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Liability Externalities and the Law: A Comment on Cooter and Porat

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Abstract

Robert Cooter and Ariel Porat have offered a simple model of tort liability with sensible reform proposals. Their focus is in on damage levels, and how those levels can be modified to reflect the socially desirable level of externalization. However, to the extent that there is any gain to be achieved by modifying damage awards, it would be better to secure this gain through other approaches, such as adopting a more careful analysis of factual causation or reducing the likelihood of judicial error.

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INTRODUCTION

Robert Cooter and Ariel Porat have offered a simple model of tort liability that makes sense,[1] and is more consistent with the law than the authors acknowledge. Their focus is in on damage levels, and how those levels can be modified to reflect the socially desirable level of externalization. However, the common law largely reflects the general concerns that they raise in their analysis. Moreover, to the extent that there is any gain to be achieved by modifying damage awards, the principle change they advocate, it would be better to secure this gain through other approaches, such as adopting a more careful analysis of factual causation or reducing the likelihood of judicial error.[2]

The core of the argument appears early in their piece:

> Law should discourage activities with negative liability externalities. A tax on the activity would discourage it. Many jurisdictions tax driving, but we know of no jurisdiction that calibrates the tax according to the risk that drivers impose on others. In the absence of a tax on risk, law should increase liability beyond full compensation in order to discourage driving. In general, liability law should adjust damages in light of the externalities that it creates.
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> Unlike pedestrians and drivers, patients contract with doctors for treatment and willingly submit to the risk of harm. … Imperfections cause some kinds of doctors to convey more positive than negative externalities on their patients. … Liability law does not need to discourage the activity of doctoring, and it needs to encourage some specialties.[3]

I agree with the general thrust of this claim, and I think the law is largely consistent with it. For the most part, the negligence rule is applied when negative externalities are roughly in balance with positive externalities.[4] Strict liability is applied when the negative externalities associated with an activity far outweigh the positive externalities.[5] I also agree with the general direction of the reform suggestions of Cooter and Porat. They have identified and provided a theoretical framework for analyzing important problems in the intersection of tort law and health care.

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[1] Robert Cooter & Ariel Porat, *Liability Externalities and Mandatory Choices: Should Doctors Pay Less?*, 1 J. TORT L. 2 (2006).

[2] For example, the likelihood of judicial error can be reduced in the medical malpractice setting by having medical professionals serve as neutral expert advisors to courts.

[3] Cooter & Porat, *supra* note 1, at 1.

[4] Keith N. Hylton, *A Missing Market Theory of Tort Law*, 90 NW. U. L. REV. 977 (1996).

[5] *Id.*

I. A FEW QUIBBLES

My disagreements with Cooter and Porat appear at the level of detail. It is not the case that drivers impose only risk on other drivers or on pedestrians. Imagine a world in which the roads were relatively empty. Would that be one of ideal safety? No. Highwaymen have existed for millennia precisely because they take advantage of low density traffic. There are some external benefits that drivers provide to other drivers and sometimes to pedestrians as well. Moreover, the risks that drivers impose among themselves are entirely reciprocal. When we take into account the externalization of benefits as well as costs, we see that the law justifiably treats driving as an activity that is not unusual in terms of risk externalization, and therefore applies the negligence rule.[6]

According to Cooter and Porat, doctors convey more positive than negative externalities on their patients. But there is no reason to think that externalized benefits – benefits that are not taken into account by the market – are unusually large in the medical care context. Most patients are aware that they are receiving benefits in excess of the fees that they are paying. I am aware of no empirical evidence that the market demand schedule for medical services fails to reflect the net benefits of those services to patients.[7]

Another detail that carries a lot of weight with Cooter and Porat is the matter of mandatory choice. Cooter and Porat have in mind the doctor who must do some procedure – he cannot simply walk out of the emergency room and say "my shift is up, time to go home." This strikes me to be a useful description of the extreme short run in many settings, but I am not sure how much should be pinned on this case. I think that once we are outside of the extreme short run, there are no mandatory choices. Any doctor can decide, after going home, that he is not going to return to work the next morning. Or, perhaps more realistically, any doctor can decide to scale back his activities gradually until he has reduced his practice to zero.

In addition, I find the mandatory choice example a little troubling because it is unclear to me whether this is an analysis of care or of activity choices. It seems most persuasive as an analysis of activity level choices. However, viewed in this

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[6] *Id.*

[7] Consider, for example, the market for food. Food also conveys the same positive externality as health care, because it permits people to function, enabling them to provide for dependents and coworkers. If medical care provides substantial positive externalities not captured by the market, the same would appear to be true of food. In spite of the absence of empirical evidence on this issue, I am willing to believe that there are substantial positive externalities in the food and medical care markets, but these would be limited to the most basic goods and services. The robust markets for food and medical care in the U.S. are far beyond meeting basic needs.

light, it runs into the problem that few activity level decisions can accurately be described as mandatory.

Cooter and Porat offer the following illustration of the mandatory choice problem.

> An obstetrician must decide whether to deliver a baby by vaginal or cesarean birth. In this difficult case, vaginal birth imposes the unavoidable risk of harm to baby and mother of 200 with probability .10 (expected harm of 20), whereas cesarean birth imposes the unavoidable risk of different harm of 300 with probability .10 (expected harm of 30). The obstetrician mistakenly chooses cesarean birth and the harm materialized. A court applies a negligence rule to these facts and finds the obstetrician liable.[8]

Cooter and Porat note that in this example, the incremental harm from the obstetrician's decision to choose cesarean birth is $100 with probability .10. However, when the court applies the negligence rule Cooter and Porat envision, it imposes a damage award of $300. The damage award that would align incentives correctly would be $100. Thus, the negligence rule leads to an excessive award and distorts the decisions of obstetricians.

Strict liability performs well in regulating incentives in the obstetrician example. If the obstetrician is held strictly liable for harms, then the incremental liability from choosing cesarean birth will be $100 with probability .10. Since incremental liability is equal to incremental harm under strict liability, the obstetrician's incentive to choose cesarean birth is not inefficiently discouraged.

Negligence, as envisioned by Cooter and Porat in their obstetrician example, does not work so well in regulating care. This is a general point that applies to the negligence rule in the presence of factual causation issues. As Mark Grady noted,[9] it is this failure that leads to a discontinuous jump in expected liability as an actor crosses the threshold from reasonable care to negligence. This discontinuous jump could lead to excessive care[10] and, as Cooter and Porat explain, discourage some medical specialties as activities.

With respect to the mandatory choices examined by Cooter and Porat, there are standard approaches available to courts that do not require any changes in the rules on damage awards. The core problem they emphasize in the obstetrician example is factual causation. Strict liability regulates optimally in this context – although, of course, it discourages medical practice in general. Alternatively,

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[8] Cooter & Porat, *supra* note 1, at 1-2.

[9] Mark F. Grady, *A New Positive Theory of Negligence*, 92 YALE L. J., 799 (1983). *See also*, Marcel Kahan, *Causation and Incentives to Take Care under the Negligence Rule*, 18 J. LEGAL STUD. 427 (1989).

[10] *Id.*

courts could attempt to be careful about causation and hold the obstetrician liable only for the incremental harm. In other words, courts could attempt to apply the same careful and perspicacious analysis of causation that Cooter and Porat provide in their paper.

Altering the rules governing damages could introduce new problems. To the extent that the new rules fail to regulate care decisions, the obstetrician's incentive to take care may decline. In addition, the new rules could be quite difficult to administer.[11]

The final detail is one I briefly noted earlier; the distinction between care and activity levels. The negligence rule usually applies to discrete precaution decisions, such as the decision to look both ways before driving across a road or the decision not to monitor a patient's vital signs for a specific time period during surgery. Negligence claims usually do not involve general methods or approaches, such as the choice between boat or airplane transportation or the choice between cesarean and vaginal delivery. By focusing on a choice between general methods of practice, Cooter and Porat may have produced reform suggestions that have undesirable consequences for discrete precaution choices. For example, a decision to reduce damage awards so that they disgorge gains from choosing one method instead of another, or so that damages start at a baseline of zero for the best method, might eliminate the incentive to take care after a particular method is adopted.[12]

II. FORMAL ANALYSIS OF COOTER AND PORAT

The formal analysis consists of a simple model I find quite useful as a way of thinking about damages and externality. Cooter and Porat say that "to completely internalize marginal net benefits, the actor's expected marginal net payoff must equal the net social benefit of the activity to others."[13] This is represented by the equation:

$$m - qd = b - ph$$

[11] Consider, for example, a disgorgement rule, one of the reforms suggested by Cooter and Porat. To work effectively, a disgorgement rule must wipe out the gains the actor receives from taking the socially undesirable option. But it may be almost impossible to objectively determine the gains. Moreover, to the extent the disgorgement remedy is a predictable tax on wages, it affects the supply decisions in a way that may partially offset the tax. A predictable tax that effectively disgorges gains would have to be determined in a several stage process of adjustment to market outcomes.

[12] Of course, Cooter and Porat recognize this potential flaw, *see* Cooter & Porat, *supra* note 1, at 18.

[13] Cooter & Porat, *supra* note 1, at 8.

All of these terms apply to marginal activity units. The model implies that if the social benefits are captured in the private reward (the price on the marginal activity unit), $m = b$ and therefore setting damages equal to h is optimal. I find this easiest to interpret as a norm for regulating activity levels.

However, I find this model useful primarily as a general shorthand framework. And I disagree with some of their specific applications. For example, take the case of driving. Cooter and Porat say that since there is no market, $m = 0$. But this ignores the fact that drivers get their own personal benefit from driving, and this is what should be taken into account on the left hand side of the equation. Given this, m should not be set equal to zero. Cooter and Porat also claim that the external benefit from driving is zero, $b = 0$. But I think the external benefit from driving is positive – recall my example of highwaymen. This means that driving should not be taxed with strict liability or with some damage multiplier, as suggested by Cooter and Porat.

CONCLUDING REMARKS

Although I disagree with some of the specific applications in the formal analysis of Cooter and Porat, I agree with the general framework. It is consistent with a framework I introduced in a paper several years ago.[14] I used my framework, which I labeled the "missing markets model", to provide a positive theory of tort doctrine – specifically of the choice between strict liability and negligence.

An analysis of external benefits as well as external costs is most useful, in my view, in trying to understand the tort doctrine that exists. Once existing tort doctrine is seen to reflect a reasonable consideration of the external costs and the external benefits associated with activities, the scope of beneficial reforms will appear to be somewhat narrower. Tort law can be reformed for the better, but any reform effort should avoid introducing new problems or making some existing problems worse.

Since Cooter and Porat have taken the valuable step of providing concrete reform suggestions, I will close with a similar effort. In spite of my disagreements with some of the details of their argument, their analysis of the causation problem in medical care should be taken seriously and followed by policy makers. Rather than modifying damage awards, the better reform in my view would be the adoption of rigorous causation analyses in medical malpractice litigation. Enhancing the rigor of causation analyses would have the same limiting effect on damage awards advocated by Cooter and Porat, and at the same time avoid introducing new problems.

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[14] Hylton, *supra* note 4. *See also* Keith N. Hylton, *Duty in Tort Law: An Economic Approach*, 75 FORDHAM L. REV. 101 (2006).

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FDA Preemption: When Tort Law Meets the Administrative State

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