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Understanding Mass Tort Defendant Incentives for Confidential Settlements

Lessons from Bayer's Cerivastatin Litigation Strategy

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UNDERSTANDING MASS TORT DEFENDANT INCENTIVES FOR SEEKING CONFIDENTIAL
SETTLEMENTS: LESSONS FROM BAYER'S CERIVASTATIN LITIGATION STRATEGY¹

James M. Anderson²

ABSTRACT: Settlement agreements that require a plaintiff not to disclose or publicize any information about her claim are both common and controversial. Under some conditions, however, a mass tort defendant will rationally choose to *discourage* such secrecy. A defendant can use publicity to act as a commitment device akin to a most-favored-nation agreement to increase its bargaining power with plaintiffs. The paper uses the real world example of Bayer's cerivastatin litigation as a case study to illustrate this theory in practice and to explore the public policy implications of this finding.

Transparency seems a self-evident aid -- if not a necessary precondition -- to an effective and just civil justice system. As a result there has been extensive concern over one of the least transparent practices of the civil justice system: private settlement agreements that require both parties to maintain confidentiality about the settlement and the nature of the underlying dispute. The public, the press and other parties can learn almost nothing from the litigation or its outcome, and important public dangers can be concealed from public view indefinitely. Environmental dangers, auto safety issues and the widespread sexual abuse of children by some priests have arguably been concealed and perpetuated by the use of these agreements (Luban, 1995; Drahozal, 2006). Critics of confidentiality agreements suggest that parties owe an informational duty to the public if they employ the

¹ A version of this paper will be included as a chapter in a forthcoming UCLA-RAND book based on the November 2007 conference, "Transparency in the Civil Justice System" at the UCLA School of Law.

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publicly funded court system to resolve their disputes. On the other hand, proponents of confidential settlements emphasize the private character of most disputes and parties' freedom to come to whatever agreement best serves them.

Suppose, however, that under certain conditions, defendants might have incentives not to seek confidentiality agreements about settlements. In this case, the difficult question of whether formal restrictions should be put on confidential settlement agreements might be avoided. This chapter explores the conditions under which parties will themselves rationally choose not to seek confidential settlement agreements and uses cerivastatin litigation as a real-world example of this situation. By understanding these conditions and the incentives that parties face, policymakers may be able to effectively discourage confidential settlement agreements without coercion or controversial changes to contract law. At the very least, policymakers should understand the legal ecologies in which confidential settlement agreements are most and least likely to thrive. The chapter also contributes to the settlement literature by informally showing how limited transparency can operate as a commitment strategy similar to a most-favored nation agreement and providing a real-world example.

In order to understand the incentives for confidential settlements, I use a recent high-profile pharmaceutical litigation as a case study to explore why a defendant might *not* seek confidential settlement agreements. In 2001, the US pharmaceutical division of Bayer A.G. faced a serious problem. Its new cholesterol-lowering drug, cerivastatin, marketed under the trade name Baycol, sometimes caused potentially fatal muscle damage, rhabdomyolysis. After withdrawing Baycol from the market, Bayer faced over 12,000 products liability claims. Rather than seek confidentiality agreements, Bayer created a schedule of payments for rhabdomyolysis based on the plaintiff's particular injury. For non-rhabdomyolysis claims of injury or for

plaintiffs who rejected the schedule, Bayer announced that they would litigate. While Bayer did not actively publicize the settlements, it only sought confidentiality agreements in a handful of unusual cases. According to George Lykos, Bayer Corporation's Chief Legal Officer in the U.S., part of the appeal of this strategy was its transparency: every claimant would know that he or she was being treated the same as other claimants.

The cerivastatin litigation provides an instructive example of a real-world litigation context in which a private-sector defendant voluntarily adopted a non-confidential settlement strategy. What were the incentives that led Bayer to pursue this strategy? More generally, what conditions will lead a defendant to eschew secret settlements?

In order to answer these questions, I interviewed defense and plaintiff's lawyers involved in the litigation and reviewed the economic and medical literature. The structured interviews helped explain both the current prevalence of confidential settlement agreements and the motivation behind the cerivastatin settlement strategy. The game theoretic models from the economic literature on settlements explain the incentives that lead to this result.³

The story that emerges is somewhat unexpected. The conventional wisdom is that confidential settlement agreements aid defendants. Confidentiality minimizes bad publicity for the corporate defendant which is important to the defendant both for its own sake and to minimize additional claims. In this case, however, openness actually aided Bayer in reducing its overall costs. Limited transparency permitted Bayer to credibly adopt a tougher bargaining strategy with plaintiffs than would have been possible had it sought confidential settlements. It allowed Bayer to commit to a take-it-or-leave-it offer to plaintiffs which allowed it to keep more of the surplus in the

settlement. As a result, it was actually in Bayer's interest to foster communication among plaintiffs and their attorneys.

This finding potentially has broad implications for policymakers interested in encouraging transparency in the civil justice system. To be sure, the transparency that resulted from this litigation was very limited - the settlement terms were never made public by Bayer or the plaintiffs. Nor was the information learned by the plaintiffs during the discovery process made public. But the settlement process resulted in more transparency and horizontal equity among plaintiffs than is common in tort litigation. To the extent policymakers value this result they should consider adopting policies to encourage the conditions that made it possible.

In the following sections, I briefly review the history of cerivastatin, describe the economic literature on settlements and mass torts, and informally analyze cerivastatin litigation using the economic models developed in the economic and legal literature. To conclude, I consider the public welfare and policy implications of these findings.

THE RISE AND FALL OF CERIVASTATIN

In April of 1997, the pharmaceutical division of Bayer A.G. launched its new cholesterol-reducing drug, cerivastatin, with great fanfare. This statin, marketed as Baycol in the United States and by a variety of other names elsewhere, reduced "bad" LDL-cholesterol.⁴

It also had important business implications for Bayer. Competitors had already released other statins, which had proved to be a

³ I focus primarily upon the incentives faced by the defendant because as the only party involved in all of the litigation, it has the most critical role in structuring settlement agreements.

⁴ For the purposes of consistency, this chapter refers to this drug as cerivastatin. It was marketed under a variety of names in different countries including Baycol, Lipobay, Lipoban, Liogis, Liposterol, Certa, Vervasta, Cholstat, Eltina, Staltor, Stativa, Vaslip, Vazqol, and Zenas.

profitable and fast-growing category of pharmaceuticals.⁵ Cerivastatin appeared to have significant potential for Bayer. It was the most powerful statin available on the market and its 0.4 mg dose had an effect comparable to that of much higher dosages of competitors' statins.⁶ Since LDL-lowering effect was the most important criterion for sales of statins, cerivastatin's potency appeared useful. Bayer was hopeful that this would reinvigorate its profits and sales, particularly in the United States (Angelmar, 2007).

While in general, statins have relatively few side effects, one of the most serious is the potential to cause rhabdomyolysis. Rhabdomyolysis is a breakdown of muscle fibers which results in the muscle protein myoglobin being released into the bloodstream. The myoglobin is toxic and can substantially damage the kidney. It can be diagnosed by the observation of creatine kinase (CK) levels approximately ten times above upper normal levels and muscle pain. In rare cases, the renal failure caused by the myoglobin can be fatal.

When cerivastatin was developed, this seemed like an isolated problem. In clinical trials of earlier statins, between 0 and .5 percent of patients experienced elevated CK levels and muscle pain consistent with rhabdomyolysis. In only a single previous clinical trial had a statin led to a hospitalization. Moreover, even though there was some knowledge of the problem of rhabdomyolysis with statins, there was little sense that risk of rhabdomyolysis differed among statins (Chong, P.H., Seeger, J.D., and Franklin C., 2001). A Bayer

This chapter only considers Bayer's litigation strategy in the United States.

⁵ Merck & Co had released Mevacor (lovastatin) in 1987, and Zocor (simvastatin) in 1988. Bristol-Myers Squibb introduced Pravachol (pravastatin) in 1991. Novartis had Lescol (fluvastatin) released in 1994. Finally, Lipitor was released in February of 1997, just before Baycol after being developed by Warner-Lambert and co-marketed by Pfizer (Angelmar, 2007).

⁶ The .4mg dose of Baycol had the same efficacy as 10mg Lipitor, 20mg Zocor, 40mg Mevacor and 80mg Lescol (Angelmar, 2007).

toxicologist did note in internal discussions that .4mg was the highest daily dose that should be developed for clinical use because the dose response curve of cerivastatin was steeper than that of other statins.⁷ Nonetheless, the risk of rhabdomyolysis was one of many listed in the warnings section in the insert that accompanied the U.S. prescribing information for all statins.

Clinical trials, however, are poor instruments for detecting rare adverse effects because the relatively small numbers involved make it difficult to observe rare events (Farmer, 2001).⁸ As a result, rhabdomyolysis was detected more frequently after the statins had been approved and used more widely from doctors and hospitals submitting reports of adverse events to the FDA ("spontaneous reports").

The situation was complicated by the common co-prescription and concurrent use of fibrates and statins. Fibrates are another class of drugs used to control high cholesterol. But prescribing statins at the same time as fibrates substantially increases the risk of rhabdomyolysis. During the development of cerivastatin this effect and the risk of rhabdomyolysis was thought to be rare and suitable for control by monitoring of CK levels and muscle pain (Lau, 2001).

Cerivastatin was released in the United States in February 1998 at the .2 and .3 dosages under the trade name Baycol. Reports by medical professionals over the next year indicated that rhabdomyolysis sometimes occurred, usually when the patient was also taking the fibrate gemfibrozil. These drugs were often prescribed together to counter high cholesterol.

⁷ Letter by Professor Dr. Schuluter, Professor Kühlmann and Dr. Ziegler, Bayer AG Geschäftsbereich Pharma, Forschung und Entwicklung Medizin und Entwicklung, Wuppertal, Germany to Dr. MacCarthy MILES INC, Pharmaceutical Division, West Haven, Conn. 2/8/91. Halton v. Bayer Corp. 699 L Plaintiffs' Exhibits.

⁸ Some have concluded that the post-release monitoring of adverse events and spontaneous reports by federal regulatory agencies needs to be increased (Farmer, 2001).

As a result of these reports, Bayer requested from the FDA a change in cerivastatin's U.S. labeling to include a bolded counterindication for prescription with gemfibrozil in May of 1999, more visible to consumers and physicians than the earlier warning. This was approved in December of 1999. In early 1999, there appeared to be little indication that cerivastatin caused rhabdomyolysis at a higher rate than any other statin.

In May 1999, Bayer received FDA approval for a 0.4mg dosage. Because it was more potent, this higher dosage allowed Bayer to compete more directly with other statins. The 0.4mg dose became the one most commonly prescribed. By the second quarter of 2000, Bayer had substantially increased its overall share of the statin market to approximately six percent (Angelmar, 2007).

In July of 1999, the clinical trial of the 1.6 dosage of cerivastatin had to be discontinued because of the very high (12%) incidence of CK elevation among patients. The effort to get the 1.6mg dosage approved was dropped and the results of the clinical trial were not published (Psaty et al., 2004).

By late 1999, spontaneous reports suggested that cerivastatin (in the approved dosages) was associated with a 2-6 cases of rhabdomyolysis per 100,000 patient years. While fairly low, this was ten times higher than the occurrence of rhabdomyolysis with other statins (Psaty et al. 2004).

In July of 2000, the .8 dosage of cerivastatin was approved by the FDA, despite increasing signs that cerivastatin was riskier than other statins. Beginning in late 2000 and early 2001, it became clear that cerivastatin caused rhabdomyolysis at significantly higher rate than other statins. Eighteen cases of fatal rhabdomyolysis were reported worldwide between September 2000 and February 2001. By comparison, there had been eight fatalities and two fatalities in the preceding two six month periods. At first, Bayer reacted by urging doctors to start

patients with a dose lower than the 0.8 dose. Bayer also stopped shipping .8mg samples to U.S. doctors (Angelmar, 2007).

On August 1, 2001, however, Bayer suspended all marketing and sales of the 0.8 dose of cerivastatin in the United States. On August 7, Bayer decided to completely withdraw cerivastatin from all markets except Japan.⁹

Following the announcement of cerivastatin's withdrawal, Bayer's stock price fell by 25%. Most observers attributed the loss to the anticipation of lost profits and massive litigation. Numerous claims were filed both by plaintiffs who suffered from rhabdomyolysis and those whose theories of causation were more speculative. Plaintiffs sought compensatory (economic and non-economic) and punitive damages (Langley, 2004). Given the chronology explained above, and other damaging documents revealed during discovery, plaintiffs could plausibly argue that Bayer concealed information about the dangers of cerivastatin and continued to market the drug even after it knew of the dangers.¹⁰ Bayer could argue that it acted as quickly as feasible under the circumstances and that it should not be held responsible for prescribing physicians' failure to abide by the contraindication for gemfibrozil co-therapy when prescribing cerivastatin. Nonetheless, Bayer's liability was expected to be large and most observers anticipated a mass tort. In the wake of American Home Products experience with fen-Phen litigation, observers expected large litigation costs and perhaps attempts to reach a global settlement with plaintiffs. Bayer was expected to agree to mass settlements in order to control potential losses and to press for the

⁹ Bayer did not withdraw cerivastatin from Japan because gemfibrozil was not available there and because the higher dosages of cerivastatin were not sold there. The highest approved dosage of cerivastatin in Japan was .15 mg. On August 23, 2001 Bayer withdrew cerivastatin from the Japanese market, partly because of the impending approval of gemfibrozil. (Angelmar, 2007)

¹⁰One damaging internal document stated: "If the FDA asks for bad news, we have to give, but if we don't have it, we can't give it to them." (Berenson, 2003).

confidential settlement agreements as is common in products liability suits.¹¹

Instead, Bayer eschewed secret settlement agreements and successfully settled the vast majority of cases according to its own schedule at a total cost much lower than expected. As this chapter explains below, the decision not to seek confidential settlement agreements was closely linked to the successful settling of many of the cases.

GAME-THEORETIC MODELS OF SETTLEMENT BEHAVIOR HELP EXPLAIN BAYER'S ACTIONS

Why did Bayer adopt this strategy? The economic literature on settlement behavior provides a good starting place to understand the incentives that parties face during litigation and settlement. Early efforts assumed that all parties possessed full information about the strength of claims (Posner, 1973); (Landes, 1971). Over the past thirty years, more sophisticated and realistic models of settlement behavior have been developed.¹² In particular, Spier (1992) showed that settlement tends to follow a U-shaped curve. After an initial flurry of settlements, settlements decline until trial become imminent when they increase. In this model, two countervailing dynamics are at work. Litigation is expensive so that parties prefer to reach a settlement earlier rather than later. However, by waiting until close to trial, parties can make stronger take-it-or-leave-it offers which allows them to extract more of the surplus from avoiding trial. Since trial is imminent, neither party can make empty offers. The result is a U-shaped distribution of the timing of settlement (Spier, 2007).¹³ Two strands of this literature are particularly relevant to understanding the

¹¹ Interviews with Gary McConnell, George Lykos, John Ruiz.

¹² Daugherty and Reinganum (2008) provide an excellent overview of this literature.

pattern of behavior in the cerivastatin litigation: the most-favored-nation clause analyses and the secret settlement analyses.

Bayer's announcement of the existence of a fixed schedule and the lack of confidentiality agreements acted as a functional analog to a most-favored-nation clause. Most-favored-nation (MFN) clauses are contractual terms that prevent one contracting party from reaching a separate agreement with another (third) party on terms more advantageous for the third party than for the first. The term comes from trade agreements negotiated among nations. If country A has a most favored nation agreement with country B, country A agrees not to provide a more favorable trade agreement with country C. In the settlement context, it is an agreement not to settle a claim with a third party on better terms than that reached with the contracting party for that party. If the party does reach a more favorable agreement with a third party, it must retroactively provide the same terms to the party with which it agreed to the MFN provision.

Using a most-favored nation clause in settlements can benefit the defendant in addition to the party to which the defendant offers the MFN agreement. Spier (2003) modeled the effect of MFN clauses on the behavior of litigants. She concluded that a defendant being sued simultaneously by multiple plaintiffs can use a MFN to commit to a single take-it-or-leave-it-offer.¹⁴ By including a MFN clause in

¹³ The increased costs of actual trial as compared with pre-trial litigation may also prompt settlement just prior to trial.

¹⁴ One way to understand this problem is by comparison to a monopolist who wants to maximize her income. As Coase (1972) explained, monopolists will have incentives to lower prices over time to sell to buyers with lower valuations for the product on which she has a monopoly. But if high valuation customers know that the monopolist will eventually lower prices, they may simply wait and not pay the initially high price until the monopolist lowers prices. As a result, the monopolist may not be able to charge as much as she would otherwise be able to the high-valuation customers. The monopolist can solve this problem by including an MFN clause in the contract. This credibly commits the monopolist to not lowering prices because the monopolist would then be forced to pay additional sums to the early buyers if she

settlement agreements with early plaintiffs, the defendant credibly commits to treating subsequent plaintiffs similarly. This convinces early plaintiffs that there is no benefit to delaying settlement or holding out for more. The MFN clause has the function of committing the defendant to not later offer a more generous settlement to other plaintiffs. If the defendant were to do so having earlier contracted to a MFN clause, the defendant would also have to make additional payments to the early-settling plaintiffs. Therefore, the plaintiffs will reason that a defendant will not offer a higher amount in the second round and will be more likely to accept the defendant's first round settlement. Spier concluded that defendants almost always gain from the use of this clause.¹⁵

Bayer's announcement of the existence of a fixed schedule coupled with no confidentiality acted as an analog of a MFN clause by serving to credibly commit it to paying out fixed amounts for particular injuries. If Bayer were to "cheat" by paying out higher amounts to later plaintiffs, its long-term reputation for honoring its commitments would be harmed.

The economic literature also models the secret settlement. Daugherty and Reinganum (1999) formally model secret settlements and show how defendants will often be willing to pay for secrecy in agreeing to a settlement. Secrecy is attractive to defendants if it will reduce the likelihood of future claims.¹⁶

sold to later buyers at a lower price. As a result, the high valuation buyers will pay full-price -- confident that the monopolist will not subsequently lower prices. Butz (1990) showed this allows the monopolist to capture full monopoly rents.

¹⁵ Early-settling plaintiffs sometimes also gain from the use of the MFN clause in a settlement. Daugherty and Reinganum (2004) extended this model.

¹⁶ In Daugherty and Reinganum (2005), the authors extend this model to include consumer behavior and show that the use of confidential settlement as a strategy leads to lower product safety which may reduce demand. If credible auditing is inexpensive enough, however, a rational firm may choose openness.

Law review articles discussing confidential settlement agreements focus more on the public policy implications of confidential settlements rather than the incentives faced by the parties.¹⁷ Several key societal disadvantages with confidential settlements are identified in this literature: (1) continuing dangers may not be averted because they are not publicized; (2) other injured people may not realize that they have even been harmed yet; (3) other injured people may not realize that they have a case against a wrongdoer; (4) discovery sharing that might have occurred among plaintiffs and defendants without confidentiality may substantially reduce litigation costs.¹⁸ Others argue for a right to knowledge of settlements on the grounds that the courts are public institutions.¹⁹

Proponents of confidentiality agreements argue that they can facilitate the reaching of an agreement and allow both the parties and the courts to avoid the expense of litigation. On this view, transparency and publicity are a transaction tax that create a "deadweight cost" in the scuttling of agreements that both plaintiff and defendant would otherwise accept. Harvard Law School Professor Arthur Miller (1991) argues that a concern about secrecy should not impede settlement and that courts should facilitate secrecy if it will increase settlements. Regulatory agencies, Miller suggests, are the proper institutions to ferret out information that is of public benefit. Richard Epstein (2002) also adopts this approach, even in considering

¹⁷ See e.g. Miller (1991), Doré (1999), Fiftal (2004).

¹⁸ Ordinarily, discovery sharing is thought to benefit plaintiffs. However, in recent mass tort silica litigation, defendant discovery sharing led to the revelation of widespread fraud. See *In Re Silica Prods. Liab. Litig.* No. MDL 1553, 398 F. Supp.2d 563 (S.D. Tex. 2005).

¹⁹ Indeed, Fiss (1984) argues against permitting most private agreements to settle at all citing the many benefits of a final public adjudication. See also Luban (1995).

such high-profile examples as the Catholic Church's secret settlements which may have facilitated further sexual abuse.²⁰

Finally, the literature on mass torts offers its own predictions as to the likely result of the cerivastatin litigation. In mass torts, a number of dynamics lead to larger expected liability for the manufacturer than would be expected by merely summing the individual torts (Carroll, 2004); (Daugherty and Reinganum, 2007). Frequently, there are many plaintiffs, many of whom had a relatively tangential connection to the most serious injuries caused by the product. Linked settlements sometimes result: defendants settle many weaker cases for more than they might otherwise in exchange for settlements of the stronger cases. The risk-averse defendant escapes the risk of potentially bankruptcy-inducing judgments in plaintiff-friendly jurisdictions (Hensler and Peterson, 1993). Counsel for plaintiffs get judgments for their clients and contingency fees for themselves without having to try weak cases, some fraction of which would actually be worthless at trial (Schuck, 1995).

The daunting logistics of defending a mass tort also help explain why defendants sometimes expect large losses. In most products liability cases, the defendant has far more resources than an individual plaintiff. In some mass torts, this asymmetry is reversed. Defendants can simply become overwhelmed by the sheer number of claims. Few, if any defendants have an in-house litigation staff necessary to credibly try more than a small fraction of mass tort claims. This requires going to outside counsel. But as trials have become less common over the past thirty years, experienced defense-side trial lawyers have become rarer. Hiring and coordinating the necessary number of trial lawyers to handle the sheer volume of litigation is a massive logistical task.

²⁰ Moss (2007) argued that the conventional economic analyses of this issue are reductively facile.

Coordination on the part of plaintiffs' lawyers to press for trials during a certain period can exacerbate this effect.²¹

A defendant can therefore sometimes face the choice of either going to trial with inadequately prepared lawyers, or settling. Neither option is attractive to the defendant. Going to trial on even one of thousands of claims without having well-prepared trial lawyers risks setting informal precedent and headline-grabbing verdicts. Large trial verdicts are not only costly in and of themselves but also raise expectations on the part of other plaintiffs and potentially other juries. On the other hand, settling borderline cases sets a negative precedent of its own. If even weak claims are likely to be settled without much scrutiny, plaintiffs' counsel have incentives to find as many claims as possible, however weak.²² As a result of these effects, some mass torts can cause larger losses to a defendant than might otherwise be expected.²³

Moreover, Daugherty and Reinganum (2007) argue that mass torts that rely upon epidemiological evidence of causation can create an "externality," an indirect effect that generally benefits plaintiffs. If liability hinges in part on the proportion of the population exposed to the product that is harmed by it, then an injured plaintiff will rationally extrapolate from other cases of which she is aware to estimate the likelihood of liability ultimately being found. Thus the more cases filed, the higher the plaintiffs' prediction of liability being found at trial and the more aggressive the plaintiff will behave.

²¹ Interview of Gary McConnell, Bayer Legal Department, 2007.

²² Bayer lawyers whom I interviewed emphasized Bayer's immediate preparation for potential trials all over the nation. This, they emphasized, made their threat to litigate credible. If, in contrast, plaintiffs' lawyers believed that Bayer was not prepared to aggressively litigate, the plaintiffs' lawyers may have discouraged their clients from accepting settlements.

²³ In some instances (e.g. breast implant, asbestos) mass tort defendants have chosen or been forced to choose bankruptcy.

Similarly, Kuran and Sunstein (1999) explain how "availability cascades" can cause the public to overestimate a particular risk. These occur when people estimate the plausibility of a risk based on how readily they can call an occurrence to mind. If even a small risk is highly publicized, people will tend to overestimate the likelihood of the risk. In the mass tort context, a jury is more likely to find for the plaintiff if they have heard of the danger occurring elsewhere. In both of these ways, mass torts can have a "snowball" effect and lead even large corporate defendants to fear them.

UNDERSTANDING WHY LIMITED TRANSPARENCY WAS IN BAYER'S INTEREST

At first, it appeared as though cerivastatin would follow the pattern of other mass torts. Plaintiffs in jurisdictions believed to be plaintiff-friendly in Texas were being recruited by newspaper, billboard, television, and website. Despite its huge market capitalization, Bayer's stock price was down appreciably -- apparently as a result of the uncertainty and the large expected losses. According to general counsel for Bayer, plaintiffs' counsel were willing to settle the stronger rhabdomyolysis cases only if Bayer would also settle the much weaker non-rhabdomyolysis cases where cerivastatin was alleged to have caused other injuries.²⁴

Instead of seeking a global settlement, Bayer announced to plaintiffs' counsel the creation of a schedule of damages for rhabdomyolysis cases and the fact that it was not generally seeking confidential settlement agreements. After a handful of trials (including some involving plaintiffs that suffered from rhabdomyolysis) that Bayer won, the vast majority of plaintiffs accepted the scheduled amounts.²⁵ Why?

²⁴ Interview with George Lykos (2007). See also Langley (2004).

²⁵ Interview with Gary McConnell (2007).

Bayer's Announcement Offer Acted as a Commitment Device

The combination of the existence of a schedule and the lack of confidentiality agreement helped Bayer reduce total payouts by allowing it to credibly commit to a single strategy of payment. In this respect it acted like a most-favored nation agreement. It effectively committed Bayer to paying a single price for any given injury to all plaintiffs. As Spier (2003) formally demonstrated, it is often in a defendant's interest to commit to a particular settlement amount. But absent some commitment mechanism, even plaintiffs who would otherwise accept a lower early offer will delay, correctly anticipating that it will be rational for the defendant to make a higher second offer rather than risk trial. A simple extended form game theory diagram, as shown in Figure 1, can illustrate this:²⁶

²⁶This simple model assumes that the defendant and the plaintiff possess complete information about the relevant payouts except for the payoffs of trial. The model does not assume that the defendant possesses perfect information about the distribution of the type of plaintiffs.

Figure 1—Informal Model of Settlement Incentives

The first number in the parentheses represents the plaintiff's recovery and the second represents the defendant's loss. The parties have an opportunity to settle the case at Time 1 or at Time 2, immediately before trial. The defendant cannot reliably distinguish plaintiffs who would be willing to settle at time 1 for 3 from plaintiffs who would be willing to settle at time 2 for 6. Assume that plaintiffs can be divided up into low-valuation plaintiffs and high-valuation plaintiffs. Low-valuation plaintiffs would be generally willing to settle the case right away (for \$3 in the diagram above at Time 1). In contrast, high-valuation plaintiffs are more willing to go to trial and have a higher reservation price (\$6 in the above diagram).

The defendant would prefer to settle with the low-valuation plaintiffs by offering \$3. However, if it is rational for the defendant to later make higher offers to the high valuation defendants, the low-valuation plaintiffs will correctly anticipate that the defendant will later offer a higher amount to attempt to settle with the high-valuation plaintiffs. So the low-valuation plaintiffs will therefore hold out for this subsequent higher amount that they know will be rationally offered. Why settle for \$3 when you know that \$6 will soon be offered? For this reason, the defendant and the low-valuation plaintiffs will be unable to reach a settlement at the low valuation (\$3).

By using a device to offer a single price to all plaintiffs, the defendant can avoid this effect. This is a commitment device: an action taken by the defendant to make it subsequently irrational for the defendant to do something that would have otherwise been rational. Like an MFN, Bayer's strategy eliminated the possibility of settling at time 2 for an amount that would be higher than that in time 1.²⁷

An MFN clause has the function of committing the defendant to not later offering a more generous settlement to other plaintiffs. If the defendant were to do so under an MFN clause, the defendant would also have to compensate the early-settling plaintiffs. Therefore, the plaintiffs will reason that the defendants will not offer a higher amount in the second round and the plaintiffs will be more likely to accept the defendant's first round settlement (Spier, 2003) (Ibáñez, 2008).

Here, in the cerivastatin litigation, the announcement of the fixed schedule, no confidentiality agreement, and Bayer's reputation for

²⁷ Whether or not it makes sense for the defendant to commit itself to a single price in this way hinges upon the distribution of valuations among plaintiffs, the communication among plaintiffs and the expenses and risks of trial. Even under our simplifying assumptions, it may not make sense for the defendant to commit itself in this way if there are

following its commitments has an analogous effect as the MFN agreement. In the MFN context, offering a higher settlement amount to some plaintiffs than others would require a payment to all the other plaintiffs, or be a breach of contract.²⁸ In the cerivastatin context, Bayer credibly committed to not making higher settlement payments to subsequent plaintiffs by its policy of not seeking confidentiality agreements, Bayer's reputation, and the level of communication among plaintiffs' counsel.

For the settlement strategy to work, plaintiffs had to believe that Bayer would not "cheat" and offer settlement amounts different from those in the announced schedule.²⁹ Otherwise, plaintiffs would not have agreed to settle for the schedule amount with the knowledge that the defendant would later make a higher offer to avoid a trial.

But what was to prevent Bayer from reaching secret settlements with some fraction of the plaintiffs for tactical reasons? Why not publicize a settlement schedule as a take-it-or-leave-it-offer, claim that the company was going to try every case that doesn't settle, but then secretly settle the cases for higher amounts to avert trials? Bayer insists that they did not do this, but, of course, if a settlement is secret, there is no way to verify this claim. Nonetheless, Bayer's long-term reputation would be damaged substantially by the discovery of

many high-valuation plaintiffs or the expected outcome at trial is sufficiently negative for the defendant.

²⁸ As a practical matter, it might be difficult to discover a breach of this sort depending on the litigation context. The examples that Spier uses of MFN clauses in settlements are all very high profile litigation (e.g. state tobacco litigation, MP3 litigation) in which the chances of a first settling plaintiff discovering a subsequent higher settlement seem very high. In other legal contexts, even a formal MFN clause may not serve as a credible commitment device if there is a risk of cheating by defendants. Since it may be in the second plaintiff's interest to keep a higher second settlement secret, a commitment not to cheat may not be credible.

²⁹ In fact, Bayer did reach off-schedule settlements in a handful of cases in which it felt the facts were unique enough that the schedule was not appropriate.

such "cheating" and it seems that plaintiffs' counsel believed Bayer.³⁰ As chief counsel of Bayer, George Lykos, put it, "no settlement is ever truly secret."³¹ Pharmaceutical mass tort trial lawyers compare notes and the legal tools for enforcing a private secrecy agreement are of only limited efficacy. Accordingly, Bayer's claim that it would not generally deviate from its schedule was apparently believed by a sufficient number of plaintiffs and their attorneys.

Comparing Bayer's Approach to a Most-favored Nation Agreement as a Commitment Strategy

In some ways the Bayer strategy is less flexible than an MFN agreement. As Spier (2003) points out, the MFN is not renegotiation-proof: the early-settling plaintiffs could renegotiate with the defendant in the second period under certain conditions. In the second period, this might be in the defendant's interest if allows it to settle with additional plaintiffs of a particular type. Suppose that after entering into the MFN agreement with early-settling plaintiffs, the defendant learns of a large number of high-valuation plaintiffs with high personal expected values of recovery at trial. It might be worthwhile for the defendant to renegotiate with the first group of early-settling plaintiffs if it would allow settlement with the second group of plaintiffs. This is true even if it would not be worthwhile to offer the first group of plaintiffs the same deal necessary to prevent trials with the second, high-valuation plaintiffs. In this respect, the MFN strategy can accommodate new information about the distribution of plaintiffs.

In contrast, the Bayer approach allows no renegotiation with early-settling plaintiffs. The combination of the large number of plaintiffs, an announced schedule, no confidentiality agreement, and

³⁰ See Schuck (1995) on importance of maintaining credibility and reputation because many actors are repeat players in litigation.

Bayer's reputation does not permit period two renegotiation of the settlement amounts. If Bayer were subsequently to discover large numbers of high-valuation plaintiffs with high expected probabilities of recovery at trial, its strategy would be sorely tested.³² As explained above, Bayer could have reached secret settlements with high-valuation second-period plaintiffs for amounts off the schedule. But, if discovered, this would harm Bayer's future litigation reputation.

The Bayer strategy also does not suffer from the problem of defining when an agreement is a settlement and when an agreement is a judgment that has arisen around some MFN agreements. For example, in a recent case one plaintiff received a substantially higher amount (\$50m) from the defendant after extensive negotiations in the judge's chambers led to a "judgment" in its favor.³³ The earlier-settling plaintiffs who had negotiated \$20m settlements with MFN agreements claimed that this outcome triggered the MFN. The defendant argued that the outcome was not a "settlement" which triggered the MFN but rather a ruling by a judge.³⁴ The cerivastatin strategy does not suffer from the problem of defining a judgment or settlement and the associated incentives that the defendant and second-period parties have in creatively labeling agreements.

The cerivastatin strategy is also perceived more positively than MFNs by courts and the public. Bayer has been able to successfully tout the transparency benefits of its approach. Indeed, one federal court cited Bayer's efforts in rejecting class-action certification (Langley, 2004). While of only limited legal relevance to the certification of

³¹ Interview with George Lykos (2007).

³² In fact, Bayer's counsel acknowledged that the strategy would have been very difficult to maintain in the face of even a few large plaintiff verdicts. Interview with George Lykos (2007).

³³ While most judgments occur after formal trial, this judgment was entered by the court after both parties consented to its jurisdiction.

class-action, Bayer's settlement policy was cited to show that Bayer made some effort to provide relief.

MFNs, in contrast, remain somewhat controversial because they are accurately perceived as tying the hands of the defendant to reach settlements that otherwise would occur. One federal judge rejected them explaining, "Because plaintiffs are 'straight-jacketed' by the most-favored-nations agreements with certain prior settling defendants, the strong public policies favoring complete settlement ... are being frustrated."³⁵ Similarly, the *Manual for Complex Litigation* (1977) warned that "the complications and even inequities which 'most favored nations' clauses almost always generate make their use undesirable." Other commentators have also criticized MFNs (Spier, 2003).³⁶ To the extent this creates doubt that they will be enforced, this may undermine their effectiveness as commitment tools.

Interestingly, the Bayer strategy has exactly the same characteristic that the use of MFN is criticized for: "straight-jacketing" Bayer from reaching settlements with later plaintiffs that otherwise would have been rational. Yet probably because this effect is less apparent, the Bayer strategy has not been criticized on those grounds.

Proof of Causation of Injury Was Relatively Direct

The relatively direct connection between cerivastatin and rhabdomyolysis aided the adoption of this commitment strategy. When

³⁴ Incidentally, the earlier plaintiffs lost with the court finding that the outcome was a "judgment" rather than a "settlement" and therefore did not trigger the MFN (Spier, 2003).

³⁵ In *Re Chicken Antitrust Litigation*, 560 F.Supp. 943, 947 (Ga. 1979).

³⁶ As Spier notes, the latest version of *The Manual for Complex Litigation* states "[MFN] clauses can provide an incentive for early settlement as well as an obstacle to later settlement." *Manual for Complex Litigation* § 13.23. See also *In Re Chicken Antitrust*

there are different groups of plaintiffs for whom the defendant can observe different case characteristics, the analysis becomes more complicated because different plaintiffs have incentives to pretend to be in higher-valuation categories of plaintiffs. Distinguishing between different classes may be difficult and expensive and plaintiffs may have incentives to obscure their class membership. For example, other mass tort cases may differ not only as to extent of injury but also as to proof of proximate causation. A former asbestos worker who alleges that asbestos exposure caused his non-mesothelioma lung cancer might be in a much stronger position if he denies smoking. With these complications the defendant cannot easily ascertain the strength of a plaintiff's claim.

Here, the relatively direct connection between cerivastatin and rhabdomyolysis and the absence of alternative causes of rhabdomyolysis facilitated the overall cerivastatin strategy. The diagnosis of rhabdomyolysis and the specific injuries suffered by the plaintiffs were verifiable by hospital records and there were limited opportunities for plaintiffs to pretend to be in another category or for other opportunistic behavior.

Worldwide Publicity Reduced Appeal of Confidentiality to Control Litigation Risk

Similarly, Bayer's decision not to press for confidentiality agreements is consistent with the literature on secret settlements and is intuitively understandable (Daugherty and Reinganum, 1999); Daugherty and Reinganum, 2005); (Shavell, 1997). This literature concludes that confidentiality agreements are more likely when they reduce the risk of future litigation. In this instance, the worldwide publicity surrounding Bayer's withdrawal of cerivastatin made concealing or downplaying the problem in the hopes of considerably reducing overall

liability implausible. Plaintiff's lawyers were attending "Baycol school" to prepare for the expected litigation. Clients were being actively solicited by mass media. Confidentiality agreements would do little to reduce the pools of plaintiffs' attorneys, the number cerivastatin claimants who were aware of the availability of compensation nor the number of future suits. Nor would confidentiality agreements provide any edge in the litigation by obscuring non-obvious legal theories of liability or causation. Since the problems with cerivastatin were known and appreciated by all, there was little chance of reducing liability exposure substantially by insisting on confidentiality agreements.³⁷

In contrast, other pharmaceutical defendants have sought confidentiality agreements in lower-profile cases. Pfizer used confidential settlements in the Feldene litigation and McNeil used confidential settlements in the Zomax litigation (Weiser, 1988) (Walsh, 1988). Similarly, Xerox used confidentiality agreements to settle suits that resulted from the leakage of trichloroethylene, a suspected carcinogen, into ground water near Webster, NY (Weiser, 1989).³⁸ In these instances, defendants sought to reduce their liability by minimizing publicity.

because it had "predatory intent".)

³⁷ The combination of structured interviews and informal economic modeling was methodologically interesting because I could see if the defendant's reasoning actually resembled the logic of the economic model. In other words, did Bayer's general counsel eschew confidentiality agreements because this helped Bayer commit to a single schedule of payments or did it do so for some other reason wholly unrelated to the informal economic model? In this case, the assumption of economic rationality seemed generally warranted: I found that the logic of the decisionmakers at Bayer generally followed that of the model.

³⁸ In that instance, the secrecy provision prevented cooperation with public health authorities.

Bayer's Ability to Credibly Litigate All Other Cases was a Prerequisite to this Strategy

Finally, Bayer's preparation for extensive litigation made credible their threat to litigate every non-rhabdomyolysis case and every rhabdomyolysis case for which plaintiffs did not accept the scheduled amount. Defense verdicts at several high-profile early trials (including some that involved plaintiffs with rhabdomyolysis) reinforced the perception of the strength of Bayer's position and their willingness to risk trials even in historically plaintiff-friendly jurisdictions. Bayer's retention of outside trial lawyers and preparations for training the necessary number of additional lawyers also signaled to plaintiffs that Bayer was prepared and able to defend these cases at trial without settling. In some other mass torts, the sheer number of claims, discovery requests, and trial dates led to the perception that a given defendant was unable to credibly defend the number of cases and was overwhelmed.³⁹

GENERAL PUBLIC WELFARE IMPLICATIONS OF BAYER'S STRATEGY

Effective commitment strategies of this kind have mixed effects on public welfare. They may reduce delay costs because plaintiffs have little incentive to engage in posturing about the amounts for which they will settle (Spier 2003). As a result, cases that would otherwise settle only on the eve of trial settle earlier because there is little chance of getting a better offer. All things being equal, this reduces both wasteful transaction costs of litigation (e.g., hiring lawyers to posture about reservation prices) and the costs of delay (the harm caused by delaying compensation to the injured).

However, an effective commitment strategy may lead a defendant to take a more aggressive posture and take more cases to trial. This may reduce plaintiff welfare and lead to increased litigation costs. As one

³⁹ Interview with Gary McConnell, 2007.

judge put it, it permits defendants to adopt a "Ulysses-tied-to-the-mast arrangement that enables them to convincingly stiff opt-outs who demand more."⁴⁰ This has social welfare implications because it leads to trials and litigation that would have been avoided absent the commitment mechanism. Finally, reduced net liability on the part of the defendant may inefficiently reduce incentives to avoid wrongdoing.⁴¹

Thus far, the chapter has analyzed Bayer's strategy exclusively as a form of commitment strategy in order to understand the incentives that Bayer might have had for adopting the degree of transparency that it required. But viewing Bayer's actions purely as an economic strategy is reductive and obscures several attractive features of the strategy that are difficult to model - issues that are connected with transparency.

First is the sense that Bayer took some responsibility for the harm that its product caused. The bare existence of a schedule suggests some acknowledgement on the part of Bayer. In ordinary life, one does not announce the existence of a schedule of payments while one loudly protests one's moral obligation to pay. The public existence of even a nonpublic schedule conveys the social meaning of acknowledging some responsibility. This is true even though a formal apology or acceptance of responsibility were not usually part of the settlement

⁴⁰ *In re Vitamins Antitrust Litigation*, 215 F.3d at 30 (Williams, J.) (Dist. D.C.) Similarly, another judge critical of MFN agreements argued, "Because plaintiffs are 'straight-jacketed' by the most favored nations agreements with certain prior settling defendants, the strong public policies favoring complete settlement ... are being frustrated." *In Re Chicken Antitrust Litigation*, 560 F. Supp. 943 (Dist. Ga. 1979).

⁴¹ Any liability (under either a strict liability or a negligence regime) will provide incentives to minimize future payouts by undertaking safety precautions. Under a negligence regime, the incentives will exist up to the point of where the defendant will not be found negligent. Under a strict liability regime, the defendant will have incentives to "purchase" safety up to the point where the decreased marginal liability costs equal the cost of the safety precautions. Under either type of regime, liability promotes a level of deterrence. See Shavell, 1987.

agreement.⁴² Miami plaintiff's attorney John Ruiz explained: "Bayer has responded in good conscience. They knew they had a problem and admitted they were wrong. In general the plaintiff's attorneys are pretty satisfied." He contrasted this behavior with the actions of American Home Products in fen-phen litigation (Kay, 2003). Ruiz also commented favorably upon the speed and efficiency with which the settlements were processed.⁴³ Similarly, Bayer did not attempt to conceal its settlements by requiring confidentiality agreements. Like the existence of a schedule, this action conveys the message of taking responsibility for wrongdoing. This contrasts with the sweeping confidentiality agreements that are often sought with settlements.

Bayer's actions convey this social meaning even if it has nothing to do with Bayer management's subjective motivations for pursuing this strategy. It may be that Bayer pursued this strategy purely as a way of minimizing overall payouts.⁴⁴

Second, Bayer's approach provided at least the appearance of horizontal equity: treating similarly situated plaintiffs similarly.⁴⁵

⁴² E-mail communication with George Lykos, September 27, 2007.

⁴³ Interview with John Ruiz, February 19, 2008.

⁴⁴ Of course, the "subjective" motivations of a corporate defendant are difficult to ascertain -- or even conceptualize.

⁴⁵ Absent access to the settlement data, it is impossible to confirm this.

Interestingly, the horizontal equity may have been only within national borders: Canadian plaintiffs appear to have been offered substantially less than US plaintiffs. According to the publicly filed class action notices, Canadian plaintiffs' payments were as follows: "Level I: Rhabdomyolysis contemporaneously with ingestion of Baycol. No hospitalization required: \$10,000; Level II: Rhabdomyolysis contemporaneously with ingestion of Baycol. Hospitalization was required but no dialysis was necessary: \$25,000 plus \$1000 for each day initial in-patient hospitalization for treatment of Rhabdomyolysis (specifically excluding rehabilitative care and chronic care); Level III: Rhabdomyolysis contemporaneously with ingestion of Baycol. Hospitalization was required and dialysis or other exceptional hospital treatment was necessary: \$50,000; plus \$1000 for each day of initial in-patient hospitalization for treatment of Rhabdomyolysis (specifically excluding rehabilitative care and chronic care) plus \$2000 for each dialysis treatment to a maximum of \$50,000; for a maximum total payment

Because of the lack of confidential settlement agreements and the existence of a schedule, plaintiffs had some assurance that they were not being treated substantially differently than other claimants for reasons that were unrelated to the injury they received. This is in marked contrast to the conventional settlement paradigm where factors such as the skill and reputation of the plaintiffs' and defendant's trial attorneys, the jurisdiction in which the plaintiff filed suit, and the judge to which the case is assigned can greatly affect the settlement amount.⁴⁶ Plaintiff's counsel John Ruiz commented that "it didn't matter who you were" and contrasted the cerivastatin experience with other pharmaceutical settlements.⁴⁷ In this respect it partially resembled a private sector version of the 9/11 Victim Compensation Fund and incorporated some of this approach's strengths.⁴⁸ Eliminating or

of \$100,000; Level IV: Rhabdomyolysis contemporaneously with ingestion of Baycol. Hospitalization was required. Person continues to require permanent dialysis on an ongoing basis or died of a cause directly attributed to rhabdomyolysis Under 30 years of age: \$175,000; 31-40 years of age: \$165,000; 41-54 years of age \$155,000; 55-69 years of age \$145,000; 70 years of age or more: \$130,000; Level V: Rhabdomyolysis contemporaneously with ingestion of Baycol which caused other serious injury not contemplated in Levels I-IV or claims where cause of rhabdomyolysis is disputed: Claims will be subject to mediation followed by binding arbitration if necessary. Notice to Users of Cerivastatin ("Baycol") in Canada and their relatives of Proposed Settlement of Class Action.

⁴⁶ The perception of horizontal equity, in addition to substantive horizontal equity, is independently important to the perceived legitimacy of the legal system.

⁴⁷ Interview with John Ruiz, February 19, 2008.

⁴⁸ Comparing the nature of the transparency that resulted from the VCF to the transparency that resulted from the Bayer settlement strategy is interesting and illustrates the priorities of the structuring authorities. In the VCF, the Special Master sought high participation among eligible claimants, but did not attempt to use the schedule as a commitment tool. Accordingly, he published a preliminary table that served as an initial bargaining position. Required confidentiality agreements with VCF claimants concealed the precise amounts agreed upon. In contrast, Bayer sought to use the schedule as a commitment tool but had no desire for publicity for its own sake. It therefore did the exact opposite of the special master - it did not publish the schedule but generally used no confidentiality agreements following agreement.

minimizing the effect of such criteria is a positive effect of Bayer's strategy.⁴⁹

But how important is horizontal equity in tort law? On the one hand, it seems like a self-evidently generally desirable characteristic. It is related to the core goal of law that that like cases should be treated alike. It has a distant constitutional cousin in the Equal Protection Clause of the Fourteenth Amendment. On the other hand, in practice, it is often ignored. There is no institutional mechanism to ensure that even two victims of the same car crash who receive identical injuries, for example, receive the same amount, even if both cases are tried before the same judge. The actual amount any given tort claimant will receive hinges upon the largely fortuitous circumstances of whether she was injured by a party who is legally responsible for her injury and has the resources to compensate. Many other factors completely unrelated to the seriousness of her injury will determine the outcome. Tort law's decentralized common-law adjudication of individualized claims is difficult to reconcile with any strong claims of the widespread existence of horizontal equity.⁵⁰ If it is truly an important goal, tort law does a remarkably poor job of serving it.

Perhaps weaker claims for the role of horizontal equity in tort law may be made. Because the defendant and the type of injuries recur, horizontal equity seems more important in mass torts than in other tort contexts where they may be more difference in the specifics of each

⁴⁹ According to press accounts, Bayer's schedule provided approximately \$1m in compensation for death from cerivastatin induced rhabdomyolysis. (Langley, 2004) For comparison, the average award for a death claim for the 9/11 Victim's Compensation Fund was \$2m with the median being \$1.7m.

⁵⁰ Rabin (1995) identifies the tension between individualized corrective justice and horizontal equity (what he calls "collective justice" as the central tension to the resolution of mass torts). See also Trebilcock (1989) (discussing importance of horizontal equity in justifications for administrative alternatives to tort law in New Zealand and elsewhere); Liebman (1976) (noting inconsistencies in

case. Peter Schuck (1995) argues that over time, a particular mass tort litigation may "mature": judges create mechanisms to handle the mass of claims and lawyers have an increasingly large sample of cases that are actually tried to verdict from which to calculate the expected value of a particular claim (Schuck 1995). Repeat players, judges and lawyers, work with each other to minimize transactions costs and develop informal unwritten settlement schedules that, ideally, provide compensation for the injured while resolving a company's liability. Ideally, this process increases horizontal equity. The cerivastatin settlement strategy could be seen as a successful attempt to vastly accelerate the maturity of this mass tort. Rather than generate a workable schedule after years of litigation, Bayer short-circuited the process and proposed an ostensibly fair way to compensate the injured without the unpredictability, variability of outcomes and expense of years of mass tort litigation.

The transparency that the Bayer strategy enabled was importantly limited. Not insisting on confidentiality settlement agreements is not nearly as transparent as publicizing the settlements or the schedule on which they are based. Neither Bayer nor the plaintiffs have publicized either the specifics of the settlements nor the schedule on which they are based. Similarly, much discovery was protected by confidentiality agreements. In this respect, the strategy is not nearly as transparent as a public trial and adjudication.

In sum, the cerivastatin strategy has both positive and negative implications for public welfare. On the positive side, the strategy reduced some litigation costs by encouraging plaintiffs to settle cases sooner than they otherwise might have. More intangibly, Bayer's approach suggested some responsibility for the harm caused by its product, provided an informal guarantee of horizontal equity, and was

definition of disability among federal benefits statutes and resulting inconsistencies).

more transparent than a conventional confidential products liability settlement. On the negative side, it may have reduced the number of settlements and probably increased the number of cases that were tried. It was also less transparent than conventional public trial.⁵¹

It also allowed Bayer to reduce the total amount paid out to cervistatin claimants as compared with a more conventional mass tort paradigm. If pharmaceutical mass tort litigation overdeters corporate misconduct and causes inefficiently high level of precautions to occur then this is a positive outcome. If, on the other hand, pharmaceutical mass torts underdeter harmful activity, then this reduced payout may inefficiently reduce future precautionary measures. Of course the tort system probably does both, depending on the specific product and the expected liability for it (Garber, 1993).

Similarly, the compensatory function of tort law was either well or ill-served depending on one's views as to the adequacy of Bayer's schedule. Press reports suggest that Bayer offered approximately \$1 m for a death from rhabdomyolysis. This is a generous settlement compared to that available to many victims of misfortune. On the other hand it is substantially less than the \$4-9 million dollars that the US labor and other markets implicitly assign to the value of a statistical human life (Viscusi and Aldy, 2003).

Ultimately, it is not possible, on the balance, to conclude that the Bayer settlement strategy either enhanced or reduced public welfare. Like many policy experiments, it is an interesting alternative whose advantages and disadvantages should be understood.

CONCLUSIONS AND POLICY IMPLICATIONS

Confidential settlement agreements are understandably decried as concealing important dangers from the public. Yet outright bans on

⁵¹ See also Hensler (1998) (discussing depersonalizing aspects of mass tort settlements).

confidential settlements may threaten the private character of tort litigation and may decrease settlements.⁵² Are there means to reduce confidential settlements voluntarily? This chapter addresses that question by examining the incentives faced by mass tort defendants in order to understand why confidential settlements might or might not be adopted in a particular litigation. In particular, I examine the non-confidential settlements that ended most of the cerivastatin litigation in order to understand these incentives.

Somewhat surprisingly, I found that mass tort defendants can actually benefit from eschewing confidentiality agreements under certain conditions. Promoting limited transparency among plaintiffs and their attorneys can allow the defendant to commit itself to offering a limited array of take-it-or-leave-it offers to plaintiffs. This analysis informally extends the settlement literature and provides a real-world example of how communications among plaintiffs can further the defendant's commitment strategy. Net public welfare effects are inconclusive: total compensation to claimants was almost certainly less than it would have been had Bayer sought confidential settlements but the process was also somewhat more transparent to plaintiffs and increased horizontal equity.

If policymakers decide that this model of limited private-sector transparency should be encouraged, there are two important policy implications that emerge from the cerivastatin experience. First, publicizing dangers reduces the incentives for defendants to demand confidentiality agreements as a condition for settlement. Since the problems with rhabdomyolysis and cerivastatin were highly publicized, there was little temptation for Bayer to attempt to reduce liability exposure by insisting on confidentiality agreements. In the cerivastatin case, the publicity resulted from regulatory inquiry and the subsequent withdrawal of cerivastatin. Regulatory inquiry and the

⁵² See Helland and Lee (*infra*) at 1.

existence of public fora for the discussion and dissemination of information about possible wrongdoing by defendants will therefore generally decrease the benefits of confidentiality agreements and encourage defendants to be more transparent in their settlement practices.⁵³ This reduced incentive for confidentiality is a non-obvious benefit of regulatory inquiry and subsequent publicity.

Second, Bayer's corporate reputation for maintaining its commitments played an important role in its commitment to avoid settling off the schedule. In other tort contexts, defendants may lack Bayer's reputation and thus be unable to credibly commit to not "cheating," even without confidentiality agreements. If legislatures wish to increase the chance of the cerivastatin experience becoming a model, they could facilitate some formal auditing mechanism to help defendants credibly commit to a schedule, perhaps in exchange for making the schedule itself public and thereby furthering transparency.⁵⁴ Alternatively, court-appointed special masters could serve this same function.⁵⁵

In some cases, this auditing system might benefit the public, plaintiffs, and defendants. If the schedules were public, the public would benefit from the increased transparency that would accompany such an approach. Rather than many tort settlements being shrouded by confidentiality agreements, the public would have access to the proposed schedule of payment and be assured that everyone was getting the same deal. Transparency and horizontal equity would be increased under this system compared to the status quo. In this respect it would resemble the 9/11 Victim Compensation Fund without the confidentiality agreements used in that example. Defendants would have an inexpensive means of

⁵³ Regulatory activity and advisories can catalyze this activity.

⁵⁴ See Ibanez (2008) for discussion of "Ulysses," a commitment-facilitating entity.

⁵⁵ Even absent government intervention, a defendant might hire an independent private-sector auditor to guarantee its commitment when the Bayer-style commitment strategy was sufficiently attractive.

credibly committing to a set of take-it-or-leave it offers of their own devising. As explained above, a commitment strategy is attractive to defendants in some circumstances as a way of reducing the overall costs of a mass tort. Plaintiffs would be assured of horizontal equity in their settlements and could quickly and inexpensively determine what the defendant's best offer would be. The wasteful pattern of lengthy pre-trial posturing succeeded by a flurry of settlements on the courthouse steps might be avoided. On the other hand, as explained above, the cerivastatin litigation strategy has important disadvantages.

Confidential settlement agreements and their limitation will undoubtedly remain controversial. This chapter describes the conditions under which mass tort defendants might rationally eschew them. Developing such an understanding might permit policy measures to discourage confidential settlement agreements short of an outright ban. At the very least, such understanding will help policymakers recognize the circumstances under which confidential agreements are most likely to occur.

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