and should not be changed.[2] Three-quarters of those judges surveyed felt that the former Rule 11's benefits in deterring frivolous lawsuits and compensating those victimized by such claims justified the use of judicial time.[3] The Advisory Committee itself recognized that while there was some legitimate criticism of Rule 11's application, such criticism was "frequently exaggerated or premised on faulty assumptions."[4] The Advisory Committee has made many sound decisions, but it did not do so when it revised Rule 11 in 1993.

There are in place so-called "systems for correction of mistakes," made by the Federal Rules Advisory Committee. The first is that the Advisory Committee decisions about rule changes are reviewed by the Supreme Court of the United States. That occurred after Rule 11 was weakened. But when the weakened Rule 11 was transmitted by the Supreme Court to Congress for its consideration, Chief Justice William Rehnquist included a telling disclaimer: "While the Court is satisfied that the required procedures have been observed, this transmittal does not necessarily indicate that the Court itself would have proposed these amendments in the form submitted."[5] Justice White warned that the Court's role in reviewing proposed rules is extremely "limited" and that the Court routinely approved the Judicial Conference's recommendations "without change and without careful study, as long as there is no

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1 Federal Judicial Center, Final Report on Rule 11 to the Advisory Committee on Civil Rules of the Judicial Conference of the United States, May 1991.

2 *See id.*

3 *See id.*

4 *Amendments to Federal Rules of Civil Procedure and Forms*, 146 F.R.D. 401, 523 (1993).

5 *Id. at* 401 (1993) (transmittal letter).

suggestion that the committee system has not operated with integrity."[6] Justices Scalia and Thomas went even further, and criticized the proposed amendment to Rule 11 as "render[ing] the Rule toothless by allowing judges to dispense with sanction, by disfavoring compensation for litigation expenses, and by a providing a 21-day 'safe harbor' [entitling] the party accused of a frivolous filing . . . to escape with no sanction at all."[7] The bottom line is that the Supreme Court corrective against unsound rule changes did not work in this instance.

The Federal Rules Enabling Act:
The Place for Final Correction May Not Work

The Federal Rules Enabling Act of 1938 created a system where Congress delegated its power to the Federal Rules Advisory Committee to formulate Federal Rules of Civil Procedure. Congress has maintained the ultimate authority to change proposals from the Federal Rules Advisory Committee. In the mid-1970s, it did so with respect to the Federal Rules of Evidence. But with the system established in 1938, Congress only has seven months to make a "correction."[8] Apart from matters of urgent national concern, it is rare in 2004 that a bill can be passed by the Congress within seven months. Often, significant legislation that impacts the courts requires debate that can span one or more Congresses in order to reach consensus. Despite the introduction of legislation in both the House and Senate to delay the effective date of the

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6 *Id.* at 505 (Statement of White, J.).

7 *Id.* at 507-08 (Scalia, joined by Thomas, J.J., dissenting).

8 *See* 28 U.S.C. § 2074(a) (providing that the Supreme Court transmits to Congress proposed rules by May 1, and that such rules take effect no earlier than December 1 of that year unless otherwise provided by law).

proposed changes to Rule 11, time ran out before Congress could act and the revisions went into effect on December 1, 1993.[9]

Shortly after the revised Rule 11 took effect, Congress attempted to repeal the Federal Rules Advisory Committee's action to weaken Rule 11.[10] By that time, some practitioners had already referred to the new Rule 11 as a "toothless tiger."[11] The repeal passed the House.[12] Those opposing the bill, however, felt that there had not yet been adequate time to determine the effectiveness of the amended rule in practice.[13]

It is now more than a decade since the Federal Rules Advisory Committee acted to weaken Rule 11, and the problem of frivolous claims has only increased. We know the consequences that flow from the weakening of the Rule. They are adverse to our society.

Since Rule 11 has been weakened, frivolous claims have led to higher health costs, job losses, and an almost total failure of attorney accountability. As officers of the court, personal injury lawyers should be accountable to basic, fair standards: they should be sanctioned if they abuse the legal system with frivolous claims.

Sanctions Against Frivolous Claims Will Not Impede Justice

Some consumer groups have argued that placing sanctions against frivolous claims will somehow impede justice and hurt the ordinary consumer. This is simply not true. If we look to the words of Rule 11 of the Federal Rules of Civil Procedure and

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9 *See* H.R. 2979 and S. 1382, 103rd Cong., 1st Sess. (1993).

10 *Attorney Accountability Act of 1995*, **H.R. 988, § 4, 104th Cong, 1st Sess. (1995).**

11 *See, e.g.*, Cynthia A. Leiferman, *The 1993 Rule 11 Amendments: The Transformation of the Venomous Viper into the Toothless Tiger*, 29 TORT & INS. L. J. (Spring 1994) (concluding that "[o]n balance, the changes made appear likely to undermine seriously the deterrent effect of the rule").

12 Role No. 207, 104th Cong., 1st Sess. (Mar. 7, 1997) (passed by a recorded vote of 232-193). The Senate did not act on H.R. 988.

congruent state rules, frivolous claims include those "presented for improper purpose" or to "harass or cause unnecessary delay or needless increase in the cost of litigation."[14] They also include claims that are not "warranted by existing law"[15] or those with an absence of factual or evidentiary basis.[16] But they do not include claims based on "nonfrivolous argument[s] for the extension, modification, or reversal of existing law or the establishment of new law."[17] This last point is important, because certain groups have argued, incorrectly, that sanctions against frivolous claims will stifle the growth of law. The very words of Rule 11 allow for growth, but not for frivolous extensions of the law.

A Way to Stop Frivolous Claims:

H.R. 4571, The Lawsuit Abuse Reduction Act of 2004

Chairman Schrock, Rep. Lamar Smith of Texas has introduced a vitally needed bill that restores Rule 11 to its strength and purpose prior to the 1993 changes. That bill, the Lawsuit Abuse Reduction Act of 2004, H.R. 4571, reverses the 1993 amendments that made sanctions discretionary rather than mandatory. Unfortunately, the 1993 amendments allowed judges to ignore or forget sanctions. For that reason,

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13 *See* H. REP. NO. 104-62, at 33 (dissenting views).

14 Fed. R. Civ. Proc. 11(b)(1).

15 *Id.* 11(b)(2).

16 *Id.* 11(b)(4).

17 *Id.* 11(b)(2). Some have argued that the manner in which judges implemented the pre-1993 version of Rule 11 disproportionately impacted civil rights plaintiffs. Even if this was initially the case, by 1988, a survey conducted by the Federal Judicial Center as well as other scholarship demonstrated that courts were construing Rule 11 more favorably to most litigants and practitioners, especially civil rights plaintiffs. *See* Carl Tobias, *Reconsidering Rule 11*, 46 U. MIAMI L. REV. 855, 860-61, 864-65 (1992) (citing Thomas Willging, Deputy Research Director of the Federal Judicial Center, Statement at Advisory Committee Meeting, Washington, D.C. (May 23, 1991); Elizabeth Wiggins et al., Rule 11: Final Report to Advisory Committee on Civil Rules of the Judicial Conference of the United States, § 1D, at 1 (Federal Judicial Ctr. 1991)). This led even some critics with "the general impression that Rule 11's implementation was not as problematic as many civil rights plaintiffs and attorneys had contended." Tobias, *supra*, at 864-65.

irresponsible personal injury lawyers could game the legal system: They knew that it would be unlikely that they would have to pay for bringing frivolous claims.

The 1993 amendments also allowed unscrupulous plaintiffs' attorneys to play the game, "heads I win and tails you lose." They could bring a frivolous claim and hope that they could succeed in getting an unjust settlement just as I outlined above. But if a Rule 11 motion was brought against the personal injury lawyer, they had 21 days to withdraw their lawsuit without the imposition of any sanction. When the 1993 amendments weakening Rule 11 were admittedly rubber stamped, as I have indicated, Justice Scalia dissented from the process, noting that,

> In my view, those who file frivolous suits and pleadings, should have no 'safe harbor.' The Rules should be solicitous of the abused (the courts and the opposing party), and not of the abuser. Under the revised Rule [11], parties will be able to file thoughtless, reckless, and harassing pleadings, secure in the knowledge that they have nothing to lose: If objection is raised, they can retreat without penalty.[18]

Finally, Representative Smith's proposed legislation wisely reverses the 1993 amendments to Rule 11 that prohibited money sanctions for discovery abuses. Perhaps more than any other abuse that has become worse in the last decade has been the rampaging, harassing abuse of discovery. A small or even a large business could be devastated by such activity. They are often asked to produce materials that have nothing to do with the merits of the case. It is another weapon to force an unfair settlement. An example is going on now in Madison County, Illinois. There, a plaintiff's lawyer in an asbestos case is trying to "discover" the names of civil justice organizations to which the defendants are affiliated, and how much money is given to those organizations. This information has absolutely nothing to do with the case before the

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[18] *Id.* at 508.

Madison County court. We desperately need the legal power to stop such discovery abuses.

The Domino Effect of the Modifications in Rule 11

If the 1993 weakening of Rule 11 only affected the federal courts, that would be bad enough. In that regard, it has had a domino effect on state procedures because many states routinely accept modifications to the Federal Rules of Civil Procedure and implement them into their state's law.[19] There is some general wisdom to such provision, so that state procedural rules will not vary between state and federal courts. In this instance, that general wisdom resulted in state courts being unwittingly led into the same problem that face federal courts – they lacked adequate force to stop frivolous claims.

Hopefully, if Representative Smith's legislation were enacted into law, it might trigger reversals of the 1993 amendments in some states. But a number of states may not be covered by that process. For that reason, Representative Smith's bill covers state court decisions that involve interstate commerce. That will assure that those state courts use their power to impose sanctions against frivolous claims. This aspect of

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[19] For example, when Minnesota revised its own Rule 11 to conform to the 1993 amendment of the federal rule, the state advisory committee commented:

> While Rule 11 has worked fairly well in its current form . . ., the federal rules have been amended and create both procedural and substantive differences between state and federal court practices. . . . On balance, the Committee believes that the amendment of the Rule to conform to its federal counterpart makes the most sense, given this Committee's long-standing preference for minimizing the differences between state and federal practice unless compelling local interests or long-entrenched reliance on the state procedure makes changing a rule inappropriate.

Minn. R. Civ. Proc. 11, Advisory Comm. Comments – 2000 Amendments; *see also* N.D. R. Civ. Proc. 1 ("Scope of Rules"), Explanatory Note ("As will become readily apparent from a reading of these rules, they are the Federal Rules of Civil Procedure adapted, insofar as practicable, to state practice.") and Rule 11, Explanatory Note ("Rule 11 was revised, effective March 1, 1996, in response to the 1993 revision of Rule 11."); Tenn. R. Civ. Proc. 11, Advisory Comm'n Comment 1995 (noting that Tennessee amended its Rule 11 to track the 1993 federal revision, despite the fact that the state had seen not seen widespread abuse of the previous rule).

Representative Smith's bill is needed because if only federal courts receive the power to block frivolous claims, much of the lawsuit abuse problem would continue unabated.

Frivolous Claims Sanctions and Loser Pays Distinguished

Some have advocated that judges in the United States adopt a "loser pays" system. Under the "loser pays" system, the party who loses must pay the other party's attorney's fees. There is a great deal of controversy about such a process. Some believe that it could chill bringing legitimate lawsuits because plaintiffs would fear having to pay very large defense costs. Regardless of the merits of the "loser pays" argument, it is important to note that Rule 11 comes into play long before a jury is ever impaneled. The decision about whether a claim is frivolous is in the hands of a judge. As I indicated by quoting the Rule, it only applies when the claim has no basis in existing law or any reasonable extension of that law.

Mr. Chairman, in sum, for the United States economy, the wellbeing of our legal system and the preservation of small business, the strength of Rule 11 needs to be reinforced now.

Stopping Litigation Tourists from Visiting Judicial Hellholes

Apart from dealing with frivolous claims, Representative Smith's bill addresses a major problem in our current national judicial system: forum shopping. Forum shopping occurs when what I call "litigation tourists" are guided by their attorneys into bringing claims in what the American Tort Reform Association ("ATRA") has called "judicial hellholes™."

As indicated in ATRA's Judicial Hellholes Report, which I ask to be made part of the record, there are certain jurisdictions in the United States where law is not applied even-handedly to all litigants. The words carefully chiseled on the top of the Supreme

Court, "Equal Justice Under Law," are ignored in practice. As ATRA's "Judicial Hellholes"™ Report documents, a few courts in the United States consistently show "a systematic bias against defendants, particularly those located out of the state."[20] Objective observers are remarkably candid about the nature of these "Judicial Hellholes™." For example, some are located in West Virginia. Former West Virginia Court Justice and currently plaintiff's lawyer Richard Nealey said that when he sat on the Court,

> As long as I am allowed to redistribute wealth from out-of-state companies to injured state plaintiffs, I shall continue to do so. Not only is my sleep enhanced when I give someone else's money away, but so is my job security, because the in-state plaintiffs, their families and their friends will re-elect me . . . It should be obvious that the in-state local plaintiff, his witnesses and his friends, can all vote for the judge, while the out-of-state defendants cannot be relied upon [even] to send a campaign donation.[21]

My friend and very prominent Mississippi plaintiff's lawyer, Dickie Scruggs, did not disagree with ATRA's designation that some places are judicial hellholes. He disagreed with what they should be called.

As he stated,

> What I call the "magic jurisdiction," ... [is] where the judiciary is elected with verdict money. The trial lawyers have established relationships with the judges that are elected; they're State Court judges; they're popul[ists]. They've got large populations of voters who are in on the deal, they're getting their [piece] in many cases. And so, it's a political force in their jurisdiction, and it's almost impossible to get a fair trial if you're a defendant in some of these places. The plaintiff lawyer walks in there and writes the number on the blackboard, and the first juror meets the last one coming out the door with that amount of money . . . . These cases are not won in the courtroom. They're won on the back roads long before the case goes to trial. Any lawyer fresh out of law school can walk

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[20] American Tort Reform Association, "Bringing Justice to Judicial Hellholes 2003" at ix, *available at* <http://www.atra.org/reports/hellholes/report.pdf>.

[21] Richard Nealey, The Product Liability Mess: How Business Can Be Rescued From the Politics of State Courts, 462 (1998).

> in there and win the case, so it doesn't matter what the evidence or law is.[22]

While comedians may make fun of what goes on in these hellholes, they thwart the fundamentals of basic justice and fairness. As the ATRA Report documents, the hellholes have become a powerful magnet for out-of-state plaintiffs that have absolutely nothing to do with a local judicial hellhole jurisdiction. The plaintiff was not injured in the jurisdiction, he never lived in the jurisdiction and he does not work in the jurisdiction. He has absolutely nothing to do with the place. With the guidance of his plaintiff's attorney, he is a pure "litigation tourist." The litigation tourist is only there to sue.

Litigation tourists do not help the states that they visit. They pay no taxes, only burdening the courts of that state that are paid for by local taxpayers. They delay justice to those who live there.

Fortunately, some states that have been a haven for judicial hellholes, such as Mississippi, have recently enacted local legislation to block litigation tourists. If we were to wait for state-by-state action on this issue, however, it could be decades before – if ever – the situation is properly corrected. Frequently, the plaintiffs' lawyers who bring these out-of-state cases have local and very strong political power to thwart even the most basic of reforms that would stop the very worst type of forum shopping.

What Mr. Smith's bill provides is what is needed: a national solution to end unjustifiable forum shopping to "judicial hellholes™". It does so with equity and justice. It allows a plaintiff to file a case where he resides at the time of filing, or where he

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[22] Asbestos for Lunch, Panel Discussion at the Prudential Securities Financial Research and Regulatory Conference, (May 9, 2002), in Industry Commentary (Prudential Securities, Inc., N.Y., New York) June 11, 2002, at 5.

resided at the time of the alleged injury, or the place where circumstances giving rise to the injury occurred and also in the defendant's principal place of business.

For the welfare of our economy and basic fairness in our legal system, the Lawsuit Abuse Reduction Act of 2004 should be enacted now. It will help small business everywhere and remove two of the biggest thorns in the side of our judicial system: frivolous claims and forum shopping.

I thank you very much for the opportunity to testify today.

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