TORT INFLATION
2010: STABILITY TODAY, BUT FOR HOW LONG?

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Dr. Robert P. Hartwig, CPCU
212-346-5520
bobh@iii.org

James Lynch, FCAS MAAA
973-333-1964
jimlynch9999@yahoo.com
Introduction

America’s reputation as a haven for litigation was well established long before Jonathan Lee Riches last year sued to prevent the Guinness Book of World Records from naming him the most litigious person in the world. America’s tort problem is serious enough that the World Economic Forum sees a significant risk that the rest of the world may become as litigious as the United States currently is.

As the providers of liability coverage, insurers are accustomed to the constant thrum of tort inflation. With The Tort Threat in 2009: A Changing Liability Landscape, the Insurance Information Institute last year documented the potential mass torts and potential threats in the shifting political and judicial landscape.

This year’s report, like last year’s, discusses some of the same issues: a combination of monster jury awards and judicial “hell holes” pushing jury verdicts steadily upward till annual tort costs sap the economy of more than $800 per person. Tort costs are rising, though slowly at present. Jury verdicts continue to average more than $1 million. Claims adjusters see settlements rising, and businesses anticipate facing more lawsuits in the coming year.

And there are new threats: More elected officials are sympathetic to plaintiff’s attorneys. A weak economy encourages more discrimination lawsuits. New tort theories threaten to put billions of dollars of global warming costs on energy companies and their insurers. Imported drywall creates a cottage industry for plaintiff attorneys. A plastic that seemed harmless for decades—and may actually be harmless—becomes notorious. The nation’s largest trade partner creates an indemnification morass.

But the news isn’t uniformly bad: Nanotechnology, for example, creates new markets for insurance, but it has already shown the potential to generate mass torts. In other areas, such as allegations of securities fraud, the overall trend looks hopeful. In many jurisdictions, medical malpractice reform has helped keep health insurance costs down, a fact that even government scorekeepers have begun to acknowledge.
But any fair winds can turn quickly. Already this year, Illinois and Georgia courts overturned laws supporting medical malpractice reform. In a matter of months, Toyota went from the top-selling auto brand in the world to a near pariah faced with dozens of class actions jockeying for a jackpot that could hit $3 billion. And an enormous oil spill in the Gulf of Mexico could tap a host of liability coverages—pollution liability, product liability, directors and officers insurance—a tort jackpot so big that, in the words of one trade journal, “lawyers envision [it] becoming one of the biggest class actions in U.S. history, [involving] billions of dollars in potential liabilities.” Estimates of the ultimate cleanup and liability costs climb as high as $15.8 billion.

THE LAWSUIT FORECAST

Businesses in the U.S. and U.K. are anticipating an increase in legal disputes, according to a survey of general counsels by the law firm of Fulbright and Jaworski. As Fig. 1 shows, 40 percent of companies anticipate facing more legal disputes in the coming year, up from 32 percent a year earlier and just 29 percent in 2006. This includes 56 percent of insurance companies, up from 35 percent a year earlier. Respondents typically cited the weak economy for the anticipated increase.

Fig. 1  PERCENT OF COMPANIES ANTICIPATING AN INCREASE IN LITIGATION, 2006-2009

Source: Fulbright and Jaworski.

Jury awards appear to be peaking at just over $1 million on average. The average jury verdict in 2008, the most recent year available, was $1.05 million, more than 60 percent higher than the 1999 average. (Fig. 2 and Fig. 3).
Fig. 2  AVERAGE JURY AWARDS, 1999-2008
($ millions)

Source: Jury Verdict Research; Insurance Information Institute.

Fig. 3  AVERAGE JURY AWARDS, 1999, 2003 AND 2008
($ thousands)

*Award trends in wrongful deaths of adult males.
Source: Jury Verdict Research; Insurance Information Institute.
The likelihood of a jury verdict in excess of $1 million has also grown steadily, to 14 percent of all jury awards in 2008, from 9 percent in 1999 (Fig. 4). Jury verdicts are rising considerably faster than the Consumer Price Index, as Fig. 5 illustrates. While inflation has averaged 2.8 percent from 1998 to 2008, the average jury award has increased at more than twice that rate, 5.7 percent annually. This rapid growth continues to put pressure on tort costs.

**Fig. 4** PERCENT OF JURY AWARDS OVER $1 MILLION, 1999-2008

![Bar chart showing the percentage of jury awards over $1 million from 1999 to 2008](source)

**Fig. 5** GROWTH IN JURY AWARDS VS. INFLATION RATE, 1999-2008

![Bar chart showing the average annual change in jury awards and inflation rate from 1999 to 2008](source)
Another sign of rising tort costs is an increase in the most extreme jury verdicts. The 10 largest jury verdicts in 2009 totaled $1.5 billion, an increase of 12 percent from the $1.3 billion resulting from the 10 largest verdicts from 2008. (Fig. 6) The 2009 total is more than double the total from two years earlier, $615.5 million.

The increases of the past two years reverse a trend from the previous three years, when the top 10 verdicts fell by more than 80 percent, to $615.5 million in 2007 from $5.16 billion in 2004.

2009 was the fourth consecutive year in which no verdict surpassed $1 billion. The largest verdict in 2009, $370 million, was slightly smaller than the largest 2008 verdict, $388 million (Fig. 7). All 10 verdicts from 2009 topped $60 million, while only seven were that large in 2008. Two verdicts in 2009 stemmed from medical malpractice cases vs. none in 2008, a sign that trends in that line of business may be accelerating.
**Fig. 7** TOP TEN VERDICTS, 2009

<table>
<thead>
<tr>
<th>Value</th>
<th>Issue</th>
<th>State</th>
</tr>
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<tbody>
<tr>
<td>$370 Million</td>
<td>Defamation</td>
<td>California</td>
</tr>
<tr>
<td>$330 Million</td>
<td>Personal Injury (Drunk driving case)</td>
<td>Florida</td>
</tr>
<tr>
<td>$300 Million</td>
<td>Personal Injury (Tobacco verdict)</td>
<td>Florida</td>
</tr>
<tr>
<td>$89 Million</td>
<td>Personal Injury (Drunk driving case)</td>
<td>Missouri</td>
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<td>$78.75 Million</td>
<td>Personal Injury (Prempro)</td>
<td>New Jersey</td>
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<td>$77.4 Million</td>
<td>Medical Malpractice</td>
<td>New York</td>
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<tr>
<td>$71 Million</td>
<td>Conversion and Breach of Fiduciary Duty</td>
<td>Texas</td>
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<tr>
<td>$70 Million</td>
<td>Workers Comp Case</td>
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<td>Florida</td>
</tr>
<tr>
<td>$60 Million</td>
<td>Medical Malpractice</td>
<td>New York</td>
</tr>
</tbody>
</table>

Source: Lawyers USA, January 15, 2010.

Already in 2010, a $500 million verdict has been recorded."
THE TORT ENVIRONMENT
On a local level, the American Tort Reform Foundation pinpoints “judicial hellholes,” “where judges systematically apply laws and court procedures in an unfair and unbalanced manner, generally against defendants in civil lawsuits.” This year’s report picked out six locations, one fewer than last year. (See Fig. 8)

Fig. 8  THE NATION’S JUDICIAL HELLHOLES, 2010

The six locations are:

South Florida
The area is notable for:
- A proliferation of medical malpractice cases, leading to some of the highest medical malpractice rates in the nation.
- Continuing tobacco lawsuits.
- Lax legal rules on slip-and-fall claims.
- Being home of whocanisue.com (metounsu.com in Spanish).
West Virginia
The area is notable for:

- A dearth of appellate review. The state has no intermediate appellate court and no guaranteed right of appeal.
- A 'home-court advantage' in which locally elected judges favor in-state plaintiffs against out-of-state defendants. The practice is so common, one of the state’s top jurists wrote a book about it.¹¹
- Liability-expanding decisions of its high court.

Cook County (Chicago), Illinois
The area is notable for:

- Being a magnet for plaintiffs statewide. The county has 41 percent of Illinois’ residents but 65 percent of the state’s lawsuits.
- Novel lawsuits, containing complaints that, for example, a zoo’s dolphins splashed spectators too much and a fire engine’s siren was too loud.

Atlantic County, New Jersey
The area and the rest of the state are notable for:

- Generating mass torts, especially against the state’s pharmaceutical companies.
- Costing the Atlantic County school district more than $180 a student in litigation costs. The $1.18 million the district spent in the 2008 school year was about 45 times the state average.
- Unusual class actions, one of which would require warning labels for hot dogs and another of which accused Denny’s restaurants of failing to warn that their meals contain a lot of sodium.

New Mexico appellate courts
The courts are notable for:

- Rejecting the “baseball rule,” where spectators assume the risk of being struck by a foul ball.
- Finding a manufacturer of a rock crusher can be held liable for the death of a worker who ignored his training and climbed inside the machine while it was running. (Someone else had tinkered with the crusher to expose its moving parts.)

New York City
The city is notable for:

- Lawsuits against the city, which “spent more settling slip and falls medical malpractice, car accident and school-related claims than the next five largest American cities combined.”¹²
- A personal injury lawyer serving as speaker of the State Assembly.
Of these, New Mexico and New York are new to the list. Falling off the list were Los Angeles County, California; Clark County, Nevada; and Macon and Montgomery counties, Alabama.

Six areas made a watch list—areas perceived to have problems, but not quite as serious as the hellholes: California and Alabama were new to the watch list, having moved down from hellhole status the previous year. Madison County, Illinois, and two Texas areas—the Gulf Coast and the Rio Grande Valley—were holdovers from the previous year’s watch list. Jefferson County, Mississippi, was added to the watch list, though it has been rated as a hellhole as recently as 2004.

Tort troubles can threaten an area’s business environment. For example, Chesapeake Energy decided to cancel a $40 million regional headquarters in Charleston shortly after the West Virginia Supreme Court of Appeals refused to hear an appeal of a $405 million verdict against them.

As Chesapeake Energy’s CEO, Aubrey McClendon, put it: “We realized that until West Virginia’s judicial system provides fair and unbiased access to its courts for everyone, a prudent company must be very cautious in committing further resources in the state.”

West Virginia appears to be trying to change. In March 2010, West Virginia lawmakers approved a plan to create separate business courts in judicial circuits with more than 60,000 persons. Proponents say the courts are seen as a way for businesses to get a fairer appeals process.

Having seen the system firsthand, claims adjusters also anticipate higher tort inflation. Except for workers compensation, adjusters report either a rise or no change in frequency and severity trends, according to a survey by Towers Watson.

**TORT INFLATION VS. REGULAR INFLATION**

At a distance, fears of tort inflation may seem misplaced. Overall, prices fell 0.4 percent in 2009, as measured by the Consumer Price Index. But the parts of the economy that are sensitive to tort costs increased, even as costs throughout the rest of the economy remained flat or fell.

Tort costs involve mending injured plaintiffs, repairing damaged property and paying lawyers to settle claim disputes. As Fig. 9 shows, each of those costs grew in 2009. Legal services costs grew 2.7 percent; medical care costs grew 3.1 percent.
Typically, tort costs climb faster than the pieces of the CPI that constitute it. That is because many policies contain retentions or deductibles, and the retentions tend to leverage up the insurer’s costs.

Here is an example: A company buys insurance two years in a row and has a $10,000 retention. In the first year, there is a loss for $20,000. The company pays its retention, $10,000, and the insurer pays the remainder, $10,000.

In the next year, tort inflation is 5 percent. The same claim happens. Last year it cost $20,000, but this year it costs 5 percent more, or $21,000. The company pays its $10,000 retention. The insurer pays the remaining $11,000.

So in the first year the insurer’s cost was $10,000 and in the second year it was $11,000, a 10 percent increase. Tort inflation was 5 percent, but the losses on the policy grew by twice that rate.
Clearly, insurance companies’ financial statements are quite sensitive to changes in tort inflation. The claims a liability insurer incurs today are not paid until several years from now, as the size and complexity of a claim emerges. Sometimes claim settlement takes years. With asbestos, it has taken decades. And tort inflation seeps into the system at every moment along the way, from the moment a policy is written to when a claim on that policy settles.

So the specter of tort inflation raises costs on insurance today, as the price of the policy must reflect the underlying cost to settle all claims, no matter when they are settled.

It also can weaken the balance sheet of an insurer. If tort inflation accelerates, the cost of settling open claims—claims that were made years ago—grows.

Over the long term, as Fig. 10 shows, tort costs have increased at twice the rate of inflation. From 1961 through 2009, tort costs have grown an average of 8.4 percent a year—faster than medical costs (5.9 percent) and twice the overall inflation rate (4.2 percent).17

**Fig. 10** TORT COST GROWTH AND MEDICAL COST INFLATION VS. OVERALL INFLATION (CPI-U), 1961-2009E*

THE LONG-TERM TREND IN TORT INFLATION

Though the long-term trend remains a concern, tort costs rose to $838 per person in 2008, a slight increase from $835 per person in 2007, according to an annual study of tort costs by Towers Perrin. This was slightly less than the rate of inflation.

Towers forecasts higher tort inflation coming. For 2009, Towers Perrin estimated growth in tort costs at 3.0 percent beyond 2009, the Towers Perrin analysts worry that government deficits will spur inflation similar to that in the 1970s and 1980s. They also worry that the Obama administration will appoint tort-friendly judges, which will increase costs, particularly in medical malpractice. As a result, they project tort costs will increase by 4 percent in 2010 and 6 percent in 2011. By 2011, it projects that tort costs will consume 1.9 percent of GDP, the highest percentage since 2005.

To show the impact of tort costs on the overall economy, Towers compares changes in tort costs to changes in gross domestic product. The news for 2008 was favorable. Tort costs rose 1.1 percent in 2008, less than a 3.3 percent increase in GDP. It was the fifth year in a row that tort costs rose less than GDP (Fig. 11). Since 2003, tort costs have fallen to 1.79 percent of GDP, down from 2.24 percent.

**Fig 11  OVER THE LAST THREE DECADES, TORT COSTS CONTINUE TO GROW**

($ billions)

Excludes the tobacco settlement, medical malpractice.

The long-term trend is less encouraging; tort costs have grown faster than GDP. Since 1950, the tort system has nearly tripled its impact on the economy, growing from 0.62 percent of GDP in 1950 to 1.79 percent in 2008.

Towers Perrin projected that tort costs would start growing faster than the economy in 2009, projecting 3 percent growth in tort costs that year, vs. a projected 1.5 percent decline in GDP projected by the Congressional Budget Office (Fig. 12). The study pointed to issues stemming from the economic troubles that began in 2008, specifically:

- An increase in claims on employment practices liability insurance and directors and officers (D&O) insurance. Both coverages tend to see an increase in claims when layoffs increase.

- Increased costs from professional liability insurance as investors whose portfolios suffered in the financial crisis seek recompense.

**Fig. 12  TORT COSTS PROJECTED TO RISE FASTER THAN GDP, 2001-2011**

(Percent change from prior year)

Source: Congressional Budget Office.
THE OBAMA ADMINISTRATION SHIFT
So far in judicial appointments, President Obama has moved slowly. For his first appointment to the Supreme Court, Sonia Sotomayor, he sought a justice with “empathy.” By October 2009, only three judicial vacancies had been filled, vs. eight at the same point in the Bush presidency and nine in the Clinton presidency. Some observers attributed this to a cautious approach by Obama, while others blamed the Republican Party for stalling confirmations.

Meanwhile, some commentators believe the president has begun moving to the left on judicial appointments with the nomination of Goodwin Liu to the Ninth Circuit Court of Appeals, the kind of judge that liberals had “hoped for and conservatives had feared.” Liu is 39, relatively young for an appeals court judge with no experience on the bench. He has written against conservative legal theories such as originalism and opposed the Supreme Court nomination of Samuel Alito.

Other appointments and policy directives could also give the appearance of a shift away from principles that rein in tort inflation. The president’s latest appointment to the Federal Reserve, Janet Yellen, is seen as a “dove” on inflation policy, preferring to risk inflation to spur employment growth. After a speech in February, she told reporters, “If it were possible to take interest rates into negative territory, I would be voting for that.” She does put enough nuance in her views, though, to recognize the threat of stagflation— inflation accompanied by slow growth—can result from misguided Fed policies.

Perhaps the White House’s most progressive actions have occurred in the regulatory agencies of the executive branch. As The New Republic magazine details, “Obama has done just about everything a liberal could ask for—but done it so quietly that almost no one, including most liberals, has noticed.” The administration has moved to the left in appointments at the Environmental Protection Agency, Food and Drug Administration and other agencies.

Federal laws, decisions and rules made can have a significant impact on litigiousness, particularly in a weak economy, where job losses can feed temptation to file suit.

One example comes from the first piece of legislation signed by President Obama after his inauguration, the Lilly Ledbetter Pay Act of 2009. The law reversed a 2007 Supreme Court decision that restricted the amount of time for filing an employment discrimination complaint.
In a press release celebrating the first anniversary of the act, the EEOC noted that it had re-examined or reopened hundreds of claims, involving more than 1,100 people. In addition, the EEOC fielded 4,800 new charges of wage discrimination, 1,900 of whom were women alleging they were underpaid because of their gender.\textsuperscript{27}

The overall number of actions filed with the Equal Employment Opportunity Commission dipped slightly in 2009, to 93,277, but remains substantially above the levels of 2007 and prior, as Fig. 13 shows.

\textbf{Fig. 13  CHARGES BROUGHT BEFORE EEOC, 1997-2009}

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\includegraphics[width=\textwidth]{charges_brought}
\caption{CHARGES BROUGHT BEFORE EEOC, 1997-2009}
\end{figure}


One reason is the recession. As the economy slows, laid-off employees become more likely to allege discrimination. EEOC data show this phenomenon. The total number of charges filed with the EEOC spiked in 2008 and stayed high in 2009. Charges of race discrimination grew 10 percent. Sex discrimination charges grew 13 percent.

Age discrimination charges grew 19 percent, driven perhaps by the aging Baby Boomer generation, the youngest of whom is about 45. Workers older than 40 join a protected class of workers.
Disability charges grew 21 percent. This increase may result from changes to the Americans with Disabilities Act that became effective January 1, 2009. The changes brought more Americans under the definition of disabled, which had been narrowed by a series of court decisions. It also raised concerns about whether people with eating disorders or users of marijuana for medicinal purposes could claim discrimination.\textsuperscript{28}

But the sharpest growth occurred in retaliation charges, which grew 26 percent. Several Supreme Court decisions over the past three years have made it easier for employees to pursue retaliation claims.\textsuperscript{29} In addition, if a workers compensation claimant happens to be laid off shortly after returning to work, the worker can claim retaliation.\textsuperscript{30}

As the frequency of claims increases, the potential for large settlements remains high. Wal-Mart recently settled a sex discrimination complaint for \$11.7 million. The retailer faces another sex-discrimination suit covering two million women.\textsuperscript{31}

Companies in the U.S. and U.K. also endured increases in workplace-related multi-plaintiff cases such as class actions, according to a survey by the law firm of Fulbright & Jaworski. Fig. 14 shows that 39 percent of companies saw an increase in multiparty wage and hour disputes, 24 percent saw increases in sex-related workplace disputes, and 13 percent saw increases in race-related workplace matters.\textsuperscript{32}
TERRORISM: A LIABILITY THREAT

Terrorism insurance is another area likely to be affected by presidential preferences. So far, federal efforts have helped nurture a market for terrorism insurance, but current budget proposals may throttle it.

After the September 11, 2001, terrorist attacks, insurers withdrew cover for terrorist events, noting that the uncertainty was too great to develop a price for the insurance.

According to the Insurance Information Institute, the attacks on the World Trade Center cost insurers $32.5 billion, mainly from property losses—the second-largest insured catastrophe in U.S. history. (Hurricane Katrina was more than $40 billion.) And that amount excludes $7 billion in payments from the 9/11 Victims Compensation Fund, which was created specifically to bypass the traditional tort system to reimburse victims and their families.

In addition, 96 families declined to participate in the fund and pursued traditional tort litigation. Results are sealed, though reports indicate 93 of those families received more than $500 million. And in June 2010, more than 10,000 workers at Ground Zero were due to receive up to $712.5 million to settle claims they were made ill working at the site. Each worker would receive an amount based on
severity of injury, following a formula in the settlement.\textsuperscript{34}

After the initial attacks, insurance markets reacted by adopting exclusions for losses attributable to terrorist attacks because insurers were unable to determine where exposures lay and how to price the coverage. The federal government intervened, first through the Terrorism Risk Insurance Act (TRIA) and most recently through the Terrorism Risk Insurance Program Reauthorization Act of 2007 (TRIPRA). These acts provide a backstop for most commercial property and casualty lines through 2014, while the market for terrorism insurance develops.

So far, the federal backstop appears to have helped, with more than 60 percent of insurers purchasing terrorism coverage, according to research by the insurance broker Aon. And terrorist threats aren’t going away. Last year, the FBI thwarted a plot to detonate a bomb on a New York subway. On Christmas Day 2009, an airline passenger attempted to blow up a jet bound for Detroit. And in May 2010, a car bomb was found in Times Square.

However, funding for the federal terrorism backstop would be reduced under the Obama administration’s current budget proposal.

The proposal would eliminate $250 million from the program, increasing insurer deductibles and co-payments. Research by Aon indicates that 70 percent to 80 percent of the property terrorism market would evaporate if the federal program were changed, and one could conclude a similar percentage would be affected in the casualty market.

**MALPRACTICE REFORM: BACKLASH COMING?**

While federal action can affect tort inflation, inaction can also make an impact. The president’s top legislative accomplishment, healthcare reform, fails to consider a proven technique for reducing medical costs: malpractice reform.

Studies consistently reach the same conclusion; tort reform lowers health care costs.\textsuperscript{35} The Congressional Budget Office estimates that the following changes would lower malpractice rates by 10 percent nationwide:

- Capping noneconomic damages at $250,000.
- Capping punitive damages at $500,000 or twice the economic damages award, whichever is greater.
- Modifying the collateral source rule to allow evidence of income from other insurance sources to be introduced at trial or to require that judgments be reduced by recoveries from those sources.
- A statute of limitations of one year for adults and three years for children from the date of discovery of an injury.
- Replacement of joint-and-several liability with a fair-share rule, under which a defendant would only be liable for the percentage of an award equal to his or her liability in the case.

The reforms would have reduced medical malpractice premiums by $3.5 billion in 2009, in addition to the savings achieved by existing tort reform.\textsuperscript{36}

The benefits of tort reform extend beyond insurance premiums. With the threat of lawsuits reduced, doctors practice less defensive medicine. This would have reduced healthcare costs by $7.5 billion in 2009, according to the CBO.

And tort reform would have reduced the budget deficit by $54 billion over 10 years. Of that $41 billion would have come from savings to Medicare and other government programs. The rest would have resulted from increased salaries to America’s workers. As employers paid less for health insurance, which is not taxed, they would have paid more in salaries, which are taxed. The shift would have increased the country’s tax receipts by $13 billion over 10 years.\textsuperscript{37}

Healthcare reform sets aside $50 million for states to “experiment” with tort reform.\textsuperscript{38} In some ways, the individual states have already acted as laboratories for medical malpractice reform. The result has been relatively stable medical malpractice rates.

Fig. 15 shows that only 6.2 percent of medical malpractice policyholders saw rates increase in 2009, vs. 36 percent who saw decreases. That is a stark contrast to 2006, when 31 percent saw increases and 23 percent saw decreases.\textsuperscript{39}
In January 2010, medical malpractice rates fell another 5 percent, according to insurance brokerage Guy Carpenter.\textsuperscript{40}

Medical malpractice rates are falling in part because medical malpractice losses have decelerated. Towers Perrin notes that, adjusted for inflation, tort costs from medical malpractice have fallen four years in a row. Even without an inflation adjustment, medical malpractice costs fell in 2008 for the first time ever, as Fig. 16 shows. Malpractice costs fell to $29.8 billion in 2008, down from $30.4 billion in 2007.\textsuperscript{41}
Meanwhile, the average size of a jury award appears to have reached a plateau. The average award was $3.7 million in 2008, barely up from a year earlier (Fig. 17).
Fewer claims are being reported. Industry observers cite four reasons:

- Hospitals are practicing better risk management as part of a movement to reduce harmful mistakes.
- Tort reform makes plaintiff attorneys more selective in the cases they pursue.
- Higher litigation costs, like tort reform, make attorneys choosier.
- Juries have begun to see that malpractice trends are creating a crisis by lowering access to health care.\(^{43}\)

A growing body of evidence is proving that tort reform pushes rates lower. Missouri’s experience is typical. On September 1, 2005, the state enacted several reforms, including:

- Joint and several liability rules changed so that a defendant that is less than 50 percent liable for an injury is only responsible for that share of damages.
- Noneconomic (pain and suffering) damages are capped at $350,000.
- Punitive damages are capped at $500,000 or five times the judgment, whichever is greater.\(^{44}\)
Fig. 18 shows that the number of claims filed peaked in 2005, with a flurry of filings ahead of the new laws. Since then, the number of claims has fallen to 1,215.

**Fig. 18** AFTER 2005 TORT REFORM, MISSOURI CLAIM FREQUENCY FELL . . .

(Number of claims)

Source: Missouri Department of Insurance, Financial Institutions and Professional Registration.

The average indemnity payment has fallen as well, till in 2008, the average payment to settle a claim is $202,612, lower than in 2002 (Fig. 19).

**Fig. 19** . . . AND SO DID CLAIM SEVERITY

($000)

Source: Missouri Department of Insurance, Financial Institutions and Professional Registration.
Missouri’s experience has been repeated in California, Texas, Florida and the 20 other states where tort reform has been enacted.

But Missouri’s performance may change. In March, the state’s Supreme Court ruled that caps on noneconomic damages could not be applied retroactively. So verdicts cannot be capped if the accident occurred before 2005.46

That ruling is one of several challenges across the country. In February, the Illinois Supreme Court ruled that caps on damages are unconstitutional.47 In March, Georgia did the same.48 Rulings from the Supreme Courts of Kansas and Maryland are expected this year.49

Shortly after the Illinois decision, the state’s Department of Insurance noted the effectiveness of the reforms the court had just rescinded. Since 2005, medical malpractice premiums had fallen to $541 million in 2008, down from $606 million in 2005, a 10.7 percent decrease. In that time, five insurance companies began writing coverage for physicians and surgeons in the state, totaling more than $22 million written premium.50

Milliman Inc., an actuarial consulting firm, estimated that the court’s decision would drive claim costs up 18 percent on physicians’ liability coverage. The average indemnity payment would rise 23 percent, Milliman estimated. The average cost to defend a claim would rise 10 percent.51

Shortly after the ruling, state Sen. Dave Luechtefeld introduced a constitutional amendment to clear the way for tort reform in the future.52

**SECURITIES LITIGATION**

For securities class actions, 2009 appeared to have a relatively calm horizon, having passed through a stormy past, according to a pair of Cornerstone Research reports.

The past: One Cornerstone report showed securities class actions that settled in 2009 paid out $3.8 billion, much of that borne by the insurance industry’s directors and officers coverage. That’s 39 percent more than in 2008. Both figures are considerably lower than the worst settlement years, as shown in Fig. 20.
The number of settlements also rose, to 103 in 2009 from 97 a year earlier.\(^{53}\)

The future: Cornerstone’s other report showed a decline in the number of shareholder class actions filed in 2009. As Fig. 21 shows, the number of shareholder class actions filed last year fell to 169, a 24 percent decrease from a year earlier.
Filings related to the credit crisis fell 47 percent, to 53 in 2009 from 100 a year earlier. Of the 53 credit-crisis lawsuits, only 17 were filed in the second half of the year, a sign of a slowdown in that area.\textsuperscript{54}

“Plaintiffs simply ran out of financial firms to sue,” said Joseph Grundfest, Director of the Stanford Law School Securities Class Action Clearinghouse, “and the rising stock market made it harder for plaintiffs to assert claims.”\textsuperscript{55}

The decline was spread across most industries, but was particularly large among financial firms, as Fig. 22 shows. A total of 11.5 percent of financial firms in the Standard & Poor’s 500, were sued in 2009, down from 32.6 percent a year earlier. However, that is still more than twice the rate for all S&P 500 companies, 4.6 percent.\textsuperscript{56}
Many of the remaining claims filed last year had a significant lag between the end of the class period and the date of the filing. The lag was especially pronounced in the second half of the year, as shown in Fig. 23, where the median lag in filing a class action was 100 days, almost twice the lag of earlier periods.57

**Fig. 22** PERCENTAGE OF FIRMS SUED IN SECURITIES CLASS ACTION, 2000-2009

![Percentage of Firms Sued in Securities Class Action, 2000-2009](chart1.png)

Source: Cornerstone Research.

**Fig. 23** MEDIAN LAG BETWEEN CLASS DATE, FILING DATE, 1996-2009

(Number of days)

![Median Lag Between Class Date and Filing Date, 1996-2009](chart2.png)

H1=First half.
H2=Second half.
Source: Cornerstone Research.
“The remarkable increase in old claims filed during 2009 suggests that plaintiffs are trying to fill the litigation pipeline by bringing older lawsuits that weren’t attractive enough to file while the firms were busy pursuing financial sector claims,” Grundfest said. “If history is a guide, these lawsuits are more likely to be dismissed and can therefore be characterized as lower quality claims.”

Another organization, Advisen, reported 38 securities class actions were filed in first quarter of 2010, down from 58 in Q1 2009. The 2009 number had been inflated by claims related to the Bernie Madoff pyramid scheme.58

**CHINESE DRYWALL: A LITIGATION MORASS**

Though the past year was relatively mild for some tort-prone areas, others emerged with new problems. Last year saw a sharp increase in the visibility of so-called Chinese drywall complaints.

During the housing boom of the last decade, manufacturers in the United States could not fill demand for drywall, a prefabricated product used to build interior walls. Builders looked overseas, and imported more than 500 million pounds of drywall from China between 2001 and 2007.

Most of it was used in Florida. Some ended up in Louisiana, as part of the rebuilding after Hurricane Katrina in 2005.

Since then, thousands of people living in homes containing Chinese drywall have complained the drywall exudes an overwhelming rotten-egg smell and contend they have suffered illness from the fumes.59

In addition, wires and coils in homes containing Chinese drywall have deteriorated severely. Homeowners have replaced their air conditioning or refrigerator, sometimes more than once, before isolating the problem.

The federal government has formed an interagency task force to study the problem, with updates found at [www.cpsc.gov/info/drywall](http://www.cpsc.gov/info/drywall). So far, the studies have shown that Chinese drywall emits more hydrogen sulfide than do other types of drywall and have linked the hydrogen sulfide emissions to the corrosion of pipes and wiring. However, there was not enough of the emissions to cause health problems, though research in that area continues.60

Insurers are concerned that the problem could become another mass tort, with thousands of claimants receiving billions of dollars in liability claims.
As awareness of the problem has grown, so have complaints. Through May 2010, as Fig. 24 shows, the total number of complaints to the Consumer Product Safety Commission (CPSC) has grown to 3,343, up nearly 450 percent from 608 10 months earlier. As of May, complaints had come from 37 states, up from 21 six months earlier, plus the District of Columbia and Puerto Rico.\textsuperscript{61}

**Fig. 24**  \textbf{DRYWALL COMPLAINTS CONTINUE TO GROW, AUGUST 1999-MAY 2010}

![Graph showing the number of complaints and states over time from August 1999 to May 2010.](image)


Two Towers Perrin actuaries estimated that economic losses could reach between $15 billion and $25 billion.\textsuperscript{62}

There are two types of claims:

- Property damage: Some homeowners contend their residences are worthless, and many have moved out awaiting repairs. Remediation would include removing the suspect drywall and repairing or replacing damaged appliances and electronics. A rule of thumb estimates the claim size to be one-third the value of the home, up to $100,000. Towers Perrin estimated losses could be $8 billion to $10 billion. The cost could climb dramatically if the metal frames critical to a modern home begin to corrode and require the house be razed and rebuilt.\textsuperscript{63}
Bodily Injury: The number and size of health-related claims are difficult to estimate right now. As noted above, researchers have found no link between the symptoms reported and the emission levels of the chemicals found. However, some news reports are highlighting the perceived health risk even while reporting that no link has been found.\textsuperscript{64} Defense costs could reach $5 billion to $10 billion, according to Towers Perrin, an amount unusually high compared with indemnity losses.\textsuperscript{65} Two issues will make it difficult to determine which insurance policy covers any loss.

The first issue is which type of insurance policy should be responsible for the claim. Faulty drywall would normally be a product liability claim. But most drywall came from subsidiaries of two non-U.S. companies, Knauf Tianjin and Taishan Gypsum Company Ltd., and it is difficult to successfully sue foreign manufacturers.\textsuperscript{66} The typical homeowners policy excludes losses from defective construction materials. In June 2010, a judge agreed, noting the policy specifically excluded damage from a latent defect, faulty materials, corrosion and pollution.\textsuperscript{67} Coverage could fall to general liability and umbrella policies. But some general liability and umbrella insurers argue that any toxic emissions would be considered pollution, which they do not cover. There could be many expensive fights over this issue, fought over and over if the matter falls into state courts.

How big will the overall problem get? Towers Perrin’s actuaries note the situation differs from asbestos. The defective product came to the country over a fairly short period. We know how much came into the country, when it came in and generally where it was used. Some of the larger insureds have self-insured retentions, which will limit insurer losses.

Typically, the actuaries say, a mass tort emerges, a series of settlements create benchmarks, then other cases tend to settle along the lines of the benchmark. They predict that Chinese drywall will follow that pattern.

The first two Chinese drywall liability cases concluded in April 2010. In one case, a Virginia case awarded $2.6 million to seven homeowners. In the other, a Louisiana homeowner received $164,000, plus attorneys fees.\textsuperscript{68}

Meanwhile, manufacturer Knauf Tianjin has negotiated a settlement with homebuilders.\textsuperscript{69} Terms were not disclosed.
OTHER IMPORT HEADACHES
Chinese drywall is only one of many products arriving from emerging markets that pose a new sort of liability risk to insurers. In less than a decade, Chinese imports more than quadrupled since 1999, to $337.8 billion in 2008, before falling in the wake of the recession. (Fig. 25)

Fig. 25  CHINA EXPORTS TO US, 1999-2008  
(US $ billions)

Although most imports from China are safe and reliable, the number of defective products from that nation has mushroomed. In 1997, 21 percent of all recalled imports were from either Hong Kong or China. By 2004, that share had grown to 35 percent. In 2007, China alone accounted for 67 percent of recalled imports, including 98 percent of toys.

The spotlight first shone on Chinese imports in 2007, with several high-profile recalls: poisoned pet food, drug-laced fish and lead paint in children's trains.

Manufacturers and importers working with Chinese companies, of course, are working hard to reduce problem imports. But it is difficult.

Insurers face two problems. The first is indemnifying their U.S. insureds for their exposure to products. Most product liability litigation involving Asian products
targets U.S. distributors and retailers. Suing the actual manufacturer is expensive and time-consuming.

If Chinese products prove unreliable in the marketplace or even if they suffer under the perception of being unreliable (because of a few, high-profile incidents), juries may “punish” the companies and the distributors by awarding large verdicts. The insurance industry ends up bearing those costs.

The second issue involves the cost of adjusting the claim. Often the insurer of a U.S. distributor can transfer the liability to the foreign manufacturer, but in a country like China, relatively straightforward steps are expensive and complex. Adding a manufacturer to a lawsuit (“service of process”) involves the U.S. State Department and the Chinese Central Authority. It can take nine months and cost more than $5,000.

GLOBAL WARMING: WHO’S TO BLAME

Most tort inflation comes from issues that have already emerged. Looking to the future, there are at least three areas where tort inflation could come from in the next few years: global warming, bisphenol A and nanotechnology.

The planet has been getting considerably warmer, scientists tell us, for about a century. Regardless of whether you believe that, the litigation environment surrounding global warming is just starting to heat up.

Most scientists agree that average temperatures worldwide have risen. They blame rising levels of carbon dioxide and methane, among other gases. These gases, once considered benign, have been classified as a danger to human health and the environment by the Environmental Protection Agency.73

As these so-called greenhouse gases proliferate, they trap heat in the Earth’s atmosphere. According to the scientists’ models, on this warmer planet, sea levels rise and catastrophic storms get more extreme. And on this litigious planet, someone must get the blame.

The insurance industry is watching a handful of lawsuits, each of which accuses major corporations in the auto, utility, or energy industries of contributing to and conspiring to suppress the truth about global warming.

Unlike other emerging issues, this one does not promise to become the “next asbestos.” Plaintiff attorneys, rather, say they are looking for the next Big Tobacco. After more than three decades of lawsuits, plaintiffs attorneys only began to
successfully sue tobacco companies in the late 1980s. Like tobacco, the conspiracy charge is key to the complaint.\(^7^4\)

So if an Alaskan village is threatened with inundation, the villagers sue 24 companies. And if Hurricane Katrina destroyed coastal properties, the property owners sue 31 companies, the Tennessee Valley Authority and the American Petroleum Institute.

Insurers could be exposed in two ways. First, the release of carbon dioxide could be considered a pollution claim on a general liability policy. Pollution has not been covered in a standard GL policy since the 1980s, but older policies could be at risk. And determining exactly what year of pollution contributed how much to global warming could prove as legally tortuous as determining the cumulative exposure to tobacco or asbestos. So even if insurers’ indemnity is limited, the industry faces potentially steep legal costs.

Second, companies may be expected to disclose more information about their exposure to global warming as awareness of it grows. Those that fail to do so may also fall prey to lawsuits that trigger D&O, according to at least one plaintiff’s attorney.\(^7^5\)

No clear pattern is emerging on the law, but the cases are in early stages. In the case of the Alaskan village, the court ruled that the issue is essentially political, thus a court cannot review it. In the Katrina case, the court ruled the opposite. Both cases are on appeal.\(^7^6\)

Global warming may offer insurers opportunities as well. Environmental liability insurers can market coverage for carbon dioxide and the other new pollutants. And growth in alternative energy industries such as wind and solar power would present more exposures for insurers to cover.\(^7^7\)

**BPA: UBQUITOUS, BUT A THREAT?**

Bisphenol A can be found just about anywhere. The chemical, known best by its acronym BPA, resists shattering and heat, so it has been used to make thousands of polycarbonate plastic products: eyeglass lenses, compact discs, computers, medical devices and, most famously, baby bottles and food and drink containers.

It has been used since the 1950s with no reports of injury. And from the 1960s until early this year, the U.S. Food and Drug Administration considered it safe.

However, low levels of it enter the body through sipping from plastic containers made with BPA. Almost every person’s urine contains trace amounts.\(^7^8\)
This had not been considered a problem until earlier this decade when researchers determined that BPA mimics the female hormone estrogen and suspected it may affect the neurological development of infants and young children.

In January, the FDA took a new stance, saying it has “some concern” about how current levels of BPA affect the brain, behavior and prostate gland of fetuses, infants and children. (The agency has “minimal concern” or “negligible concern” about the effects of BPA anywhere else.) The FDA calls for studying the situation further and has appropriated $30 million to do so over the next 18 to 24 months. The EPA has acted similarly.

However, even Canada, which banned the importation of polycarbonate baby bottles in 2009, indicates that the chemical is safe: “Exposure levels are below those that could cause health effects.” Canada banned baby bottles because the marketplace already provides alternatives to bisphenol A, so no risk was worth taking.

More recently, BPA levels have been linked to heart disease, although others have questioned the validity of those studies.

All of the concern has legislators concerned. Denmark banned some BPA products. France is considering whether to do so. As of April 2010, there were 54 bills in 20 states that would restrict BPA sales.

The sudden public questioning of a product that for decades has been seen as safe has led at least one researcher to question “whether America has been spun by clever marketing rather than clever science.”

Into the hubbub came the lawyers. None of the lawsuits allege an injury. They contend that the manufacturers defrauded them because they knew BPA was dangerous yet continued to sell it. The lawsuits were joined into a class action in late 2009.

Normally, insurers would not be pulled into a case like this; the typical general liability policy excludes claims of fraud. In August, a federal judge agreed.

But as the controversy continues, more legal challenges seem certain, and insurers will likely need to respond.
NANOTECHNOLOGY: GREAT PROMISE, BUT NOT RISK-FREE

Nanotechnology is the development of super-tiny materials, usually less than 100 nanometers. Material that small can have unique properties quite different from its life-size counterparts.

The science behind it is new—the ultra strong microscopes that kick-started the nanotech revolution were invented about 30 years ago—so commercial applications are only beginning to emerge.

For example, nanoparticles of zinc oxide and titanium dioxide let sunscreens rub into the skin smooth and clear. Silver nanoparticles destroy smelly bacteria. Meshing them into footwear keeps socks smelling fresh.

As Fig. 26 shows, through August 2009, there are 1,015 products officially considered to be the result of nanotechnology methods, according to a database compiled by the Project on Emerging Nanotechnologies. The chart also shows that the number of nanotechnology products has increased almost 20-fold in the past three years.

Fig. 26  NANOTECHNOLOGY CONSUMER PRODUCTS INVENTORY, 2005-2009
(Number of products, through August 25, 2009)

Source: The Project on Emerging Nanotechnologies
As the technology matures, the future of nanotechnology is fantastic.

On the horizon, scientists say, are stronger, lighter metals, lighter, more efficient computer processors, and medicines that target individual cells. Applications appear boundless. Scientists made an ink from carbon nanotubes that holds an electrical charge, turning a printed page into a battery.91

By 2015, spending on nanotechnology could top $150 billion, and two million people will work in nanotechnology fields.92

For insurers, there is opportunity. New products are new exposures to insure. And a product strengthened by nanotechnology, say a car bumper, will be less susceptible to damage, perhaps reducing auto injuries and hence, liability costs.

With the great promise, though, comes concern. The silver nanoparticles can wash out of the socks, accumulate in lakes and rivers and cause mutations in fish embryos.93 The carbon nanotubes can accumulate in the lungs like asbestos fibers.94

David Rejeski, director of the Project on Emerging Nanotechnologies at the Woodrow Wilson International Center for Scholars, notes that the first concerns about the asbestos-like qualities of carbon nanotubes arose in Science magazine in 1992, and more than 15 years passed before any regulatory action. Such a gap could give a product time to become ubiquitous, and subsequent economic losses would likely be borne by product liability insurers.95

As with any new technological advance, the concerns can outrace the science. Nanoparticles in sunscreen can react with sunlight to create free radicals, which have been linked to cancer. However, an Australian regulator indicates that the risk appears overstated. The free radicals remain in the outer layer of skin cells and do not penetrate into the living cells, where potential for damage is higher.96


The U.S. Food and Drug Administration, for example, indicated that nanotechnology presents problems similar to other emerging technologies. Complications arise because the properties of nanomaterials may change as materials grow larger. The agency also acknowledged the challenge of regulating an area of emerging technology where rapid growth is expected.97
Although regulation doesn’t necessarily relieve a manufacturer or its insurer of liability, a regulated product should be less likely to create a mass tort as its exposure into the environment will be more tightly controlled.

Regardless of regulation, product liability insurers would likely be exposed to the financial costs of nanotechnology. Insurers worry that one downside risk of nanotechnology is litigation, including mass torts—the worst-case scenario being an asbestos-like situation. Any health risks would go undiagnosed for years as the product or products become ubiquitous. By the time the problem is recognized, thousands of people would have been harmed. The liability could fall, in part, to the insurance industry to fund.

The World Economic Forum lists concerns over the unintended consequences of nanotechnology as one of the leading emerging risks for the next decade. The study estimates the probability of a nanotechnology crisis at between 1 percent and 5 percent. Should a crisis occur, the group estimates the cost will be between $10 billion and $50 billion.

Progress is never risk-free. With the first automobiles came the first auto fatalities. Electrification increased the risk of electrocution. Over the centuries people have risen to the challenge and produced insurance and risk management solutions that allow these technologies to bring benefits to society while allowing their promoters to efficiently and affordably manage the significant risks that may accompany them.

The risk for nanotechnology, like all business, is that the burden of an overaggressive tort system could snuff it out. Then, the greatest losses are from missing out on successes that society is unable to achieve.
SUMMARY
We have seen that tort inflation seems relatively tame, at least for now, especially compared with the past three decades. That appears to be driven, at least in part, by legal reforms in areas like medical malpractice.

But there are signals tort inflation could start again. Companies have grown increasingly concerned about lawsuits. A weak economy appears to stimulate tort claims. Some state courts have turned back measures that cap claims. The federal government, some fear, may follow suit. Tort inflation, like any other kind of inflation, never goes away.
END NOTES

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