A MARKET IN PERSONAL INJURY TORT CLAIMS

*MARC J. SHUKAITIS**

I. Introduction

Millions of Americans suffer each year from personal injuries caused by tortious acts. Under today's law, a tort victim may not sell his personal injury claim to a third party who would then pursue the claim against the tortfeasor. To receive compensation, a personal injury tort victim must choose between settling with the tortfeasor or litigating to a court judgment.

Both litigation and settlement, however, have serious disadvantages for a tort victim. Delay and uncertainty reduce the attractiveness of litigation for risk averse victims who need immediate compensation. While settlement may provide quick and certain compensation, its price is usually a smaller recovery because settlement places risk averse tort victims who need immediate compensation in a poor bargaining position.

Allowing victims to sell their claims to third parties, that is, allowing a market in personal injury tort claims, would have significant advantages for tort victims. Compared with litigation, tort victims would be able to receive immediate and certain compensation by selling their claims to purchasers in the market. Compared with settlement, tort victims would receive compensation at a market price closer to what they would expect from a court judgment. Thus compensation by the tort system would be made less dependent on the tort victim's ability to withstand delay and uncertainty. Victims who now do not pursue their claims because of ignorance of their rights or a lack of resources might receive compensation. Some of the incentive problems of hiring an attorney on either a contingent fee or an hourly arrangement would be lessened. And, by

* J.D./M.B.A. 1987, Harvard Law School/Harvard Business School. I wish to thank Steven Shavell and John Pratt for their ideas and support. I also thank the Olin Foundation for financial support.

[*Journal of Legal Studies*, vol. XVI (June 1987)]
 0047-2530/87/1602-0008$01.50

increasing the costs of tortfeasors, a market would increase deterrence against harm-causing activities.

Yet there are also possible difficulties with a market. An active market might increase the total volume of litigation. Litigation of spurious claims might increase. Unscrupulous claim purchasers might take advantage of unsophisticated tort victims. Finally, some people might find the very act of selling personal injury tort claims offensive.

In Section II of this paper, I briefly examine the legal framework that now bars the operation of a market in personal injury tort claims. In Section III, I discuss the potential benefits such a market would have. In Section IV, I discuss the arguments against allowing a market. I conclude that a market in personal injury tort claims would provide substantial benefits that would more than outweigh the costs imposed.

II. The Law Today

Following a long common-law tradition, state laws today bar the operation of a market in personal injury tort claims. Most states prohibit the assignment of personal injury tort claims either out of a professed fear of maintenance, champerty, and barratry[1] or on the theory that personal injury claims do not "survive" and only actions that survive can be assigned.[2] In most states, the prohibition against assignment of personal injury tort claims flows from judicial interpretation of common law and public policy,[3] but a few states explicitly ban the assignment of personal injury actions by statute.[4] Even where transfer of personal injury tort claims is permitted, the limits on such transfer prevent the formation of a market.

A. Common-Law Fear of Maintenance, Champerty, and Barratry

Prohibitions against maintenance,[5] inherited from English common-law doctrines developed in the fifteenth and sixteenth centuries, arise out of

[1] See, for example, Hospital Serv. Corp. of R.I. v. Pennsylvania Ins. Co., 101 R.I. 708, 227 A.2d 105, 109 (R.I. 1967). "Maintenance" exists when a person "without interest" in a suit assists a party in litigation. "Champerty" is maintenance plus an agreement to share in the proceeds of the suit. "Barratry" is repeated maintenance or champerty.

[2] See, for example, Employers Casualty Co. v. Moore, 60 Ariz. 544, 142 P.2d 414, 415 (Ariz. 1943).

[3] See, for example, Forsthove v. Hardware Dealers Mut. Fire Ins. Co., 416 S.W.2d 208 (Mo. Ct. App. 1967).

[4] See, for example, Ga. Code Ann., § 85-1805 (Supp. 1985); N.Y. Gen. Oblig. Law, § 13-101 (McKinney 1978) ("Any claim or demand can be transferred, except in one of the following cases: 1. Where it is to recover damages for a personal injury . . .").

[5] For convenience, the term "maintenance" will be used to refer to maintenance, champerty, and barratry.

the fear that otherwise disinterested parties would stir up litigation for harassment and profit.[6] Conditions in England at that time gave courts considerable reason to bar third parties from participating in the litigation process. Resourceful lords commonly profited from supporting litigation in a system that gave the rich tremendous advantages in litigation. Witnesses could be bought because perjury was not a crime,[7] the judicial system was expensive and highly technical,[8] and direct corruption of juries and judges was widespread.[9]

To discourage these injustices, the common law broadly prohibited the assignment of choses in action,[10] a category including personal tort actions as well as most contract and property tort actions.[11] The common-law condemnation of maintenance was also an effort to discourage both the remnants of feudalism and the spread of capitalism in England.[12] In recognition of business needs, the English common law slowly loosened the prohibition against maintenance to allow the assignment of debt actions.[13] Judicial integrity and social conditions, however, have improved markedly since the development of the common-law prohibitions. Today one must question whether any reason remains for prohibiting assignments to avoid maintenance.[14]

B. *Common-Law Assignability/Survivability Equivalence*

At common law, a person's death terminated any cause of action for a personal tort that the victim could have asserted before his death[15]—a

[6] See William S. Holdsworth, The History of the Treatment of *Choses* in Action by the Common Law, 33 Harv. L. Rev. 997, 1007 (1920).

[7] Note, The Law of Maintenance and Champerty and the Assignment of *Choses* in Action, 10 Sydney L. Rev. 166, 166 (1983).

[8] Holdsworth, *supra* note 6, at 1007.

[9] See Note, *supra* note 7, at 166.

[10] Choses in action are rights to bring legal action to recover money or property. The term "choses in action" includes contract and tort actions. See Holdsworth, *supra* note 6.

[11] See Lott v. Kees, 165 So. 2d 106, 108–9 (Ala. 1964). In Lampet's Case, 10 Co. Rep. f. 46b (1613), Lord Coke declared that the prohibition derived from the aversion of the "sages and founders of our law" to the "multiplying of contentions and suits." While the fear of maintenance spurred the development of the prohibition against assignment, the early origins of the prohibition lie elsewhere. See text at note 67 *infra*.

[12] See Max Radin, Maintenance by Champerty, 24 Calif. L. Rev. 48, 65–66 (1935).

[13] Holdsworth, *supra* note 6, at 1021.

[14] See Casserleigh v. Wood, 14 Colo. App. 265, 59 P. 1024, 1026 (Colo. Ct. App. 1900) ("The progress of law, enlightenment, and civilization during the last few hundred years has, however, to a large extent, obviated the necessity of these stringent rules. . . . [I]n the United States . . . there are no privileged or aristocratic classes, all being equal before the law; and it has never been charged that there was fear in this country of the courts being improperly dominated by such influences as were dreaded by our ancestors a few hundred years ago"). See also Radin, *supra* note 12, at 66.

[15] William Prosser, Handbook of the Law of Torts 898 (4th ed. 1971).

cause of action for personal tort was thus said not to "survive" the injured party's death. The common law's reasons for refusing to allow the survival of personal tort actions are obscure but involve notions of a tort remedy as meting out punishment and revenge.[16] Revenge was thought possible only by the injured person; after the tort victim's death, the crown was expected to punish the tortfeasor.

While the survival doctrine originated in English common law, the equivalence of survival and assignability of causes of action is peculiarly an American doctrine.[17] In 1828, the U.S. Supreme Court declared in *Comegys v. Vasse* that, "[i]n general, it may be affirmed, that mere personal torts, which die with the party, and do not survive to his personal representative, are not capable of passing by assignment. . . ."[18] Following this *Comegys* dictum, many American courts accepted the equivalence of survivability and assignability, although "[t]he reason for this equation between survivorship and assignability is seldom explained."[19]

Survivability restrictions have been legislatively eased in many states to allow personal injury tort claims to survive.[20] Courts in some of these states have blindly followed the equivalency doctrine, holding that a statute that permits survival authorizes assignment.[21] Other courts have rejected the survivability/assignability equivalence where state laws permit survival, analyzing assignability as a separate policy choice.[22]

[16] *Id.*

[17] For a detailed examination of the historical assignability/survivability equivalence, see Harold R. Weinberg, Tort Claims as Intangible Property: An Exploration from an Assignee's Perspective, 64 Ky. L. J. 49, 59–74 (1975).

[18] Comegys v. Vasse, 26 U.S. 193, 213 (1828).

[19] Geertz v. State Farm Fire & Casualty, 253 Or. 307, 451 P.2d 860, 862 (Or. 1969).

[20] Ky. Rev. Stat., § 411.140 (1972); Mich. Comp. Laws Ann., § 600.2921 (West 1985 Supp.); S.C. Code Ann., § 15-5-90 (Law. Co-op 1977); Wis. Stat. Ann., § 895.01 (West 1983); Wash. Rev. Code, § 4.20.046 (1962). The Washington legislative history records that ". . . the humanitarian aspects of permitting survival of the remaining actions which do not survive far outweighs [*sic*] the fear of the insurance companies that they may have to increase their rates." Harvey v. Cleman, 65 Wash. 2d 853, 857, 400 P.2d 87, 89 (Wash. 1965). Washington's unusual statute permits the survival of all actions, but an assignee may not recover for the pain and suffering of the injured victim. In practical terms, the statute thus precludes the purchase or sale of most personal injury claims because a purchaser would be unable to compensate a victim for pain and suffering.

[21] See, for example, Davenport v. State Farm Mut. Auto. Ins. Co., 81 Nev. 361, 404 P.2d 10, 12 (Nev. 1965); Doremus v. Atlantic Coast Line R.R. Co., 242 S.C. 123, 130 S.E.2d 370, 379 (S.C. 1963).

[22] See, for example, *Forsthove,* 416 S.W.2d at 217; Southern Farm Bureau Casualty Ins. Co. v. Wright Oil Co., 454 S.W.2d 69, 71 (Ark. 1970); City of Richmond v. Hanes, 203 Va. 102, 122 S.E.2d 895, 899 (Va. 1961). The *Forsthove* court declared: "We think the reasons for the applicability of such a public policy are as fundamental and as necessary today as in the days of the origin of this rule. We do not think economic or social changes since its origin make the reasons for this humane rule anachronistic." 416 S.W.2d at 217.

C. Subrogation and Other Lawful Claim Transfers

Some courts allow the functional equivalent of assignment of personal injury claim rights in the limited context of subrogation by an insurer.[23] A tort victim compensated for his injuries by his insurer retains a cause of action against the tortfeasor for the harm done. Either contractually or equitably, the cause of action may be subrogated to the insurer to the extent of the insurer's payment. While some courts allow subrogation of personal injury claims,[24] other courts do not,[25] arguing that subrogation of a personal injury claim is equivalent to assignment of the claim and, similarly, should be prohibited.[26]

In a few states, courts have allowed the assignment of personal injury tort actions, typically through the interpretation of state survival statutes. Courts in New York have in effect permitted assignment by interpreting a New York statute that forbids the transfer of a personal injury claim[27] as not precluding the assignment of the *proceeds* of the claim.[28] Even in the states that permit assignment of personal injury tort claims, courts and legislatures have erected significant barriers to the development of a market in tort claims. In Texas, for instance, although personal injury tort claims can be "bartered, sold, and contracted for,"[29] barratry laws prohibit solicitation of claims.[30] Other states that permit assignment of tort claims bar the purchase of tort claims by market participants through maintenance, champerty, and barratry statutes.[31] Courts in two states

[23] Subrogation is the right that one party has against a third party following the payment of a legal obligation that was owed by the third party. Allen D. Windt, Insurance Claims and Disputes § 10.05 (1982).

[24] See, for example, *Hospital Service*, 227 A.2d at 110. See generally James Donaldson, Casualty Claim Practice 627–30 (1984).

[25] See, for example, Travelers Indem. Co. v. Chumbley, 394 S.W.2d 418, 425 (Mo. Ct. App. 1965) (allowing an exception to the "long-recognized and well-established legal principle prohibiting assignment . . . [would lift] the lid on a Pandora's box crammed with both practical and legal problems").

[26] For a discussion of the differences between subrogation and assignment, see Spencer L. Kimball & Don A. Davis, The Extension of Insurance Subrogation, 60 Mich. L. Rev. 841, 866–67 (1962).

[27] N.Y. Gen. Oblig. Law, § 13–101 (McKinney 1978). See note 4 *supra*.

[28] Williams v. Ingersoll, 89 N.Y. 508 (1882); Stathos v. Murphy, 26 A.D.2d 500, 276 N.Y.S.2d 727 (N.Y. App. Div. 1966). Other states that have considered New York's approach have rejected it as a "a distinction without a difference." *Harvey*, 400 P.2d at 90.

[29] McCloskey v. San Antonio Traction Co., 192 S.W. 1116, 1119 (Tex. Civ. App. 1917).

[30] Tex. Penal Code Ann., § 38.12 (Vernon 1974). For a discussion of the evolution of Texas law, see text at notes 58–66 *infra*.

[31] See, for example, N.Y. Jud. Law, §§ 488, 489 (McKinney 1983); S.C. Code Ann., § 16-17-10 (Law. Co-op. 1985), § 40-5-340 (Law. Co-op. 1986); Miss. Code Ann., § 97-9-11 (Supp. 1985).

appear to prohibit an assignee of a personal injury claim from recovering more than the consideration the assignee paid to the tort victim,[32] thus effectively preventing a market by removing the profit incentive of a potential claim purchaser.[33]

III. The Potential Benefits of a Market

A. *Compensation to Tort Victims*

The creation of a private market in personal injury claims would provide tort victims with the advantages of a competitive market. No longer would the sole source of compensation come from the tortfeasor, who has every incentive to delay settlement of the claim. Instead, the ability to sell claims would improve the level of compensation received by tort victims, increase the number of meritorious claims that are brought within the system, and obviate some of the contracting difficulties associated with hiring attorneys on either contingent fee or hourly arrangements.

1. *Increased Value of Compensation.* A tort victim seeking compensation from the tortfeasor is frequently in a very poor bargaining position. He may need money immediately to pay medical bills, to replace lost wages, and to cover living expenses.[34] If he seeks compensation through the court system, however, he may wait as much as several years before trial.[35] The tort victim who is unwilling or unable to wait for a court

[32] D'Angelo v. Cornell Paperboard Prods. Co., 19 Wis. 2d 390, 120 N.W.2d 70 (Wis. 1963) (voiding as against public policy an assignment in excess of what an insurer paid the injured insured for the claim); City of Detroit v. Bridgeport Brass Co., 28 Mich. App. 54, 184 N.W.2d 278, 281 (Mich. Ct. App. 1970) (holding that a personal injury claim may be obtained from an injured person in exchange for a "reasonable" consideration and finding that the challenged assignment was reasonable where assignee could recover no more than was paid to the injured).

[33] Roman law allowed the sale of tort claims until A.D. 506, when the buying of claims was effectively stopped by taking away a purchaser's profit incentive: the constitution of the emperor Anastasius allowed a purchaser to recover only the amount paid for the claim with interest. The constitutional ban developed because tort victims were being induced to sell their claims for far below their value. See Radin, *supra* note 12, at 55.

[34] If the tort victim has insurance, the need for immediate compensation may be alleviated. Insurance coverage limits, however, may be lower than the actual expenses incurred by the victim. More important, many people do not have insurance, and it is those who most need immediate compensation (the poor) who are the least likely to have insurance. Even a victim fully compensated for his economic losses by insurance may have a significant interest in pursuing the tortfeasor for pain and suffering damages (for which he would not have been compensated by insurance).

[35] See Maurice Rosenberg & Michael I. Sovern, Delay and the Dynamics of Personal Injury Litigation, 59 Colum. L. Rev. 1115 (1959).

judgment must attempt to settle with a resistant tortfeasor[36] who may insist on litigating so as to discourage future claims. If the tortfeasor insists on litigating, the tort victim will receive no compensation except through the legal process no matter how pressing his immediate need.

Unlike the tort victim, the tortfeasor typically has little incentive to settle quickly. Indeed, the tortfeasor prefers delay because a payment in the future costs him less than an immediate payment.[37] Delay also helps the tortfeasor, who is better able to bear the ongoing expenses of litigation.[38] The tort victim's need for immediate compensation and the tortfeasor's incentive to delay thus reduce the level of settlement.

The parties' differing attitudes toward risk also reduce the settlement. If both the victim and the tortfeasor had the same attitude toward risk, that is, if both were risk neutral or equally risk averse, then neither party would have a bargaining advantage based on his ability to subject the other party to risk. The tort victim, however, is probably risk averse rather than risk neutral.[39] Typically, the tort victim has a very high discount rate and is unable to borrow money inexpensively from a bank or other institution, especially if his only substantial asset is the tort claim itself. Banks are not well equipped to evaluate tort claims as collateral for loans; in any case, the maximum amount a lending institution would be willing to loan on the security of a tort claim would be the discounted expected value of the claim (that is, the price a tort victim could sell his claim for in the market).

The tortfeasor, on the other hand, is probably much less risk averse.

[36] From the tort victim's point of view, settling with the tortfeasor is essentially equivalent to *selling* the cause of action to the tortfeasor in what amounts to a one-buyer market, that is, a monopsony. A monopsony provides the buyer with significant bargaining power. See Richard G. Lipsey, Peter O. Steiner, & Douglas Purvis, Economics 358 (7th ed. 1984). A major difference between settlement and selling in a market is that a market would present *many* potential buyers to a tort victim.

[37] The tortfeasor can invest the money in the interim. At a 10 percent interest rate, a tortfeasor saves himself $8,333 per month of delay on a $1,000,000 future judgment. For a discussion of the present and future values of money, see Richard Brealey & Stewart Myers, Principles of Corporate Finance 10–21 (2d ed. 1984). Where present, prejudgment interest statutes reduce the incentive of the tortfeasor to delay. See Note, The Availability of Prejudgment Interest in Personal Injury and Wrongful Death Cases, 16 U.S.F. L. Rev. 325 (1982).

[38] Contingent fee representation by attorneys reduces the burden of litigation expenses for tort victims. For a comparison of contingent fee representation with a tort market, see text at notes 50–53 *infra*.

[39] Most individuals are risk averse rather than risk neutral or risk seeking. H. Raiffa, Decision Analysis 52 (1968). That most people are risk averse is evidenced by the widespread purchase of insurance. Also, to the extent the tort victim is poor one expects a high degree of risk aversion because the initial amount of money represents "a lot" of money to him. *Id.* at 91–92.

Since most personal injury defendants are insured, one would expect a tortfeasor to be risk neutral. A bargaining situation between the risk averse tort victim and the risk neutral tortfeasor favors the tortfeasor who can threaten the victim with the uncertainty of the litigation.[40] By improving the bargaining position of risk averse tort victims, a market in tort claims would raise the amount of compensation to a tort victim closer to the expected court judgment.

A market would also provide many potential buyers for tort claims and thereby eliminate the monopsony advantage that a tortfeasor now enjoys.[41] Thus a tortfeasor would no longer be able to threaten a tort victim with the choice between a low settlement and an interminable court battle. Rather than bargaining with one intransigent tortfeasor, a tort victim could simply sell his claim to one of many potential buyers in the market.[42]

A tort claim market would similarly reduce the amount of compensation that the victim must now forgo to obtain an immediate cash payment.[43] Once claims are freely alienable, the tort victim could sell his claim to a third party with a lower discount rate, who should therefore attach a higher value to the claim.

A tort claim would also be worth more to a market purchaser than to the victim because a purchaser would hold a diversified portfolio of claims. A diversified portfolio would include many (perhaps a dozen or more) claims from different victims that would involve different accidents and types of injuries and that would be presented in different courts using different legal theories. Such a diversified portfolio of tort claims would be worth more than the sum of the expected monetary values of the individual claims because diversification would reduce some of the risk associated with the claims.[44] A purchaser of a diversified portfolio would eliminate the "unsystematic" risk associated with claims and would thus

[40] Alfred F. Conard, The Economic Treatment of Automobile Injuries, 63 Mich. L. Rev. 279 (1964) (citing studies showing that half of all tort victims receive less than their monetary loss while others are awarded five times their loss). See also Jeffrey O'Connell, The Lawsuit Lottery (1979) (comparing the outcome of litigation to a lottery).

[41] See note 36 *supra*.

[42] Assuming a well-functioning market, a tort victim would be unable to sell his claim only if the discounted expected recovery were less than the expected expenses of pursuing the claim.

[43] There may also be significant noneconomic advantages to providing immediate compensation to tort victims. See Conard, *supra* note 40, at 315 ("the speeding up of settlements . . . would do more to relieve the distress of injury victims than any other conceivable change in tort law administration").

[44] For a discussion of diversification and how it reduces the riskiness of a stock portfolio, see Brealey & Myers, *supra* note 37, at 123–26.

discount his purchase price of a claim only for "systematic" risk.[45] The diversified portfolio holder could thus pay the tort victim more than the victim's valuation of the claim, which would be reduced for both systematic and unsystematic risk.

Collecting a diversified portfolio would be to some extent inconsistent with increasing value through expertise. The purchaser of the claims would therefore be required to trade off expertise against diversification. This trade-off exists in all separate markets, and there is no reason to believe that professional purchasers of tort claims would be less able to make this trade than are, say, professional managers of mutual funds. A tort victim should be able to receive greater compensation from a market purchaser than from the tortfeasor if the market purchaser is an expert in the sort of claim that the victim has. For example, a purchaser might specialize in automobile accident claims or in airplane crash claims in much the same way some law firms specialize in particular types of claims. The claim will be worth more to the expert (who will thus be willing to pay more for the claim) because his knowledge or experience allows him to value the claim more precisely and to recover a larger judgment in court. A purchaser might also have his own legal staff, which could reduce the costs to him of litigating a claim. The net effect of a well-functioning market would be to raise the compensation received by a tort victim toward the expected value of the claim discounted at a market interest rate appropriate for the riskiness of a diversified portfolio of personal injury tort claims.

2. *Increased Access to Compensation.* Many tort victims now receive no compensation from tortfeasors because they do not pursue their claims.[46] Even tort victims who both are aware of their legal rights and have the resources to pursue those rights may choose not to do so; some may decide that the discounted expected value of the claim is less than the expected costs of pursuing the claim.[47] Presumably, however, many tort victims fail to pursue valid claims simply because they are unaware that they have legal rights to compensation. Tort claim purchasers in the mar-

[45] "Unsystematic" or "unique" risk is risk peculiar to the individual claim (for example, the risk of a key witness failing to testify). "Systematic" or "market" risk is economy-wide risk that affects all claims (for example, the risk of inflation or a shift in public sentiment toward the appropriate level of compensation to personal injury victims). See *id.* at 125.

[46] See Marc A. Franklin, Robert H. Chanin, & Irving Mark, Accidents, Money, and the Law: A Study of the Economics of Personal Injury Litigation, 61 Colum. L. Rev. 1, 34 (1961).

[47] Some of these potential claimants would find it worthwhile to pursue their claims (that is, sell their claims) if there were a market for the reasons discussed above that a market would increase compensation to tort victims who pursue their claims.

ket could inform these potential claimants about their legal rights when soliciting to buy their claims.

Other tort victims presumably remain uncompensated because they lack the money needed to pursue their rights. Given their expected risk averseness, poorer tort victims may be especially dissuaded from pursuing valid claims because of the costs involved. In the United States, personal injury tort victims have access to legal counsel through contingent fee representation. While a contingent fee arrangement shields the tort victim from paying attorneys' fees if he does not prevail in the suit, the tort victim at least in theory remains liable, win or lose, for other expenses of litigation such as court costs, witness fees, and so on.[48] The contingent fee arrangement, unlike a straight sale, leaves the tort victim with some risk. As with contingent fee lawyers, there is no reason to expect that all purchasers would specialize in the same type of claims. There may be some who would take claims with little risk and others who would specialize in high-risk cases. As long as there is a broad band of purchasers, the same range of talents found today in contingent fee lawyers should be found in the purchasers of tort claims.

3. *Tort Market Compared to Contingent and Hourly Fee Representation.* Almost all personal injury tort victims hire attorneys on a contingent fee basis[49] instead of an hourly fee basis. From the point of view of the tort victim, both contingent fee and hourly compensation schemes frequently suffer two serious deficiencies. Ideally, the risk averse tort victim desires representation that (1) enables him to control the settlement and litigation efforts of his attorney so as to maximize the victim's recovery and (2) enables him to shift the risk of recovery onto a risk neutral party. A typical tort victim is probably unable to ensure that his attorney's efforts are congruent with the victim's interests other than through the structure of the compensation arrangement.[50]

Neither contingent nor hourly fees, though, perfectly motivate an attorney to act in the tort victim's economic interest.[51] An attorney on an

[48] See generally Annot., 8 A.L.R.3d 1155 (1966). But see note 52 *infra*.

[49] See Kevin M. Clermont & John Currivan, Improving on the Contingent Fee, 63 Cornell L. Rev. 529, 531 (1978).

[50] A typical tort victim presumably does not have the knowledge to make independent informed decisions. For instance, a client offered a settlement will depend heavily on his attorney's advice about whether to accept the offer or to continue litigation efforts. That a client must rely on the fee structure to motivate an attorney to act in the client's best interests assumes that an attorney makes decisions based on the *attorney's* economic interests. Obviously, an attorney's decisions are also influenced by reputational considerations (including the desire to attract future business) as well as professional and personal ethics.

[51] See Geoffrey P. Miller, Some Agency Problems in Settlement, 16 J. Legal Stud. 189 (1987) (analyzing conflicts of interest between attorney and client under various fee arrange-

hourly fee makes more money the longer he works, whether or not his client benefits from the additional efforts: an attorney paid by the hour thus has an incentive to work more hours than is in the client's best interest. The problem is acute where the tort victim cannot monitor the attorney's effort.

An attorney on a contingent fee, meanwhile, stands to gain only a percentage of the recoveries from additional effort but "pays" for the entire amount of additional time he devotes to a case; a contingent fee attorney therefore has an incentive to work fewer hours than his client would desire. For example, assume a contingent fee of one-third for an attorney who would otherwise charge $100 per hour, and assume that four hours of work could improve the expected recovery by $900. The contingent fee attorney here would not have financial incentive (ignoring reputational factors) to do the labor even though it is in the client's interest: the attorney would earn only $300 for $400 of his time. In contrast, the hourly fee attorney could charge $400 for the work and still leave his client $500 better off.

In addition to desiring a fee structure without conflicts of interest, a risk averse tort victim would like a fee structure that shifts much of the risk of recovery onto a relatively risk neutral party. Both contingent and hourly fee arrangements, however, leave substantial amounts of recovery risk with the risk averse tort victim. An hourly fee obviously shifts no risk at all—the client receives the full amount of any recovery and can suffer a loss on his claim if the litigation costs exceed the amount of recovery. While a contingent fee eliminates the client's risk of out-of-pocket loss,[52] it leaves him at risk for any positive recovery. A client paying, for example, a one-third contingent fee will receive two-thirds of the recovery. This does not reduce the risk of the amount of a positive recovery in any meaningful sense: while the range of expected recoveries for the client is narrowed, this is accomplished only by proportionately reducing each possible recovery without increasing the certainty of any recovery to the client.

A market in tort claims could solve the problems of conflict of interest

---

ments); Clermont & Currivan, *supra* note 49; Murray L. Schwartz & Daniel J. B. Mitchell, An Economic Analysis of the Contingent Fee in Personal Injury Litigation, 22 Stan. L. Rev. 1125 (1970).

[52] In theory, a client represented on a contingency fee basis remains liable for litigation expenses other than attorney costs (for example, court filing fees, expert witness fees, and so on) even if these costs exceed the amount of recovery. Model Code of Professional Responsibility DR 5-103(b) (1981). In practice, however, personal injury attorneys typically do not seek to recoup these expenses from their clients when the expenses exceed the settlement or judgment recovered. A zero recovery is thus the worst result a client represented on a contingent fee can ordinarily expect.

and risk shifting that plague both contingent and hourly fees. A tort victim who sells his claim for a definite amount shifts all the risk of recovery onto the claim purchaser, who is either risk neutral or less risk averse than the tort victim. After the claim buyer has purchased the recovery rights of the tort victim, there can be no misalignment of economic incentives between the tort victim and the purchaser. A claim purchase is thus analogous to a hypothetical 100 percent contingent fee where the attorney pays his client a definite sum in exchange for increasing the percentage of the recovery that the attorney receives.[53] The claim purchaser might then hire an attorney to pursue the claim, but, unlike the typical tort victim, he would have the knowledge to direct efficiently the efforts of an hourly fee attorney. Compared to the contingent fee representation for the ordinary tort victim, selling a claim thus improves a tort victim's welfare.

There is one important market impediment for the outright sale of tort claims, however. The amount of recovery in a personal injury suit may depend not only on the efforts of the attorney but also on the efforts of the tort victim. After a tort victim sold his interest in a claim, he would have little incentive to appear sympathetic and deserving before a jury. To the extent the tort victim's lack of incentive reduces the expected recovery, the development of a market in claims could be inhibited. Either a purchaser would have to reduce the amount offered for a claim, or he would have to find a way to motivate the tort victim.

There are several ways in which the tort claim purchaser could structure the purchase so as to minimize this incentive problem. For instance, purchasers could require tort victims to cooperate as a condition of purchase; such cooperation clauses are routinely found in standard insurance contracts, which raise the mirror problem with the defense of claims. Purchasers might also pay the purchase price in installments, with payments contingent on cooperation. Finally, purchasers might condition part of the purchase price on the amount of recovery. A purchaser thus might purchase only 90 percent of the claim, leaving the tort victim with 10 percent at risk as an incentive to cooperate in pursuing the claim.[54] So long as the tort victim and the purchaser have some stake in the outcome of the case, each has incentive to cooperate in its prosecution. The law of contract is often concerned with the need to regulate the conduct of both parties simultaneously; the complex solutions for joint participation and

[53] Attorneys are now prohibited from so purchasing an interest in a lawsuit. See note 81 *infra*.

[54] In subrogation, the one area today in which there are transfers of personal injury claim rights, the insurer typically does not have this problem of motivating the tort victim: since any amount recovered from the tortfeasor in excess of what the insurer paid the tort victim (that is, recovery for pain and suffering) belongs to the tort victim, the victim has an incentive to cooperate in recovery efforts. See text at notes 23–26 *supra*.

control are adopted in recognition of that fact. By agreement the parties should be able to provide the joint inputs necessary for the successful prosecution of any given claim.

B. *Increased Deterrence of Harm-causing Activities*

The increase in compensation is not the only benefit provided by a market in personal injury claims. The market should also improve deterrence against harm-causing activities. Ideally, deterrence operates by imposing the costs of liability on those parties best able to take steps to prevent the harm from occurring at all. Both negligence and strict liability rules are designed to insure that parties take the optimal level of care;[55] their effectiveness depends on the reliable enforcement of rights within the legal system. The sale of personal injury claims increases the likelihood of the successful enforcement of claims and thus should impose greater costs on tortfeasors, who are no longer able to reduce their payments to plaintiffs in a weak bargaining position. This appears to be socially desirable.

A substantial objection to a tort claim market is the argument that the claimed "benefits" of a market are not socially desirable and would impose substantial costs on society in the form of increased litigation. A basic premise of the argument in favor of a market is that increasing compensation to tort victims to an amount closer to what they would be awarded by a court is a desirable goal. One might disagree with this premise if one believed that court judgments today are "too high" and that conditions are desirable that encourage tort victims to settle for less than what their claims are worth in court. While this argument is logical, it countenances economic discrimination by the judicial system: the tort victims who are the most likely to receive the higher court awards are those who are least risk averse and who least need immediate compensation. These problems of the "second best" are far better handled by a candid revision of the substantive rules of tort or damages that are themselves judged inappropriate. It is inappropriate to correct the imperfections of the tort system by perpetuating the mistaken prohibition on the free alienation of tort claims.

IV. Arguments against Allowing a Market

A number of arguments have traditionally been offered to explain why permitting the free alienation of personal injury claims is undesirable. These arguments can be grouped into four categories: first, that pur-

[55] See generally John Prather Brown, Toward an Economic Theory of Liability, 2 J. Legal Stud. 323 (1973) (analyzing various liability rules).

chasers would harass defendants with spurious claims; second, that the volume and duration of litigation would increase; third, that "personal" injury claims are inherently inalienable; and fourth, that unsophisticated tort victims might be taken advantage of by unscrupulous professional claim buyers. These considerations, however, do not overcome the case for free alienation.

A. Nuisance Suits

One potential danger of a market in tort claims would be that unscrupulous people could purchase groundless claims and pursue them for their nuisance value. Several courts have cited this as a reason for prohibiting the assignment of personal tort claims, with the Supreme Court of Rhode Island commenting that "to hold otherwise would permit the pernicious and somewhat profitable practice of allowing a person to purchase these claims with the consequent harassment and annoyance of others."[56] In an ideal, costless judicial system, a defendant would never be willing to settle when threatened with a groundless suit. The considerable time, expense, and possible publicity engendered by real world litigation, though, offer powerful incentives for defendants to settle even groundless suits for hard cash.[57]

The risk of abuse in an uncontrolled market is evidenced by the Texas saga of Frank McCloskey. After Texas passed a survival statute in 1895, Texas courts allowed causes of action to be "bartered, sold, and contracted for like personal property."[58] State barratry statutes prohibited only *attorneys* from soliciting claims.[59] McCloskey, who was not an attorney, set up a business in San Antonio, where he and his employees solicited accident victims for their tort claims. McCloskey's business prospered: a San Antonio railroad testified that 60 percent of the claims against it were presented by McCloskey;[60] the San Antonio Public Service

[56] *Hospital Service*, 227 A.2d at 109.

[57] The concept that the costs of litigation affect whether "justice" results from a dispute is difficult for some courts to accept. Faced with a series of baseless claims, the defendant in McCloskey v. San Antonio Traction Co., 192 S.W. 1116, argued that the expense it incurred in defending the baseless claims was reason to restrain the plaintiff from further threatened suits. The court rejected this argument, stating: "We cannot for a moment indulge the presumption that a trial of the cause will result in an unfair loss to appellee. On the contrary, it must and will be presumed that a trial will result in exact justice being meted out to all parties to the suit. A threat to sue is not coercion . . . but an offer of a fair and equitable settlement." *Id.* at 1120.

[58] *Id.* at 1119.

[59] *Id.*

[60] *Id.* at 1117.

Company testified that thirty-eight of the sixty-seven suits filed against it in 1931 were presented by McCloskey.[61]

McCloskey's representation of tort victims went well beyond acceptable bounds. Courts found that McCloskey "counseled malingering to enhance damages"[62] and insisted on the injured parties "using crutches when not necessary."[63] Efforts to curtail his practice were frustrated. The Texas legislature tried unsuccessfully to shut down McCloskey's business in 1917 by amending the state barratry statute to prohibit solicitation of claims by nonlawyers as well as lawyers.[64] McCloskey's business must have been a profitable one; despite a U.S. Supreme Court decision[65] against him in 1920, he continued soliciting claims in Texas at least until 1935.[66]

B. *Increased Volume and Duration of Litigation*

Another argument against the free alienation of personal injury actions is that it would increase the volume of civil litigation. In the short run that conclusion seems correct because the total level of tortious behavior should remain constant, while the fraction of claims prosecuted would increase by virtue of sale. Nonetheless, in the long run the situation is not as clear. While a larger fraction of claims would continue to be pursued, the increased efficiency of the system should improve deterrence and therefore decrease the level of tortious activity. The two effects cut in opposite directions; their relative size is largely an empirical question.

Similar ambiguities pervade the settlement process. Here at first glance it appears that the fraction of claims settled would be reduced once as-

61 McCloskey v. San Antonio Pub. Serv. Co., 51 S.W.2d 1088, 1089 (Tex. Ct. App. 1932).

62 *Id.* at 1089.

63 McCloskey v. San Antonio Traction Co., 192 S.W. at 1117.

64 *Ex Parte McCloskey*, 199 S.W. 1101, 1103 (Tex. Crim. App. 1918).

65 McCloskey v. Tobin, 252 U.S. 107 (1920). After McCloskey was arrested for soliciting employment to collect two claims, he filed a writ of habeas corpus with the U.S. Supreme Court. McCloskey contended that, since tort claims were assignable in Texas, they were an article of commerce and that the Texas legislature violated his constitutional rights by prohibiting the business of soliciting claims. Writing for a unanimous court, Justice Brandeis dismissed McCloskey's argument, noting that "[t]o prohibit solicitation is to regulate the business, not to prohibit it." *Id.* at 108. The Court also remarked that regulation seeking to bring a "business into harmony with ethical practice of the legal profession . . . is obviously reasonable." *Id.*

66 See Yellow Cab Co., Inc. v. McCloskey, 82 S.W.2d 1042 (Tex. Ct. App. 1935). I have been unable to discover the ultimate fate of McCloskey, but the implications for the system seem clear. The problem is whether the assignee of the claim is more willing or better able to exploit the gaps in the current system of civil procedure. Again, the issue is profoundly one of "second best." More tailored reforms of civil procedure are possible: selection of venue can be limited, discovery rules can be tightened, and the loser can be assessed costs.

signment is allowed: risk neutral professionals with a diversified portfolio of claims are more resistant to delay. Professional claim purchasers may well be more astute in the valuation of claims than their sellers, however, as well as more efficient in handling them since they do not have to be educated in the claims process generally. Their willingness to take delay may well spur a quick settlement where both sides benefit by saving additional administrative costs. In light of these factors, professionals may respond more quickly to settlement offers.

The problem of the increased volume and duration of litigation thus appears to be overrated. In addition, any effort to solve it faces serious difficulties of its own. For instance, the law could give the tortfeasor an absolute option to settle the claim purchased within some short period, say thirty days, for some fixed premium, say 10 percent, above what the claim purchaser paid the injured party. The idea behind the system is twofold. The claim purchaser would have less incentive to underpay the injured party, and settlement would be encouraged because the tortfeasor would always be offered the opportunity of settling for the "market price" plus the small premium.

Yet adopting such a procedure would spawn new difficulties. First, the calculation of the settlement price will not be straightforward where the purchase is not in the form of a straight cash sale. Second, and more important, the option would confer powerful strategic advantages on the tortfeasor, who frequently has superior information about the potential value of the plaintiff's claim. When the tortfeasor knows that the claim is a valuable one, he will exercise the option to settle for the stated premium. When he knows that the claim is weak, he will resist settlement. The automatic settlement option of the tortfeasor therefore eliminates all potential upside gain of the purchaser while exposing him to all the downside risk. The rule thus reduces both the value of each claim in the portfolio and the gains from diversification that the purchaser hopes to obtain. As it seems likely that defendants have good information on claim aspects, it would be inadvisable to institute any reform that confers such an option on the tort defendant.

In conclusion, there is no obvious reason to think that the assignment of claims would in the long run increase appreciably the burdens imposed on the tort system. And any net cost that assignment imposes should be more than overcome by the increased benefits of deterrence and compensation that the free alienation rule offers.

C. *Inalienability and Trafficking in Claims*

A further objection to a market in tort claims is the notion that personal injury tort claims are so inherently "personal" that society should not allow them to be bought or sold. This was one of the rationales for the early common-law prohibition against assignment of choses in action.[67] In observing that the rule against assignment of choses in action predates the doctrine of maintenance in England, Ames made the surprising statement that the rule "is believed to be a principle of universal law."[68] Ames explained that a chose in action always "involves a personal relation between two individuals" and that a personal relation "in the very nature of things cannot be assigned."[69]

While Ames's attempt to argue the logical necessity of inalienability seems unconvincing at best,[70] the recognition that there is something distasteful about buying or selling personal injury tort claims cannot be so easily dismissed. Several courts have noted the "personal" nature of tort claims as a reason to restrict alienability. The Kentucky Court of Appeals, for instance, has stated that "a claim for personal injuries is peculiarly a personal right that the injured party may or may not assert as he pleases. . . ."[71]

From the perspective of economic welfare, restrictions on alienability of tort claims initially seem allocatively inefficient.[72] A person selling a cause of action believes the sale improves his welfare, or he would not sell; a person buying a cause of action similarly believes the sale improves his welfare, or he would not buy.[73] This simple analysis ignores two reasons why an inalienability rule might still be desirable: people other than the buyer and the seller may be affected by the transaction, and victims may be incapable of making wise decisions whether to sell.[74]

Courts have observed that a market in tort claims offends public "sensibilities" so as to outweigh any advantages it might otherwise create.

[67] See J. B. Ames, The Disseisin of Chattels, 3 Harv. L. Rev. 337, 339 (1890); Holdsworth, *supra* note 6, at 1003.

[68] Ames, *supra* note 67, at 339.

[69] *Id.*

[70] *See* Walter Wheeler Cook, The Alienability of *Choses* in Action, 29 Harv. L. Rev. 816 (1916).

[71] Wittenauer v. Kaelin, 228 Ky. 679, 683, 15 S.W.2d 461, 462 (Ky. 1929).

[72] One would also worry whether allowing alienability of tort claims would lead to undesired results of wealth distribution. Assuming one thought a market in tort claims was allocatively efficient, however, one would probably find the market to be distributionally desirable as well because the poor are most likely to have the largest discrepancy between their subjective valuation of tort claims and market value.

[73] The reasons why buyers might value claims more highly than sellers, thus allowing both parties to be made better off by a sale, are discussed above in Section III.

[74] For a discussion of inalienability rules, see generally Richard A. Epstein, Why Restrain Alienation? 85 Colum. L. Rev. 970 (1985). See also G. Calabresi & A. Melamed, Property Rules, Liability Rules, and Inalienability: One View of the Cathedral, 85 Harv. L. Rev. 1089 (1972).

The Supreme Court of Arkansas, for instance, decried the possibility of a claims market, declaring, "If causes of action for personal injuries could be assigned, then speculators could buy up such claims, perhaps at necessitous discounts, and conduct a profitable traffic in human pain and suffering."[75] A federal district court has refused to allow a personal injury claim to be assigned in a bankruptcy proceeding, saying that to do so would be "encouraging a market in the pain and suffering of unfortunate persons and the law neither does, nor should it, encourage so callous and barbaric a practice."[76] In addition, allowing a market in tort claims could change the way tort victims think about their claims and their decision whether to pursue them. One might not want tort victims to act as though they were the owners of a commodity, presented with an economic decision to make.[77]

What are being sold, however, are not human injuries and pain but rights to compensation for injuries that have already been suffered. There is, after all, little difference between a tort victim selling his claim to a claim purchaser and a tort victim settling his claim with a tortfeasor. A market in tort claims may seem unnatural to many people simply because a market does not exist now—tort liability insurance is widely accepted today but was strongly attacked at its inception as an immoral sale of the right to injure.[78] Certainly, the desire to compensate tort victims and to set optimal deterrence levels should outweigh any value placed on preserving the "sensibilities" of people who would be offended by the thought of people profiting by the purchase of personal injury tort claims.

D. *Protection of Unsophisticated Victims*

Refusal to sanction a market might also be justified with the paternalistic argument that tort victims are incapable of making wise decisions whether to sell their claims. To the extent that a tort victim may be ignorant about his legal rights, one might worry that unscrupulous tort

[75] *Southern Farm Bureau,* 454 S.W.2d at 70; 228 Ky. at 683. See also *Wittenauer,* 15 S.W.2d at 462 ("to permit one's pain and suffering to become a matter of speculation is not looked upon with favor by the law").

[76] *In Re Schmelzer,* 350 F.Supp. 429, 437 (S.D. Ohio 1972).

[77] See North Chicago St. Ry. Co. v. Ackley, 171 Ill. 100, 108, 49 N.E. 222, 225 ("[t]he law will not consider [personal injuries] to be a commodity of sale"). See also Mark Kelman, Consumption Theory, Production Theory, and Ideology in the Coase Theorem, 52 S. Cal. L. Rev. 669, 688, n.52 (1978) (commodification applied to baby selling; "certain social practices may simply serve to redefine 'static states' from which departures are unwelcome").

[78] See Robert E. Keeton & Jeffrey O'Connell, Basic Protection for the Traffic Victim 252 (1965).

claim buyers would coerce victims into selling their claims too cheaply.[79] A tort victim unfamiliar with the legal system might have little basis on which to value his claim, and a prospective purchaser might have little incentive to inform the injured person accurately. Similarly, to the extent that many tort victims are unsophisticated and relatively ignorant about their legal rights, one might worry that quick-talking purchasers would be able to purchase many claims for a fraction of what they are "worth." One can imagine purchasers applying high-pressure tactics to close a sale before the tort victim has the opportunity to negotiate with other potential purchasers: for a competitive market price to develop, competing potential buyers must be informed and have an opportunity to purchase.

Certainly, abuses would occur—there would be instances of unscrupulous buyers making unconscionable purchases from unsophisticated victims. Even in the absence of regulation, however, buyer behavior would be constrained by purchase price competition of other potential buyers. Even where only one market purchaser is interested in the claim, the purchaser would always have to offer the tort victim more than the tortfeasor (or the tortfeasor's insurer) is offering to settle. Careful court scrutiny of purchase arrangements would also restrain buyer behavior. A court would always have the power to void an unconscionable assignment and award part of the judgment to the tort victim.[80]

Regulation of the market would also reduce the danger from unscrupulous buyers. Ethical standards similar to those for the legal profession[81] could be enforced. The fear of quick-talking purchasers buying a tort victim's claim before the victim has had a chance to receive advice or competing offers could be lessened by giving tort victims an absolute

[79] Because of this fear, Roman law prohibited a purchaser of a tort claim from recovering more than he had paid for the claim. See note 33 *supra*.

[80] Since most purchased claims presumably would be settled rather than litigated, one might want to require a purchaser to file with the court a statement of the settlement amount and the amount paid for the claim.

[81] Existing bar rules would prohibit an attorney from purchasing claims in a market. See Model Rules of Professional Conduct, Rule 1.8(j) ("A lawyer shall not acquire a proprietary interest in the cause of action except for a reasonable contingent fee contract"). Bar rules aside, lawyers might make ideal purchasers in a claims market: they are well informed about the value of claims, they presumably understand the ethical considerations that would be involved in purchasing and pursuing claims, and they are already subject to state and self-regulation. The primary objection (sometimes voiced with respect to contingent fees) to lawyers' purchasing claims in a market is that purchases might be inconsistent with an attorney's duties as an officer of the court. A lawyer acting as a principal in a case would have greater economic incentive to violate ethical canons in order to secure a recovery. See Dahms v. Sears, 13 Or. 47, 58, 11 P. 891, 896 (Or. 1886) ("To allow an attorney of the court, however, to purchase a chose in action . . . would shock the moral sense of all right-minded people").

option to void their sale contracts within a stated period—perhaps one week—after sale. One might also require central registration of purchased tort claims and publication of purchase.

Another objection to a market is the argument that tort victims would receive less than their claims are "worth" because a market purchaser could not capture the "sympathy" of a court or jury,[82] that is, "the considerations urged to a jury in a personal injury case are of such a personal nature that an assignee cannot urge them with equal force."[83] But this is not a strong argument against allowing a market. Tort claim purchasers, presumably, would require the seller to covenant cooperation in pursuing the claim; purchasers might also purchase only a percentage of the claim so as to leave the tort victim an incentive to cooperate.[84] In any event, a purchase would take place in the market *only* if the value of the claim to the purchaser, after any reduction in value for lost sympathy, were greater than the value of the claim to the seller. Thus a market would function only if claims in fact were not so reduced in value as to offset the increase in value of a tort claim from purchase by a market participant.

V. Conclusion

This paper has developed the case for allowing the free assignability of tort claims in the market place. The chief advantage of assignment is that it moves the claim from the victim who assigns it a low value to the professional claim purchaser who assigns it a higher value. By itself, that gain in welfare should be decisive unless it can be shown that the purchase has negative effects on third parties, in this case tortfeasors. Such effects could arise if the rules regulating tort actions permitted the claim purchaser to harass and abuse the tort defendant or if there were an increase in amount and duration of litigation between professional claims purchasers and tortfeasors. This paper argues that these external risks are

[82] Value could be diminished through a loss of sympathy whether or not the jury was aware that the claim had been purchased. Evidence that the claim had been purchased might be excluded under the collateral-source rule, which prohibits the introduction of evidence that the tort victim has received compensation from an outside source. 22 Am. Jur. 2d Damages, § 206 (1965). If purchase of claims became widespread, juries might *assume* the injured party had sold his claim even if the defendant were not able to introduce evidence of the sale directly. Judges and juries are commonly thought to assume defendants are insured. See Keeton & O'Connell, *supra* note 78, at 23. Even if the jury were unaware and did not assume the claim had been purchased, a plaintiff who had sold his claim might have little interest in the outcome of the suit and thus tend to evoke less sympathy.

[83] *Southern Farm Bureau,* 454 S.W.2d at 70.

[84] See text at note 54 *supra*.

typically overstated and are better controlled by rules directed toward the actual conduct of litigation itself.

State legislative action is needed to authorize and regulate the development of a market in personal injury tort claims. There are powerful interest groups that might be opposed to such legislation, however. Insurance companies might oppose the change if it increases their overall defense and indemnity costs. Beleaguered defendants in product liability and medical malpractice areas are likely to resist the proposal as well, especially if there are no concomitant changes in the substantive and procedural rules governing tort litigation. Even plaintiff's lawyers might join the opposition if they thought that nonlawyer purchasers might diminish their now dominant position in the contingent fee market. Nonetheless, if the arguments set out above are correct, a market in tort claims promises substantial benefits that more than outweigh the costs imposed. The organization of a rational market in personal injury tort claims therefore is an important legislative priority that deserves far closer attention than it has received.