

## **U.S. Legal System** **- Implications for UK Insurers**

Peter Clark  
Kendra Felisky-Watson  
Dewi James  
Tim Mardon

*The views expressed in this paper are given in our personal capacity and do not necessarily represent the views of the Institute of Actuaries or The Faculty of Actuaries or our Employers. Legal procedures vary between different States and the descriptions of legal procedures in this paper are only intended as a general guide for background information for this workshop. Clarification of points of law should be referred to The American Bar Association or a U.S. Legal Expert as none of the workshop members are lawyers.*

## INTRODUCTION

Two years ago former US Vice-President Dan Quayle described America's legal system as "a self-inflicted competitive disadvantage", with a cost of at least US\$ 300bn a year. Although Mr. Quayle's remarks were labelled cheap political capital by US lawyers, American people and businesses sympathised with his view. There are numerous examples of law suits, resulting in multi-million dollar damages awards; which would be regarded as ludicrous in the U.K.

For example - a man sued a ladder maker for US\$3m after he fell off and injured himself because the manufacturer failed to provide a general warning of the dangers of using ladders.

Americans are notably more litigious than Europeans - there were no less than 18.4 million lawsuits filed last year; and there are three times the number of lawyers per capita compared with the U.K.. However it is not the frequency, but the size of awards (particularly punitive damages for corporate misconduct) which cause concern. Businesses believe the US civil liability system may itself have become a liability to the economy. The business community regards excessive awards as discouraging innovation and curtailing competitiveness, although consumer groups argue the threat of lawsuits and awards of damages forces companies to make safer products.

UK insurers can be exposed to the US legal system in a number of ways - by directly insuring US businesses or US ventures by European companies, or via reinsurance. This workshop paper will attempt to set out the basic structure of the US legal system, discuss idiosyncratic parts of the system, and present examples of how these can affect insurers. Our workshop presentation will assume knowledge provided in this paper and concentrate on examples.

## STRUCTURE OF U.S. COURTS

There are two distinct court systems:

1. State courts
2. Federal courts

The vast majority of cases are filed in state courts - a typical split would be over 90% of cases filed in state courts, and under 10% in federal courts.

State courts are established in each state under the authority of the state government. Each state is free to determine its own court structure under its own constitution. No two states have identical systems.

State courts are involved in all types of cases; except federal crimes, constitutional and civil rights issues. They are located in many towns and are the courts with which most US citizens have contact.

There are a much smaller number of federal courts mainly located in the larger cities. Cases are only filed in federal courts if there is a specific federal statute or a provision in the U.S. constitution granting the federal courts jurisdiction to hear the case. Cases can not generally be heard in both systems. The federal courts differ from the state courts which in turn differ from each other in many aspects of procedure. This is clearly a problem for U.K. insurers involved in U.S. cases who are unfamiliar with the multitude of different systems, and will have to hire outside expertise at considerable expense.

There are basically three layers of court:

1. "Limited" or "General jurisdiction" where cases start.
2. "Intermediate" (appellate) courts; where appeals are first heard.
3. "Supreme" courts which have final judicial authority.

This division usually applies to state and federal courts. Higher courts can review the work of lower courts. In practice over 90% of civil cases are settled prior to trial, and the vast majority which do go to court are settled at trial court level and not appealed.

## JUDGES

Given that most trial court rulings which are appealed are upheld, the judge on the trial bench is a key figure. The role of the judge is to umpire in the proceedings, and it is the judges' obligation to be neutral. Judges in the U.S. are not allowed to ask questions to clarify points as they are in the U.K. They must only act as umpires.

More recently judges have been encouraged to take responsibility for reducing/eliminating backlogs that are widespread in many tort systems. The American Bar Association's Action commission has recommended that a "Fast Track" system should be adopted for the trial of tort cases, with active judicial management of pretrial phases. If such recommendations are implemented insurers may find long tail liability cases settling sooner than they have anticipated. Although this could reduce investment income in insurers' reserves, this could be offset by reductions in representatives costs if the system becomes more streamlined.

## APPELLATE JUDGES/SUPRE

When cases are appealed the facts established in the trial court are usually not reviewed. The role of the judge in appeal courts is to review the application of the law that governed a verdict.

## SELECTION OF JUDGES

Judges maybe appointed or elected, methods vary considerably between states. Federal judges, however, are always appointed for life - nominations being made by the president and accepted or rejected by the Senate.

In practice this means that different federal district courts have different "penchants" ie political leanings. This arises because many (nearly 70%) of the federal judges have been appointed by Reagan or Bush. This has tended to result in the Federal system being more favourable to the

business culture and insurers where such judges preside. Clinton's political appointees will have a different philosophy on the Federal system, probably weakening the position of commerce in cases they preside over.

### JURISDICTION AND VENUE

The plaintiff's lawyer decides where the case is filed, although a court has no authority to decide a case unless it has jurisdiction over the subject of the case. Certain actions are transitional - they can be brought in any location where the jurisdiction has contact with any of the parties giving rise to the suit.

This has a particular impact on potential actions involving UK insurers. The plaintiff's lawyers may be able to choose from a number of courts where the insured's company has businesses, and will clearly attempt to select a court likely to favour the plaintiff. This has often applied in asbestos claims where cases can be filed in a variety of locations.

### APPEALS

#### Rights of Appeal:

Either party can appeal to a higher court in a civil case. Appeals are usually made on grounds of errors in trial procedure or errors in the judge's interpretation of the law.

#### Appeal Procedure:

The appeal is started by filing a notice of appeal, which begins a set time within which the appellant must file a brief. This is a written statement detailing that side's view of the facts and legal argument in which it seeks reversal.

The other party then has a specified time in which to file an answering brief. Many appeal courts then make their decision solely from the briefs, with no further

oral arguments. If there is oral argument, each side's attorney is given a relatively brief opportunity to argue the case to the court.

The first level of appeal has only one judge. Higher levels of the appeal process have a panel of judges, usually three.

#### Errors of Law:

Not every error of law is cause for a reversal. Harmless errors are those which are not deemed to have prejudiced the rights of the parties to a fair trial. However, a serious error of law (e.g. the admission of improper evidence) may be viewed as harmful to a fair trial, and is therefore a "Reversible Error".

#### Opinions:

Most appellate courts are required to issue written decisions, and one judge will be designated to write an opinion. This may be redrafted several times until the majority of the court agrees with it. Judges who disagree with this "majority opinion" can issue a "dissenting opinion". Alternatively, some judges may agree with the result of the majority decision whilst disagreeing with the reasoning behind it. They may file a "concurring opinion".

When the opinion has been handed down to the final court and the time for a rehearing has expired, the appeal court will send a mandate to the lower court for further action. If the lower court's judgement is upheld the case ends unless the loser appeals to a higher court. If there is a reversal, the mandate may order a new trial or correction of the trial court's judgement.

Appeals can be dismissed (usually because of jurisdiction) or sent back to a lower court to reconsider the facts. An appeal in a civil case will not prevent immediately the enforcement of the trial court's judgement. Winning parties in the trial court may order the judgement executed unless the appealing party files an appeal or "Supersedes bond". The filing of the bond stops further action on the judgement until the appeal is over (in fact it guarantees the appealing party will pay or perform the judgement if it is not reversed on appeal).

## DISCOVERY

'Discovery' in the strict sense is the disclosure by one party to another of the existence of relevant documents which are or have been in his possession, custody or power. The disclosure may be general requiring a list of all documents, or particular documents falling within a particular class of document. The party entitled to discovery may inspect any of his opponents documents which are not classed as privileged. In practice the term 'discovery' is often used to include both the disclosure and the subsequent inspection.

A document covers anything which records information, including for example audio tapes or a computer database. Only relevant documents can be subject to discovery and they will be relevant if they relate to 'any matter in question' in the proceedings; a term wide enough to cover all documents which directly or indirectly assist or damage either party's case. Inspection means examination and carries with it the right to take copies.

The party required to produce the documents may object to producing for inspection privileged documents and this includes:

- a. confidential correspondence between a client and his legal advisers for the purposes of obtaining legal advice and documents prepared with a view to litigation.
- b. documents tending to incriminate or expose to a penalty.
- c. documents which would be injurious to the public interest if inspection is carried out.

Privileged documents can be subject to discovery, however, if when including them in a list, a party can give them a general description only so as not to reveal their contents.

'Interrogatories' are questions answerable on oath and is just another form of discovery and is sometimes called 'discovery of facts'. Interrogatories may be served by any party on his opponent and are usually given by affidavit. If the party interrogated omits to answer some of the questions or gives insufficient answers the court may order further answers to be given by affidavit or oral examination. Alternatively a request can be made for further and better particulars of the answers given. Interrogatories proposed must be relevant to the action; however, relevance is defined very widely. The questions may relate to any matters which go to support the

interrogators case or impeach or destroy his opponents case.

### Purpose

The main purpose of discovery is to enable parties to evaluate the strength of their case in advance of the trial and thereby prompt the compromise of disputes and the saving of costs. The party making discovery must disclose all relevant documents and must answer all questions put to him. The scope of the remedy is limited in so far as it does not allow for the general collection of information. However when discovery is granted litigants can elicit admissions, information and documents from their opponents, that they are prevented from obtaining by other means.

### Scope

The remedy is only obtainable against persons properly joined as parties to an action. Information can not be obtained from strangers to the dispute except by calling them as witnesses at the trial. As a rule it is improper to join a stranger as a party merely for the purpose of obtaining discovery, although exceptions have been made. At the trial documents from witnesses may be revealed for the first time. A litigant is not required to give discovery of documents which have never been in his possession, custody or power even if he could have obtained them by request at any time.

Discovery does not allow a party to subject his opponent to a general inquisition. It can only be used to elicit information relating to an existing claim or defence raised. Therefore, it can not be used for a 'fishing expedition', ie seeking discovery merely in the hope of finding something, nor to find out the names of his opponent's witnesses or to seek information merely as to the credit of possible witnesses.

Discovery is an equitable remedy ie it is never granted as of right, therefore the court has a discretion and can make orders as are appropriate to prevent the remedy being used oppressively. On application for discovery the burden is on the party objecting to satisfy the court that discovery is not necessary either for disposing fairly of the action or for saving costs. On application for inspection it is necessary for the applicant to satisfy the court that an inspection order is necessary.

### Disallowing Discovery

The court will not order discovery which would unfairly prejudice the respondents rights for example discovery and/or inspection of documents relating to trade secrets; or allow interrogatories which do not precisely formulate the question asked, or which could only be answered by consulting an expert and repeating his opinion.

Discovery of document or facts may not be necessary if the information sought can be supplied by some other means.

It may be limited to certain specified documents or classes of documents or matters in question or postponed until after determination of some preliminary issued or only permitted on terms as to cost if the information sought is so voluminous as to impose excessive inconvenience or expense.

### Disallowing Inspection

The court must not order inspection of privileged documents, however the court will not order inspection merely on the grounds that a document is not privileged. The court has a discretion and will take into account other factors for example confidential documents may be inspected first by the court and inspection disallowed if they are of insignificant weight or value.

Where production for inspection is likely to cause excessive expense the party seeking inspection may be required to give security for costs.

If, by affidavit, a party states that certain documents are irrelevant or he objects to producing documents or answering interrogatories on the grounds of privilege the court is reluctant to go behind his oath unless there is good reason for doing. An attorney owes a duty to the court to examine his client's documents and ensure full disclosure is made and must ensure that his client understands what discovery entails and the importance of not destroying documents which have to be discovered.

In most actions, by writ, general discovery occurs automatically.

## Default

If a party fails to comply with any requirement to make discovery, produce documents, supply copies documents or answer interrogatories, the court may make such order as it thinks fit including dismissing the action or striking out a defence.

## CLASS ACTIONS

A class action is a lawsuit brought by one or more persons on behalf of a larger group. The aim of a class action is to co-ordinate the claims of a larger number of plaintiffs (eg in a big disaster or drug case), to create a more level playing field between plaintiffs and defendants.

A good example is the recent breast implant class action of Butler, etal v Mentor Corporation, etal. This case was filed on behalf of a class of all persons who have received silicone gel and saline breast implant procedures, and those whose relationship to the breast implant recipient gives rise to independent or derivative claims.

The Butler action was conditionally certified as a "mandatory" class action, from which class members may not opt out, because the settlement amount will potentially exceed the liquidation value of Mentor's assets, creating a limited fund. Under these circumstances, it would be unfair to allow separate lawsuits to deplete these assets - the class action settlement should preserve the assets for all class members.

This shows the second main aim of class actions; to ensure that all potential litigants can get a share of the compensation where the funds (including insurance) of the defendant are limited in relation to the size of the claims. This often affects asbestos case - for instance, in the suit involving the Keene Corporation, a class action was filed in an effort to fairly allocate Keen's remaining funds of about US\$104 million among all competing claimants. This included people suing Keene for bodily injury caused by asbestos, and property damage claims. Stuart Rickeson, Vice President and general counsel of Keene stated, "The fact is Keene does not have enough money under the present circumstance to continue to resolve the 98,000 pending claims one at a time nor the new cases being filed at a rate of 2000 per day while maintaining the

company's viability". Keene has already paid out more than US\$447 million to settle and defend nearly one million claims and these costs continue to run at about \$7 million a week.

### PUNITIVE DAMAGES

Punitive damages are damages awarded not to compensate the plaintiff for actual damages he has suffered, but rather to punish the defendant. The public interest is said to be served by the deterrent effect of punitive damages on the future conduct of the wrongdoer. Punitive damages are not a matter of right but are within the discretion of the trier of fact, usually the jury.

In the 1950's, punitive damage claims were relatively rare and usually were awarded only in liability cases. At the present time, almost every complaint has a punitive damage count.

Punitive damages can affect insurers in two ways. Firstly, in some states punitive damages are allowed to be covered by insurance. These actions tend to be based on tort cases. Secondly, insurance companies are often involved in 'bad faith' actions as party to the contract of insurance.

### Tort Cases

Ordinary negligence in tort does not support a claim for punitive damages. Punitive damages can be awarded only where:

- a. there was actual intent to cause injury
- b. the defendant acted oppressively, maliciously or fraudulently.

The above is called 'outrageous conduct' and may be found where a wrongful act is done with a bad motive; or so recklessly as to imply a disregard to social obligations; or where there is such wilful misconduct or entire lack of care as to raise a presumption of conscious indifference to the consequences.

Punitive damages are usually awarded only in personal tort actions involving at most a few plaintiffs or defendants. It has been held that they can be awarded in strict liability cases even those predicated on a product defect rather than a design defect. This can present a problem in mass tort litigation, such as toxic torts and asbestosis, because the money might run out before some plaintiffs get compensatory damages.

#### Contracts - including insurance contracts

These punitive damages include awarding damages for breach of contract by the insurer that go beyond simply making good the loss of the benefit of the bargain. The theories under which such 'extra-contractual' damages are assessed are:

- a. breach of good faith and fair dealing implied in every contract.
- b. intentional infliction of emotional distress on the insured by extreme and outrageous conduct on the part of the insurer, its agents and its employees.

#### Amount of Punitive Damages

In assessing damages, courts take only three factors into consideration:

- a. the nature of the actions of the defendant
- b. the size of the assets of the defendant, and
- c. the purpose of punitive damages ie as a deterrent

Therefore, the wealthier the defendant, the larger the award.

Frequently, the size of punitive damages bears no relationship to the actual damages. There is a vague rule of 'reasonable relationship', but it is purely objective and poorly defined.

## Future of Punitive Damages

There is a call for changes to the punitive damages system. Firstly, because the punitive damages awards are so inconsistent from case to case.

The U.S. Supreme Court realized this and passed an opinion on an insurance company breach of contract suit involving punitive damages, Pacific Mutual vs Haslip. In this case, \$840,000 of punitive damages were assessed while only \$260,000 of compensatory damages were awarded. The Supreme Court upheld the amount of punitive damages as not being excessive but gave a very loose guideline of the relationship that should exist between punitive and compensatory damages. Most people regarded their decision as inadequate. Therefore, the Supreme Court has recently heard another case involving punitive damages where the ratio of punitive damages to compensatory damages was 526 to 1! Their opinion is expected in October, 1993.

As part of general 'tort reform' efforts, some states now require that punitive damages be proved by the more rigorous 'clear and convincing' evidence standard rather than the current 'preponderance' of evidence. Some states also require that part of the punitive damages be given to the state. In addition, laws have recently been enacted, in some states, capping punitive damages awards.

## CONTINGENCY FEES

A major reason why there are so many lawsuits in the U.S. is that lawyers can work on a contingency fee basis, ie they do not get paid unless they win the lawsuit. If they are successful they may receive up to 33% of the award. This leads to many advertisements in the media by 'ambulance chasers' which would not be permissible in the U.K. Part of the tort reform efforts is to make contingency fees work on a sliding scale basis, for example only 10% for awards over a certain amount.

A study in California suggested that workers compensation claimants would have actually had more take home money if they had not used lawyers in the process, ie the increase in the award was negated by the lawyers fees.