A TRANSFORMATION OF AMERICAN BUSINESS DISPUTING? SOME PRELIMINARY OBSERVATIONS

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Introduction

Over the past generation, and particularly since the early 1970s, there has been an enormous increase in business litigation and other use of legal services in the United States. When it is noted at all, increased business consumption of legal services is usually attributed to a general, and generally unexplained, increase in the "litigiousness" of American society. Expenditures on legal services have increased among all three major categories of law "consumers" -- business, individuals, and government -- in the last two decades. But the growth in business consumption has greatly outpaced growth in consumption by individuals and government, with the result that business has recently emerged as the primary consumer in the rapidly expanding legal services market. Among varied indicators of this growth in business use of law:

- Over 1972-82, business legal fees for outside purchases of legal services (not counting "in-house" expenditures in corporate law departments) almost doubled in real terms -- thus registering a rate of growth more than four times the growth of national economic product. During this period, the business share of the total (expanding) market for legal services grew from 42 to 49 percent.

- Large law firms that primarily service businesses are growing much faster than the rest of the legal profession. In-house corporate legal departments have greatly expanded at the same time.
Corporations report spending more on litigation and other law-related expenses than in the recent past, and within corporate legal practice there is increased emphasis on litigation.

Contract cases (almost always involving at least one business party) have displaced torts as the most numerous category of cases in the federal courts.

In a growing portion of federal cases businesses are opposing other business firms, rather than individuals or government.

In this article, we begin to document and explain this surge of business use of law in the United States. We focus on business litigation, as distinct from other use of law.¹ Our discussion is divided into three parts.

In the first part ("The Growth of Business Disputing"), we assemble the scattered but accumulating evidence for the explosion in business litigation. This includes both direct evidence of increased business litigation, and such indirect evidence as the growth of corporate law firms, in-house counsel, and organizations promoting "alternatives" to costly litigation.

In the second part of our discussion ("Explaining the Increase in Business Disputing"), we speculate on possible explanations for the observed increase in business litigation. By definition, increased business litigation must result from either or both of two developments. Either, holding constant the

¹This places a severe limit on the analysis, since business heavily consumes the services of lawyers in non-litigious activity as well. The precise connection is between such litigation use and non-litigation use is far from clear. We lack any overall account of the role of law (both in litigation and non-litigation activity) in business governance. For the moment, however, we assume that there is a relation, and that the relation is positive. The basic reason for thinking this is that non-litigious use of law (be it the execution of a will or the perfection of the documents on a Wall Street deal) aims centrally at avoiding future litigation. As the threat of litigation increases, then, we would expect more non-litigious lawyering as well.
percentage of governance problems that lead to litigation the number of problems has increased. And/or, holding the number of problems constant, the percentage of those problems resulting in litigation has increased. It seems likely that both sorts of changes have occurred. On the one hand, the sheer number of commercial transactions has almost certainly increased -- and at a much faster pace than the gross value of economic activity. On the other, the viability and appropriateness (to particular transactions) of pre-existing non-legal governance mechanisms has almost surely been reduced by recent changes in the competitive position of American firms.

In a brief concluding section ("Possible Futures"), we speculate on the future of American business disputing, assess the significance of the phenomena under view, and suggest some directs for future research.

1. The Growth of Business Disputing

Over the course of the past generation, there has been a substantial change in the pattern of business disputing -- defined here as disputing between business firms. This includes changes in the number of such disputes, in the identities of the disputants, and in their subject-matter, complexity, stakes,

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2Recent years have seen many casual assertions about "litigation explosions" and "liability crisis" that rely on anecdote and on selective, unreliable data. See Galanter, "Reading the Landscape of Disputes: What We Know and Don't Know (And Think We Know) About Our Allegedly Contentious and Litigious Society," 31 UCLA Law Review 4 (1983); Galanter, "The Day After the Litigation Explosion," 46 Maryland Law Review 3 (1986). In contrast to this casual sort of argument, we attempt in what follows to document the change described here with as much specificity as the available evidence allows, indicating gaps in the data and problems in their interpretation. We present this evidence to expose it to response and challenge.
location, the modes and forums by which they are pursued, and expenditures on them.

For reasons detailed in Part 2, we suspect that these changes vary from one business sector to another. In this part of our discussion, however, we will ignore sectoral difference, and simply present scattered aggregate data, going back to 1960. No single source of data is capable of providing the definitive picture of American business disputing. Nor in most instances are the data direct and straightforward. But by combining observations from disparate sources we are able to construct an incomplete but revealing portrait of disputing trends. To reach our conclusion we rely primarily on data of two types: those which evidence the increased business use of the courts to settle

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4The selection of 1960 as a baseline satisfies several impulses. It is the time when Stewart Macaulay did the fieldwork, that is reported in his "Non Contractual Relations in Business: A Preliminary Study," 28 American Sociological Review 55 (1963), which provides us with an invaluable observational baseline on dispute handling in American business. It is sufficiently before the onset of those changes in business environment and practice that we employ to explain changes in disputing that it provides a useful "before." Incidentally, 1960 appears to many observers to be the time at which contemporary litigation patterns began to emerge. R. Posner, The Federal Courts: Crisis and Reform Cambridge: Harvard University Press (1985), refers (p. 80) to "the litigation explosion that began in a short period centered around 1960." See also p. 65 where he says the period 1958-62 represents a "sharp turning point." Cf. the observation of Bork, "Dealing with the Overload in Article III Courts," 70 F.R.D. 231, 232 (1976) that "the real acceleration [in case load] began in the 1960s."
disputes, and those which document increased corporate and business consumption of dispute-oriented legal services.

1.1 More Corporate Litigation

1.1.1 Contracts

The occurrence of litigated contracts cases between businesses strikes us as an important measure of business disputing because they are likely to arise from fundamental commercial relations rather than casual encounters. Because the relationships from which they arise are key components of business activity, we can take changes in contract cases as pointing to changes in those relationships.

Given this, perhaps the most striking piece of evidence for the increase in corporate litigation is the increase in contracts cases in the federal courts. Over the period 1960-1988, contracts filings in the federal District Courts increased from 13,268 to 44,027. This increase of 232 percent far outstripped the increase in tort cases, which grew by 128 percent over this period. Contract cases grew at an annual rate of some 4.4%

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5 In this discussion, the contracts category does not include either recovery cases (i.e., cases by the government seeking recovery of defaulted student loans or overpaid veterans' benefits) or cases that are in the federal courts under their "local jurisdiction." Except as otherwise noted, the source of data on federal court cases is the Annual Reports of the Administrative Office of the United States Courts. The statistical year ends on June 30 of the named year. Figures on filings are found in Table C-2.

6 We omit tort cases from our initial analysis since such a small portion of tort cases involve businesses on both sides. Of the 264 business vs. business cases that Ross Cheit found in the federal district court in Rhode Island (in four widely separated years), only 11 (4.2%) were tort cases. Cheit, Patterns, Table 1. However, we suspect that there may be a significant amount of disputing among businesses that are denominated as co-defendants in tort cases and we hope eventually to include tort litigation in our analysis.
percent, almost half again as fast as the tort growth rate of 3 percent. By 1988, contracts filings made up 18.4 percent of all civil filings, having surpassed torts as the largest category of civil litigation. The changing pattern of tort and contract filings are displayed in Figure 1.7

[ Figure 1 About Here ]

7A more detailed comparison of contract filings with torts and other leading categories is presented in Galanter, "The Life and Times of the Big Six," 1988 Wisconsin Law Review 921 (1988). How the steep rise in contract litigation has escaped the notice of those who have examined litigation patterns is itself an intriguing puzzle. Contract cases, an ethnographer of American legal life reminds us, hardly register as a disturbance and do not excite the same condemnation as other kinds of litigation. Thus David Engel reports of an Illinois county where:

[c]ontract actions...were nearly ten times as numerous as personal injury actions. ....One might expect that concerns about litigiousness in the community would focus upon this category of cases, which was known to be a frequent source of court filings. Yet I heard no complaints about contract plaintiffs being "greedy" or "sue happy" or "looking for the easy buck." Such criticisms were reserved exclusively for injured persons who made the relatively rare decision to press their claims in court. (Engel, "The Oven Bird's Song: Insiders, Outsiders and Personal Injuries in an American Community," 18 Law & Society Review 551, 575 (1984))

All Contracts and Torts Cases
Filed in Federal Dist. Courts 1960-1983

The ascendency of contracts over torts is particularly pronounced in the diversity jurisdiction i.e., in those cases in which the federal courts have jurisdiction because the parties are citizens of different states, as opposed to jurisdiction based on the existence of a question of federal law. In 1960, only 29 percent of contracts filings were based on diversity; in 1988, diversity cases were 73 percent of all contracts filings.\textsuperscript{8} Since the mid-1970s, there have been more contracts cases than tort cases in the diversity jurisdiction. In crude figures, diversity contracts filings have increased over 8 times during this period while diversity torts increased two and a third times. This changing pattern of tort and contract diversity filings can be seen in Figure 2.

\begin{itemize}
\item [ Figure 2 About Here ]
\end{itemize}

The diversity contract filings category includes many kinds of cases among various kinds of parties, so we must be cautious in taking its growth as a measure of increasing corporate litigation. However, there are grounds for confidence that much of the increase in diversity contracts cases represents an increase in cases involving businesses. The requirements that the parties be citizens of different states and that the claim be for a minimum of $10,000 (to satisfy the statutory requirement

\textsuperscript{8}The percentage of tort filings based on diversity of citizenship remained relatively unchanged, rising slightly from 64\% in 1960 to 68\% in 1986.
Tort and Contract Diversity Cases
Filed in Federal Dist. Courts 1960-1988

for exercise of the federal courts' diversity jurisdiction), keep out many small cases and cases among local actors. Also, the tendency of lawyers to invest more in federal cases screens out cases in which parties are unable or unwilling to undertake the larger investments.\textsuperscript{10}

Confirmation that the diversity contract category contains a significant admixture of business-related cases is provided by preliminary results of an analysis of federal litigation that identifies the presence of corporations as plaintiffs and defendants.\textsuperscript{11} Because this information is derived from a data set that includes only the first named party on each side, no matter how many parties there are and regardless of their relative importance, we believe it seriously undercounts the presence of corporations in diversity contract litigation. Even with this limitation, however we can see from Figures 3A and 3B that the number of diversity contract cases\textsuperscript{12} in which we know there were

\textsuperscript{9}The $10,000 requirement was raised to $50,000 by Act of Nov. 19, 1988, 102 Stat: 4646 (1988), codified in 28 U.S.C. 1332(a) and (b).


\textsuperscript{11}The discussion in this paragraph is based on data provided by Terence Dungworth of the Institute for Civil Justice. We are presently collaborating with Dungworth on a study that moves substantially beyond the data reported here. This study, which makes use of the Integrated Federal Court Data Base (available from the Inter-University Consortium for Political and Social Research), analyzes the litigation activities of the top 1,000 firms in the economy (500 industrials, 500 service firms) over the period 1971 to present.

\textsuperscript{12}For purposes of this analysis, we have taken only the largest of the three categories into which the Administrative Office of the Courts divides diversity contract cases. We have eliminated "Insurance" and "Negotiable Instruments" cases and used the figures only for "Diversity Contract--Other."
corporations on both sides rose from 518 in 1971 to 6277 in 1986. In 1971, these corporate vs. corporate cases made up only 5.5 percent of all diversity contracts cases; by 1986, they made up more than 19.7 percent. Over the course of these fifteen years, corporation vs. corporation cases grew 1,112 percent, over four times as fast as the total of diversity contract cases.\textsuperscript{13}

[ Figures 3A and 3B About Here ]

Two studies of business litigation in single federal districts have found comparable increases in contract filings. Ross Cheit, studying all the business versus business cases filed in the federal district court in Rhode Island, found that "Diversity Contract - Other" cases of this type rose from 7 in 1966 to 17 in 1973 to 34 in 1980 to 74 in 1987.\textsuperscript{14} Filings of business versus business contracts cases increased by 957 percent from 1966 to 1987; during this same period, the filings of all private contracts cases in the district court for Rhode Island increased by 432 percent.\textsuperscript{15}

\textsuperscript{13}This is an aggregate measure of corporate vs. corporate filings. Again, there may be very significant variation in the incidence of litigation. From one economic sector to another as well as among firms within particular sectors.

\textsuperscript{14}Cheit, Patterns at Table 1. Cheit's data provides strong support for our employment of increases in this category as an indicator of the growth of business litigation. Cases in the Diversity Contract -- Other category rose from 28\% of total business versus business cases in 1966 to 64\% of the much larger total in 1987.

\textsuperscript{15}In 1966 there were 34 private contract cases in the District of Rhode Island; in 1987 there were 181 private contract cases. 1966 Annual Report of the Administrative Office of the United States Courts, 175, Table C3; 1987, 185, Table C3.
Figure 3A

KNOWN CORPORATE VS. CORPORATE CASES
IN DIVERSITY CONTRACT - OTHER CATEGORY


Figure 3B

KNOWN CORPORATE VS. CORPORATE CASES
AS # OF DIVERSITY CONTRACTS - OTHER

Source: Federal Judicial Center, The Integrated Courts Data Base, (Machine readable records available from the Inter-University Consortium for Political and Social Research in Ann Arbor, Michigan.)
The surge of business versus business litigation is also documented in William Nelson's recent study of contract litigation in the Southern District of New York from 1960 to 1979. Nelson found that contract cases became an increasing portion of the caseload in this key commercial district and registered increases in complexity, size, and, presumably, cost.

Increases in complexity have to be measured indirectly. The available data indicates that contracts cases involve more docket entries, more judicial appearances, and are terminated at later stages in the adjudication process than other types of federal cases. Sampling federal contract cases in the Southern District of New York, Nelson found that while large contract cases were 17.9 percent more frequent in the 1970s than in the 1960s, these cases accounted for 29.3 percent of the increase in number of docket entries and in the number of judicial appearances.

Contracts cases have also increased in size. Nelson reports

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17It seems reasonable to assume that complexity will be reflected in the amount of case preparation and the number of issues addressed to the court. It also seems reasonable to assume that parties who have more at stake in a case will be willing to pay the costs involved in raising more issues and pursuing the case further in the process of adjudication. We recognize that stakes and complexity are not independent. Cf. the observation of Heinz and Laumann that "the discovery of a unique issue is likely to be a function of the amount of time that lawyers devote to a case, and thus of the amount of money that the client spends on lawyers. If the stakes are high, the problems can become very complex; if the client lacks money, his problems are likely to be routine." Heinz and Laumann, "The Legal Profession: Client Interests, Professional Roles and Social Hierarchies," 76 Michigan Law Review 1111, 1117 (1978).

18Nelson, op. cit., 461, n. 185.
that the average amount at stake in contract cases in the
Southern District of New York increased from $165,000 during the
1960's to $887,000 during the 1970's. Accounting for inflation,
this was a threefold increase for the decade of the 1970's
compared to the decade of the 60's.\textsuperscript{19}

Nelson develops another measure that we believe offers a
useful indicator of the complexity, size, cost and corporate
character in these contract cases— the extent to which large law
firms are involved in them. He estimated that during the 1960s,
a set of 43 major New York City law firms appeared in 17.5
percent of all contract cases in the Southern District. This
increased to an estimated 24.8 percent of the much larger number
of contract cases in the years 1971-79. "[L]arge firm
involvement substantially increased from an estimated 73 cases
per year to over 290."\textsuperscript{20}

1.1.2 Other Federal Cases Involving Businesses

Apparently there has been an upsurge of commercial
litigation that spills beyond the bounds of contracts. There has
been a rapid growth in other areas that might be identified as
business litigation such as intellectual property, bankruptcy,
and civil RICO cases.

Filings of intellectual property cases [i.e., patent,
copyright and trademark] provide an interesting indicator
because, unlike contract cases, these are cases in which firms
may dispute with competitors rather than with suppliers or

\textsuperscript{19}Nelson, at 415.

\textsuperscript{20}Nelson, at 416.
customers. As Figure 4 shows, there has been an overall increase in intellectual property filings that roughly parallels the increase in contracts cases. Intellectual property cases increased from 1,585 cases in 1961 to 6,059 cases in 1988.

[ Figure 4 About Here ]

The significant role of intellectual property litigation as a component of business disputing is suggested by Cheit's data on Rhode Island. In the four years that he studied, taken together, intellectual property disputes were just over a quarter of all business versus business disputes. Intellectual property and diversity contracts made up some 85 percent of all the business versus business cases that he found in the District Court.

Increased litigation with competitors is exemplified in Arthur Best's study of the filing of private suits under the 1946 Lanham Act, which allows competing businesses to sue for misleading advertising statements. "From 1946 to 1976, there were only 16 advertising cases under this provision. In the five years from 1980 through 1984, there were at least 49 such cases. The current annual rate of litigation under this statute is thus about 2,000 percent greater than the rate during the 30 years

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21 The other major set of cases that register disputes with competitors is private antitrust cases, but filings of these are closely linked to government policy.

22 Cheit, Patterns, at Table 1.

Intellectual Property Cases
Filed in Federal Dist. Courts 1960-1982

from the mid-1940s to the mid-1970s."

Since the Bankruptcy Reform Act of 1978 became effective, bankruptcy filings of all types have been on the rise. Between 1979 and 1987, the annual rate of bankruptcy filings nearly doubled from 298,492 to 547,640. But while the annual rate of overall filings was doubling, the annual rate of business filings under chapter 11 of the law was quadrupling from 5,557 to 23,675. And while chapter 11 cases represent less than 5 percent of all bankruptcy filings, on average they account for 43 percent of all work by bankruptcy attorneys.

The 1970 Racketeer Influenced and Corrupt Organization Act (RICO) created an entirely new basis of private civil litigation against businesses. Despite some court decisions that have discouraged civil RICO cases by nongovernmental parties, use of this new vehicle for litigating business disputes has grown to an average 1000 filings per year.

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27G. Robert Blakey, "Myths and Facts About Rico Reform" (1989) (Unpublished Manuscript). This should not be considered a net increase in business litigation, since the Dept. of Justice indicates that, as of 1985, 65% of the private cases for which data was available could have been brought under some other heading, especially as fraud cases. Oversight on Civil RICO Suits, Hearings before the Senate Judiciary Committee, 99th Cong., 1st Sess. at 127 (1985).
1.1.3 State Court Business Litigation

It is not possible to present comparable data on business litigation in the state courts. The available aggregate data portray trends that are quite distinct from those in the federal courts.\textsuperscript{28} Contract cases in federal and state courts seem to be populations of very different composition.\textsuperscript{29} The federal totals, as we have seen, contain a substantial number of what we have called business cases. We assume that the contracts category in


The most recent published data on state trends compares the rate of contract filings per 100,000 population for the years 1984 through 1989. Data was available for the general jurisdiction courts of thirteen states: over this period, the rate of contract filings increased in seven states and declined in six. National Center for State Courts, \textit{State Court Caseload Statistics: Annual Report 1988}, Table 14 (1990). The comparability of these state figures with federal court data and with each other is obviously quite limited. One reason is that there are vast differences in the required jurisdictional amounts in various state courts and in the monetary ceilings of their respective courts of limited jurisdiction. In the thirteen state courts of general jurisdiction for which contract filing data was available for 1988, the median rate of filings per 100,000 was 393; but the range was from a low of 9 to a high of 2741. \textit{Id.} Obviously, different strata of cases are being measured.

\textsuperscript{29}This different make-up reflects in part the preferences of business lawyers who, because most larger corporations can usually invoke the diversity jurisdiction, often can choose to file cases in (or remove them to) federal courts. These preferences may in turn reflect desires to avoid localism, appear before higher caliber judges, avoid (or enjoy) clogged calendars, appear in a forum with whose rules they are familiar, enjoy the convenience of appearing in a larger city, and so forth. Cf. Bumiller, "Choice of Forum in Diversity Cases: Analysis of a Survey and Implications for Reform," 15 \textit{Law & Society Review} 749 (1980-81).
the state courts contains a much smaller admixture of such cases— but, in the view of the vastly larger caseload of the state courts, not necessarily a smaller number of cases.

While we are confident that there is a substantial amount of business disputing in the state courts, it is lost in the vast composite labeled "contracts" and for the time being remains unavailable for separate analysis. But our sense that such

[30] Cheit found that in 1987 business litigation constituted 21% of the federal docket in Rhode Island while in the same year business litigation composed under 14%— perhaps as little as 8%— of the Rhode Island state docket. Cheit, Patterns.

[31] In 1987, the total number of civil cases filed in the federal courts was 238,982. Just over 16 million civil cases were filed in state courts— just over half of them in courts of general jurisdiction. National Center for State Courts, State Court Caseload Statistics; Annual Report, 1987 pp. 15-16 [1989].

[32] We suspect that on the whole the business litigation in state courts involves smaller businesses. Cheit finds that in Rhode Island, cases litigated in state courts mostly involve small "mom and pop" businesses and rarely involves the State's larger manufacturers. In contrast, cases litigated in federal courts frequently involve larger manufacturing concerns. Cheit, Patterns, 17-29.

[33] In interpreting these diverging patterns of large and ordinary contract cases, we should recall the well-documented long term decline of contract/property cases as a portion of the caseload of state courts. In a study of five counties prepared for the Council on the Role of Courts, commercial and property cases fell from 71.7% of filings in 1903-1904 to 32.3% in 1976-77. Arthur Young & Co. and Public Sector Research, Inc., An Empirical Study of the Judicial Role in Family and Commercial Disputes Table 10 (1981) (J.J. Pearlstein, ed.) (Washington: Department of Justice). In Alameda County, California, contracts and property fell from 57% in 1890 to 18% in 1970; in San Benito County the decline was from 58.1% to 12.3%. L. Friedman and R. Percival, "A Tale of Two Courts: Litigation in Alameda and San Benito Counties," 10 Law & Society Review 267, 281-283 (1976). In St. Louis contract and property cases fell from 54.5% in 1895 to 21.4% in 1970. W. McIntosh, "150 Years of Litigation and Dispute Settlement: A Court Tale," 15 Law & Society Review 823, 829 (1980-81). Using three reported data sets on state trial courts (including McIntosh and Friedman and Percival mentioned above), Kagan found that debt collection case filings as a percentage of total civil case filings fell from 33% for 1890 to 12.8% for 1970 in Alameda County, California; from
cases are there and may exhibit some of the same tendencies as
the federal cases is confirmed by several sets of data. Eugene
Flango and Craig Boersma compared federal diversity cases and
"corresponding" cases filed in 1986-87 in the state courts of
general jurisdiction in five urban counties.\textsuperscript{34} They found no
significant difference in the proportion of cases in which
corporate plaintiff was suing corporate defendant. Taking their
five counties together, corporate vs. corporate cases were 12.3%
of federal filings and 12.5% of state court filings.\textsuperscript{35} Peterson
analyzed trends in jury trials in both state and federal courts
in two major cities and found that:

There was only one constant change over time and across
jurisdictions: the increasing number of trials of
business/contract cases. Jury trials for such cases
increased continuously between 1960 and 1984 in both
jurisdictions. The number of trials roughly doubled every
five years in Cook County. By the 1980s, the resolution of
business or contract disputes became one of the principal

77.3\% for 1855-64 to 35.9\% for 1945-54 in Chippewa County,
Wisconsin; and from 85.2\% for 1820 to 4.5\% for 1970 in St.
Louis, Missouri. However, Kagan found debt collection case
filings in California municipal and small claims courts increased
between 1970 and 1980, indicating that some of the decline in
courts of general jurisdiction may be explained by diversion to
lower courts. R. Kagan, "The Routinization of Debt Collection:
An Essay on Social Change and Conflict in the Courts," 18 Law &
Society Review 323, 328-35 (1984). It may be that as
contract/property cases experience a relative decline, corporate
disputes make up a larger portion of them. We view this as
plausible because there has been less change in the factors
discussed—below in sectors such as retail
installation, home construction and repair, etc. than in other
sectors of business life.

\textsuperscript{34}V.E. Flango and C. Boersma, "Changes in Federal Diversity
Jurisdiction: Effects on State Court Caseloads," 15, Univ. of
Dayton L. Rev. 405 (1990). The five counties were Allegheny
County, Pennsylvania; Cuyahoga County, Ohio; Dade County,
Florida; Harris County, Texas; Oklahoma County, Oklahoma.

\textsuperscript{35}The percentage of corporate versus corporate cases varied
from 7% to 19\% in the five federal courts and from 7\% to 16\% in
the five state courts. Flango and Boersma, Table 13.
tasks of San Francisco juries. One-fourth of all civil jury trials in San Francisco during the 1980s involved a business or contract dispute, almost as many as involved automobile accidents.  

1.1.4 Arbitration

Businesses, we suggested, are taking more disputes not only to courts but also to other dispute resolution institutions. Arbitration, the most well established of these "alternatives," has flourished over the past decade. Arbitration tracks have been incorporated into many courts and use of free-standing arbitration forums has multiplied. A significant part of this use represents an influx of business disputes. The American Arbitration Association, the most prominent supplier of arbitration services, has maintained a count of filings for commercial arbitration since 1942. As Figure 5 shows, arbitration filings in their "Commercial" category rose from 818 in 1960 to 10,979 in 1988. Although there is limited information concerning what these cases are about and who is bringing them, it appears that few are brought by consumers, injury victims or employees, and that a sizable portion are by businesses against other businesses. 

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38Since at least as far back as 1983, the AAA has broken down these "commercial" cases into sub-types. Examples of cases within the American Arbitration Association "Commercial" category include "Franchise," "Computer Technology," "Patent, Licensing, and Trademark," and "Business Venture-Partnership" cases.
conclusion awaits analysis of the composition of the caseload, the arbitration pattern appears to parallel rising federal contracts filings.

1.15 Increased Use of ADR

In the past decade there has been a proliferation of new dispute resolution "alternatives" promoted by an ADR "movement" that has inspired a burst of creative innovation and experimentation. Over the past decade a number of non-profit institutions, foundations and academic centers have been established to advance the use of ADR techniques.\textsuperscript{39} Compared to earlier crusades for alternatives, the contemporary ADR movement is more informed by empirical learning, more theoretically sophisticated and more ambitious in scope. It proposes alternatives to litigation not only for small matters and intimate ones, but also for the legal heartland of large business disputes.

Although there are abundant indications of a growing interest by businesses and the legal profession in exploring alternative means for resolving business disputes, it is difficult to gauge the amount of corporate use of these

\textsuperscript{39}Such institutions have been created by industry (such as the Center for Public Resources) and by foundations (the National Institute for Dispute Resolution, funded by the Ford and Hewlett Foundations and the thirteen university-based centers of research funded by the Hewlett Foundation).
Figure 5

Commercial Arbitration Docket
of the American Arbitration Association

mechanisms. One indirect measure is provided by the willingness of corporations to commit themselves, at least in principle, to consider alternative means for resolving disputes once they arise. Since 1984, the Center for Public Resources has encouraged corporations to sign a pledge to this effect, and the number of corporations willing to make this pledge has grown steadily from an initial 46 to almost 500 today.40

[ Figure 6 About Here ]

Another indirect indicator is the multiplication of non-profit and for-profit providers of ADR services, such as Endispute, Judicate, and United States Arbitration, Inc.41 A recent survey of large corporations offers some confirmation for these indirect measures. Twenty-two of 30 ADR users indicated that they had increased their use of ADR techniques over the past five years.42 With a very low 8.3 percent response rate, this

40The CPR pledge reads, in part, "...In the event of a business dispute between our corporation and another corporation which has made or will then make a similar statement, we are prepared to explore with that other party, resolution of the dispute through negotiation or ADR technique, before resorting to full-scale litigation..." 2 Alternatives to the High Cost of Litigation 3 (March 1984). Figures on corporations taking the CPR pledge are from Alternatives to the High Cost of Litigation, July 1984, March 1985, March 1986, December 1987, October 1988, November 1988, January 1989, January 1990.


Figure 6

CUMULATIVE TOTAL OF SUBSCRIBERS TO Center for Public Resources' ADR Pledge

survey constitutes only weak evidence of ADR use. But its very existence is eloquent testimony to increased and continued interest in ADR for corporate disputing: a major law firm assigned a partner to produce it, hired an outside public relations firm to conduct it, and presented it at a one-day symposium that attracted over 300 in-house and outside lawyers.\textsuperscript{43} A scatter of available data suggest that the growth in corporate use of ADR is concentrated in contract disputes.\textsuperscript{44} 1.2 Enlarged Capacity for Litigious Disputing

We can get another reading on the growth of business litigation by examining the enlargement of the corporate capacity for conducting such disputes. Large "corporate" law firms provide services primarily to large corporations and other organizations.\textsuperscript{45} Since 1960 these firms have increased in size and number at a pace far greater than the general growth of the legal profession. In the late 1950s there were only 38 law firms in the United States with more than fifty lawyers.\textsuperscript{46} In 1985,


\textsuperscript{44}A CPR review of 48 ADR cases reported to their publication Alternatives found that contract was overwhelmingly the case type to which ADR techniques were applied. Center for Public Resources, "Survey of Legal Cost Savings," (1988) (Unpublished paper) (On file with the authors). The Donovan Leisure Survey, op. cit. 42, reports a similar finding.


there were 508.\textsuperscript{47} Large firms were larger. Firms with more than a hundred lawyers grew from fewer than 20 in 1960 to 251 in 1986. The accelerating growth of the large firms that serve corporations can be gauged by our analysis of their annual growth rates. During the decade from 1955-1965, a group of fifty of the largest firms grew at an average yearly growth rate of 5.3 percent; from 1975 to 1985, those same firms grew at an average yearly rate of 8 percent.\textsuperscript{48}

Not only are there more big firms and bigger ones, but the work they do has shifted away from the provision of routine office lawyering to include a higher portion of litigation and other risky or contested transactions.\textsuperscript{49} The shift in one prominent firm is marked in this 1978 account:

...at Cravath, Swaine & Moore, which has such blue-chip clients as IBM, CBS, Westinghouse and Chemical Bank, ten years ago, litigation was about 20 percent of Cravath's "total effort." Now more than 40 percent of the firm's manpower is so occupied.\textsuperscript{50}

Increasingly, firms perform specific designated tasks for


\textsuperscript{48}Galanter and Palay, \textit{Tournament of Lawyers: The Transformation of the Big Law Firm} (University of Chicago Press, 1991), p. 46. This pattern of accelerating growth is not confined to the largest firms. A second group of fifty large firms, corresponding to those listed as the 200 to 250th largest in the National Law Journal 250 for 1988, grew at an average annual rate of 5.5% from 1955-1965 and 8% from 1975-85.


corporate clients who use many law firms, rather than providing comprehensive service for clients on general retainer arrangements.\footnote{Chayes and Chayes, at 294. Generally, see Galanter and Palay, at 50.}

1.2.1 Corporate Law Departments

The increase in the size and number of corporate law firms is not simply a shift of corporate capacity for conducting disputes from in-house legal departments to outside counsel. At the same time that outside law firms have been growing in number and size, in-house corporate law departments have also been growing in size and responsibility.\footnote{There is some indication that there are more large corporations that have corporate law departments. A 1959 survey of manufacturers found that 134 of the 286 companies surveyed had legal departments. A 1987 survey found that 74 of the 126 manufacturing companies replying had in-house counsel. This is an increase from 47% to 59%. The comparability of these surveys, however, is unclear. National Industrial Conference Board (1959), "Organization of Legal Work," 16 The Conference Board Business Record, 463-468. Arthur Andersen & Co., "The Corporate Market for Legal Services," 4, Exhibit 3 (Chicago, Arthur Andersen).} And the fact that both sectors of the corporate bar are growing provides further evidence of business interest in increasing legal capacity.

and 1984.54 This increase was general rather than confined to a few economic sectors. A 1985 Arthur Andersen survey found that between 1980 and 1985 there was an increase in the number of corporate counsel in 14 of the 17 industry sectors they surveyed, with increases of 44 percent to 95 percent occurring in banking, brokerage, communications, utilities, leisure and publishing, and health care.55 A 1987 American Corporate Counsel Institute [ACCI] survey of eight industrial sectors found that between 1982 and 1987 there had been an increase in the size of corporate law departments in all eight.56

With increased size has come increased responsibility. While law departments formerly confined themselves to processing routine corporate legal matters and left major transaction and litigation work to outside counsel, they are now undertaking more work that once would have gone to outside lawyers.57 A series of

54Arthur Young survey reported in "A New Corporate Powerhouse: the Legal Department," Business Week, April 9, 1984 at 66.

55Arthur Andersen, at 4, Exhibit 3.

56American Corporate Counsel Institute Corporate Law Department Trends and the Effect of the Current Bar Admission System: A Survey of Corporate Counsel (1987) (Washington, DC: American Corporate Counsel Institute) [Hereinafter "ACCI"]). The ACCI sent questionnaires to a sample of 1,209 non-Fortune 1000 companies from a list of 2,418 American Corporate Counsel Association members. They had a response rate of 28.3%. The ACCI also sent questionnaires to 992 Fortune 1000 corporations. They had a response rate of 26.2%

57Berkow and Spiciarich, "Inside Counsel Gets More Competitive," National Law Journal, Nov. 4, 1985, at 13; Strasser, "The In-House Lure Gets Stronger: Corporations Compete for Best and Brightest," National Law Journal, July 22, 1985, at 1. Commercial contracts tends to be the area of legal activity most frequently handled by in-house counsel (as compared to antitrust, compliance with governmental regulation, litigation, securities work, and labor). This pattern appears to be consistent across various industrial sectors. Arthur Andersen,
surveys by Altman & Weil, Inc. showed that from 1976 to 1982, the percentage of firms reporting that in-house counsel do three-quarters of the corporation's legal work increased from 56.0 percent to 66.5 percent.\textsuperscript{58} Some in-house counsel now conduct some or all of their litigation.\textsuperscript{59} The 1987 ACCI survey found that 60 percent of their respondents whose organizations litigate in-house reported an increase in the size of their in-house litigation staffs during the previous five years.\textsuperscript{60}

With such growth in the capacity and range of functions of in-house corporate legal departments, in turn, the relation of those departments to outside counsel has shifted from comprehensive and enduring retainer relationships\textsuperscript{61} toward less

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\textsuperscript{59}"Outside counsel if he is involved at all, need only supply local support services." Temporary needs for more staff can be supplied "by the growing practice of leasing lawyers." Salibra, "Controlling the Cost of Litigation," International Financial Law Review, February 1986, at 28. See also "Ma Bell: Top Lawyer Employer," National Law Journal, Feb. 4, 1980, at 25.

\textsuperscript{60}ACCI, at 11.

\textsuperscript{61}A 1959 Conference Board survey on the legal work of 286 manufacturing corporations found that "three fourths of them retain outside counsel on a continuing basis....Companies most frequently report that 'present outside counsel has been with us for many, many years,' or that 'we are satisfied with the performance of our outside counsel and have never given any thought to hiring another.'" 16 The Conference Board Business Record 463, 464 (1959).
exclusive and more task-specific ad hoc engagements. In a 1980 survey of corporate law departments by the National Law Journal, one quarter of the corporations responding reported that they no longer use a general outside counsel. In their relationship with outside law firms, today's enlarged corporate legal departments impose budgetary restraints, exert more control over cases, and engage in comparison shopping among firms.

1.22 Expenditures on Legal Services

The legal services sector plays an increasingly important role in U.S. economy -- producing a larger share of national product and receiving a larger share of national income. Between 1960 and 1985, the legal services share of Gross Domestic Product (GDP) roughly doubled, rising from 0.59 to 1.17 percent. Between 1960 and 1983, its share of national income also nearly doubled, rising from 0.52 to 0.98 percent. Given the growth of the underlying economy, of course, this growth in share signifies very substantial increases in the absolute size of the legal

62 Chayes and Chayes, at 294.


67 The Legal Services component of the National Income is not available for 1985 in published statistics.
services industry. For example, over 1967-82 alone, in constant 1982 dollars, gross receipts by U.S. law firms with a payroll increased from $14.57 to $34.30 billion.\textsuperscript{68}

As the size of this legal services "pie" was increasing, businesses were buying a greater share of that pie. In 1967, individuals bought more legal services than businesses, government, and other clients combined. By 1982, the share purchased by businesses had surpassed the share purchased by individuals. The business share grew from 39 percent to 49 percent, while the share purchased by individuals declined from 55 percent to 45 percent.\textsuperscript{69} Table 1 summarizes these changes. Figure 7 shows the change in the portion of purchases of legal services by different buyers.

\begin{center}
[ Table 1 About Here ]
\end{center}

\begin{center}
[ Figure 7 About Here]
\end{center}

\textsuperscript{68}While this data does not include gross receipts of law firms without a payroll, this is a small and decreasing segment of the legal services industry. Gross receipts by law firms without a payroll as a percent of gross receipts by all law firms decreased from ___% in 1967 to 7.04% in 1982. In 1982, gross receipts by law firms without a payroll were only $2.63 billion out of a total gross receipts by all law firms of $36.93 billion.

\textsuperscript{69}The share of total legal services purchased by government decreased during this period. U.S. Dept. of Commerce, Bureau of Census, \textit{Census of Service Industries, "Legal Services,"} 1972 (Table 4), 1977 (Table 9), and 1982 (Table 30). Figures for 1967 are from Richard H. Sander and E. Douglas Williams, "Why Are There So Many Lawyers?," Perspectives on a Turbulent Market, 14 \textit{Law & Social Inquiry} 431, Table 5 (1989) [hereafter Sander and Williams]. "Figures for 1967 are estimates derived by combining data on the receipt distribution for a subsample of firms of varying sizes with data on the total distribution of firms by size."
<table>
<thead>
<tr>
<th>Year</th>
<th>Suppliers of Legal Services</th>
<th>Consumers of Legal Services</th>
<th>Other Clients &amp; Sources</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total Number of Receipts by Suppliers</td>
<td>Total Suppliers</td>
<td>Individuals</td>
</tr>
<tr>
<td>1967:</td>
<td>77,282</td>
<td>$20,785,394</td>
<td>100.00%</td>
</tr>
<tr>
<td>1972:</td>
<td>94,882</td>
<td>$24,671,064</td>
<td>100.00%</td>
</tr>
<tr>
<td>1977:</td>
<td>115,407</td>
<td>$34,325,371</td>
<td>100.00%</td>
</tr>
<tr>
<td>1982:</td>
<td>15,270,087</td>
<td>16,699,757</td>
<td>1,101,112</td>
</tr>
</tbody>
</table>

**Sources:**
1) U.S. Department of Commerce, Bureau of the Census, "Census of Service Industries: Legal Services," 1972, Table 4; 1977, Table 9; and 1982, Table 30. All receipt figures express $1,000's in 1982 dollars.

2) 1967 percentages for "Consumers of Legal Services" are estimates from Richard H. Sander and E. Douglass Williams, "Why Are There So Many Lawyers?" Table V (1988) (Unpublished Manuscript). These percentages are "estimates derived by combining data on the receipt distribution for a subsample of firms of varying sizes with data on the total distribution of firms by size." 1967 percentage of "Government" expenditures includes expenditures by other clients and sources.
Sources: (1) U.S. Department of Commerce, Bureau of Census, "Census of Service Industries: Legal Services," 1972 (Table 4), 1977 (Table 9), and 1982 (Table 30).

(2) Figures for 1967 are from Richard H. Sander and E. Douglass Williams, "Why Are There So Many Lawyers?" Unpublished Manuscript, 1988 (Table V). "Figures for 1967 are estimates derived by combining data on the receipt distribution for a subsample of firms of varying sizes with data on the total distribution of firms by size."
What Table 1 indicates is that while real individual expenditures on legal services increased 40 percent over 1972-82, real spending by business increased by 90 percent. Business expenditures on legal services have grown at better than twice the rate of individual expenditures. Moreover, even these figures understate the growth of total business expenditures, since they record only expenditures on outside lawyers. To this must be added the greatly increased spending on in-house legal services during this period. 70

1.3 Summary

In spite of incomplete and imperfect data, it thus seems clear that business has a much greater capacity for litigation than it did 20 years ago, and that a rising number of business disputes are not being resolved by the parties among themselves but are being brought to courts and various other forums. We can envision a "pyramid" of business disputes the base of which is formed by all the troubles and disappointments experienced by businesses. The next layer is formed of those troubles that are attributed to some external agent, and the next layer consists of those instances in which a claim is expressed to that party.

70 For exclusion of in-house legal services from Census of Service Industries, see the introduction to the U.S. Department of Commerce, 1982 Census of Service Industries, iii-vi (1985) (Washington, D.C.: Dept. of Commerce). Cf. Sander and Williams, who estimate the total value of legal products not included in the Census of Service Industries (produced by lawyers inside corporation, government, and legal aid societies) to be approximately $18 billion. "There are approximately 200,000 attorneys practicing law outside of law firms. Assuming that the average income of those attorneys is $45,000 and the overhead costs of each attorney are, on average, equal to his or her salary, the value added by these other legal activities would be approximately $18 billion." Sander and Williams (1989), 435, n.10.
Some of these claims are disputed; a smaller number of these are taken to lawyers; and successively smaller fractions result in filings, in trials, in appeals, and so forth. Figure 8 provides a schematic depiction of such a "dispute pyramid."

[ Figure 8 About Here ]

Using the pyramid image, our description of increased business litigation can be summarized as an observation that an increased area is occupied by the upper layers of the pyramid. Two different interpretations of this increase are possible.

First, we might think this enlargement of the upper layers of the pyramid simply reflected an increase in the aggregate size of the pyramid. The top layers may cover more area, but that area could remain an unchanged proportion of a larger base of dealings, injuries and grievances. We might have more litigation because, and only because, we have more underlying transactions and injuries.

Alternatively, it may be that the shape of the pyramid has changed as a consequence of the fact that a greater share of transactions eventuate in injuries, or injuries in grievances, or grievances in claims, and so forth. If this occurred, the top of

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71 This is an abbreviated account of the dispute pyramid, omitting many of the obvious complexities. For a fuller account, see Galanter, "Reading the Landscape of Disputes: What We Know and Don't Know (and Think We Know) About Our Contentious and Litigious Society," 31 UCLA Law Review 4, 11 (1983). The techniques of measuring these dispute pyramids were developed by the Civil Litigation Research Project. See Miller and Sarat, "Grievances, Claims and Disputes: Assessing the Adversary Culture," 15 Law & Society Review 525 (1980-81); Felstiner, Abel and Sarat, "The Emergence and Transformation of Disputes: Naming, Blaming, Claiming...," 15 Law & Society Review 631 (1980-81).
Figure 8

A Schematic Dispute Pyramid of Business Litigation
the pyramid could grow without corresponding changes at the bottom.

Regarding this second interpretation, it is important to stress that, to a degree proportionate to the prior effectiveness of the intermediate mechanisms that screen injuries from emergence into filings,\textsuperscript{72} enormous percentage increases in filings can result from small percentage declines in screening effectiveness. For example, assume that the prior effectiveness of screening mechanisms was very high, on the order of 99 percent; thus only 1 percent of injuries would result in litigation. Assume then that the effectiveness of this screen drops marginally, to 98 percent, with the result that 2 percent of injuries now result in litigation. In this hypothetical, a decline in screening effectiveness of only 1.01 percent\textsuperscript{73} results in a 100 percent increase in the incidence of litigation.

At this point we cannot test which of these sources of increased litigation -- more disputes alone, or less effective screening mechanisms -- dominates in accounting for the growth of business litigation. For reasons detailed in the next section, however, it seems safe to assume that both have occurred.

2. Explaining the Surge in Business Disputing

How is the surge of business disputing to be explained? The limitations of the sorts of data on which we have just relied (and we have relied on such data because we know of no other)

\textsuperscript{72}The inverse of the (unsigned) slope of the pyramid.

\textsuperscript{73}That is, 1 (the decline)/99 (the previous screening rate).
preclude the development and testing of a truly satisfying model of litigation. A satisfying model of business litigation would be a model specified at the microfoundational level of individual firms, or classes of firms (controlling for variation in size, product market, and other potentially determinative predicates). To develop and test such a model, however, we would need a record of variation in litigation across firms, or at least sectors, in the economy. As a practical matter (that is, excepting infinitely expensive attempts to recover data), however, such records do not exist.\footnote{A partial exception to this generalization is the Federal Courts Data Base, which we are presently mining with Terence Dungworth. See note 11, supra.}

These limitations admitted, in this section we attempt to make some progress in thinking about increased business litigation by engaging in a four-step exercise, tacking back and forth between the analytics and empirics of litigation. In the first two steps, we abstract from changes in the number of transactions in the economy. First, we consider the simple economics of the litigation decision, as clarified by conventional models of that decision. While we have many problems with such models, they at least have the merit, we assert, of specifying some of the variables worth tracking in an explanation. Second, we put the litigation decision in the context of alternative mechanisms of business governance and the presence of long-term-continuing-relations among firms. This has the effect of directing attention to additional, and commonly intervening, variables. Third, we indicate, in light of the
preceeding discussion, the sorts of changes in an actual economy that might be thought to increase business litigation -- by increasing the number of disputes, or the values of the "litigation favoring" variables just identified. Fourth, we look to the actual experience of the American economy since the early 1970s for evidence of such changes.

2.1 Initial Variables: The Simple Economics of Litigation

With conventional economic modelers of litigation, we make the assumption that firms are wealth maximizers. On this assumption, firms can be expected to initiate a lawsuit (or respond to one with a full legal defense, rather than a settlement offer) when the costs of litigation are exceeded by its expected benefits. In the familiar model of Priest and Klein, a dispute will be litigated if:

\[ P_p - P_d > (C - S)/J, \]

where:

\( P_p \) is the plaintiff's probability estimate of a liability verdict, \( P_d \) is the defendant's estimate of the same, \( C \) is the combined costs of litigation for the parties, \( S \) is the combined costs of settlement, and \( J \) is the size of the judgment if liability is found.\(^7\) Other things being equal, this model thus

\(^7\) Priest and Klein, "The Selection of Disputes for Litigation," 13 Journal of Legal Studies 1 (1984), at 13. Where Macaulay concentrated on the informal and embedded character of most business disputes, and practices of dispute resolution, Priest and Klein consider, more abstractly, the strategic filters that limit firms' recourse to litigation. Their basic model is simple enough. In considering whether to initiate a lawsuit (or to respond to one with a full legal defense, rather than a settlement offer), what matters are the parties' respective estimates of success in the suit, the respective costs of litigation and settlement, and the size of the judgment if liability is found.

Priest and Klein also consider the effects of inequalities
predicts increased litigation upon an increase in the difference between the parties' probability judgments of success ($P_p - P_d$), a decrease in the combined costs of litigation ($C$), an increase in combined settlement costs ($S$), or an increase in the size of judgments if liability is found ($J$).

Even leaving aside the assumption of wealth maximization, there are problems with this model. For one thing, it is not a model of strategic action, or the behavior of parties who, in

in the stakes of the parties in the dispute. Where the defendant has more to lose than the plaintiff has to gain, they predict more settlement; where the reverse holds, more litigation. The likelihood of litigation rises as the parties' estimates of the likelihood of a finding of liability diverge, if costs of litigation decrease, or if the settlement costs or value of the judgment increase.

The Priest-Klein model has much of the ex post facto obviousness of good social science. While it is of course an abstract model -- i.e., it does not assign specific values to the variables it considers relevant -- it has the virtue (common to all good models) of providing a simple identification of key variables, and the direction of their effects; in locating the sources of increase in the production of litigation. It tells us "where to look."

To be sure, the "microfoundations" of this model may be reasonably considered incomplete, or even tendentious. As a model of strategic behavior, for example, it assumes selfish and optimizing behavior on the part of actors. This assumption presents problems in understanding the real world, where individuals (and even organizations) are often moved by interests other than economic gain, and where species of "satisficing" behavior (muddling through, under conditions of imperfect information) dominate even within the business community. But this is a fault we share (pending the development of a rigorous way to think about non-selfish behavior), at least provisionally, in the account we wish to offer.

This might be questioned on two grounds: that firms are interested in maximizing something other than wealth (e.g., managerial salaries), or that they are not best understood (for such reasons as bounded rationality and the claims of habit) as maximizing anything. There is evidence for both qualifications, but again, we can live with them.
contemplating a course of action, take into account the effects of that action on the behavior of others. This is a real problem in considering litigation, since that is an activity that is intrinsically interactive, in which outcomes are jointly produced, and where strategic gaming may be assumed to be ubiquitous. In addition, the model assumes away various information and agency problems of relevance to the

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77The interactive character of litigation is captured in the old joke that "If there's only one lawyer in town, the lawyer starves; if there are two lawyers, they both get rich." A lawsuit against one party almost always calls forth a response from the attacked party (this is where the meters start spinning, and both lawyers get "rich"). In view of this, much of good lawyering consists in the ability to predict the sort of response that will be elicited, and then to choose the most appropriate line of attack (or bluffed attack) to make in the first place. In brief, much of good lawyering consists in the ability to frame a course of action in light of the action of others, or to frame a strategic course of action.

78Possible asymmetries in information possessed by the warring parties is the most important.

79Are lawyers perfect agents for firms? Even assuming that lawyers wish to be (some advocates of lawyer "professionalism" argue that they should not so wish), it seems unlikely that they are. As in other professional contexts (e.g., medicine), the difference in knowledge between the provider and consumer not only makes provider discretion possible, but necessary. And even with the best will in the world, the discretionary provider can be expected to offer services departing from what the consumer, on perfect information, would wish to consume.

Our colleague Bill Whitford, after a large study (joint with Lynn Lopucki), of bankruptcy negotiations, underscores these agency problems in the bankruptcy context, where legal rules are notoriously uncertainty. That uncertainty can lead to litigation, as Priest/Klein would predict. Equally, however, uncertainty enlarges the space of settlement strategies acceptable to clients. Wishing to "succeed" for her client, the bankruptcy lawyer finds that ambiguities in the law permit all manner of settlements to be advertised as "victory." And since lawyers for both sides wish to make their clients happy (a goal different from maximizing their client's wealth), this creates powerful incentives to settle.
litigation/settlement tradeoff. Finally, on plausible assumptions about litigation costs, the model in fact predicts no equilibrium for the incidence of litigation, one of its central goals.\textsuperscript{80}

If the traditional neoclassical model tells us little or nothing about when firms will actually litigate, however, it remains useful at least in decomposing some of the cost and benefit terms that can be assumed to animate firms in making the litigation decision. Taking the terms it applies to individual decisions, moreover, it suggests that for an exercise such as ours, attempting to account for a global increase in litigation, it is worth paying attention to changes in business transactions or their commercial or legal environment that might produce greater uncertainty about the application of legal rules, greater stakes of parties in individual disputes, reduced litigation costs, or greater costs of settlement.

2.2 Additional and Intervening Variables: Litigation in the Context of Alternative Business Governance and Long-Term Continuing Relations

If these are among the sorts of variables to be considered in the analysis of litigation decisions, it is important, in getting a purchase on such decisions, to keep the real-world economic context of litigation squarely in mind. This context

\textsuperscript{80}This point was suggested to us by our colleague Neil Komesar. Komesar's plausible assumption is that litigation costs increase as one moves toward the margin of legal certainty. If that assumption is credited, however, then there is no reason to assume that litigation centers on that margin, as Priest/Klein centrally contend.
actually determines the value of most of the variables just noted.  

By way of introduction to this context, we can advert to a point implicit in the very notion of a "dispute pyramid" of the sort considered in the previous section: only a small fraction of all disputes are litigated. Far more common is resolution of differences by negotiation, compromise, exit from the relationship giving rise to the dispute, or informal sanction of the party violating the terms of that relation. Litigation is only one form of business "governance" (simply, the rules and sanctions regulating inter-organizational dealings) necessary to secure orderly commercial dealings. Alternatively, markets,  

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How context affects stakes, litigation costs, and settlement costs will become evident in the next section. How it affects legal uncertainty is indirect, but proceeds through the effects on established firm practice (the typical legal frame invoked in commercial disputes).

In what follows, we speak of governance as pertaining to relations among firms, not within them.

Competitive markets generalize performance standards for firms, and ensure that firms that do not meet those standards (i.e., that are not competitive) are extinguished. It is difficult to think of a more exacting form of regulation. Real-world markets also sometimes (usually?) provide incentives to the fulfillment of contractual terms, since non-fulfillment risks loss of future sales. The more precise conditions under which this latter effect is sustained are explored in Lein and Leffler, "The Role of Market Forces in Assuring Contractual Performance," 89 Journal of Political Economy 615 (1981), the conclusion of which is summarized thus:

A necessary and sufficient condition for performance is the existence of price sufficiently above salvageable production costs so that the nonperforming firm loses a discounted stream of rents on future sales which is greater than the wealth increase from nonperformance. This will generally imply a market price greater than the perfectly competitive price and rationalize investments in firm-specific assets.
the state,\textsuperscript{84} the bonds of community,\textsuperscript{85} labor organizations,\textsuperscript{86} associations of business firms\textsuperscript{87} or individual firms,\textsuperscript{88} may

\textsuperscript{84}How the state does this is broadly familiar. It exercises regulatory powers in setting prices, labor protections, product standards, licensing requirements, and the like. It plays an essential role in giving force to private contracts. And it constitutes the legal personalities and affects the resources of exchanging parties through its articulation and enforcement of private and public rights.

\textsuperscript{85}In what follows we neglect the possible role of communitarian norms in shaping business practice. We are not yet sufficiently jaundiced to believe that they play no role in the real world, however.

\textsuperscript{86}One traditional, though in the U.S. traditionally neglected, role of unions is to supply regulation to otherwise chaotic markets. Unions do this by controlling the supply of labor, an essential input in production, and using that power to compel acquiescence by firms to certain standards of wages, benefits, and working conditions, to order the introduction of new technology, impel investment, and the like. For recent work emphasizing the importance of this regulatory union role (or the failure to secure it) in the U.S., see S. Vittoz, \textit{New Deal Labor Policy and the American Industrial Economy} (1987); J. Bowman, \textit{Capitalist Collective Action: Competition, Cooperation, and Conflict in the Coal Industry} (1989); Rogers, "Divide and Conquer: 'Further Reflections on the Distinctive Character of American Labor Laws,'" 1990 \textit{Wisconsin Law Review} 1; C. Gordon, "New Deal, Old Deck" (PhD dissertation, Department of History, University of Wisconsin-Madison, 1990). On Europe, see J. Visser, \textit{The Search for Inclusive Unionism} (1990).

\textsuperscript{87}The importance of business associations in securing order in inter-firm dealings was a central theme in discussions of "democratic corporatism," and has survived increasing doubts about the viability of that form of social coordination. For several case studies, as well as an essay from the editors distinguishing associative regulation from other sorts of regulation, see W. Streeck and P.C. Schmitter (eds.), \textit{Private Interest Government: Beyond Market and State} (1985). For recent reviews of U.S. experience with business associations, see Rogers and Gordon, supra note 76.

\textsuperscript{88}Firms "govern" business regulations in many ways. Among them: by forcing issues of legal interpretation and implementation, lobbying for government action, or in other ways influencing the exercise of state authority over commercial dealings; by forming trade associations that typically impose behavioral obligations on member firms (ranging from assumption of master agreements in collective bargaining to uniform product standards); and by entering into informal agreements with other firms (suppliers, competitors, customers) to assure profitable
perform this role. Most commonly, of course, some significant number of these mechanisms are in play, with litigation playing a distinctly minor and supplementary role.

The existence of these alternative mechanisms of business governance not only reminds us of the relatively minor role of litigation in settling differences among business firms. It also tells us something about the litigation decision itself. Briefly, that decision is best understood as a choice among alternative governance mechanisms. Suffering from a commercial injury, an aggrieved business party typically has choices more numerous than either "eating" the harm or initiating a lawsuit against its author. Instead, the aggrieved party can choose among a variety of possible responses. Assuming wealth-maximizing firms, an injured firm would thus be expected, in considering its best strategy of redress, not only to weigh the costs and benefits of litigation, but to weigh the result of that calculation itself against the result of another calculation -- of the costs and benefits of pursuing these alternative routes.

This way of thinking about the economics of the litigation decision owes obvious debts to Stewart Macaulay's pioneering study American business use of litigation, circa 1960.89 The central finding of that study was that American business relied

stability in their dealings.

less on litigation than on "non-contractual" means of governing its affairs. Instead of taking disputes to court, or even specifying the possible bases of disputes in legalistic ways, firms relied on informal norms and sanctions to control relations

90Macaulay's account is confirmed by and provides a theoretical underpinning for other observations of abandonment of the courts by business disputants. A generation earlier a New York lawyer had observed that:

Litigation...is gradually being eliminated from the practice of law and is growing less and less. The main reason for the decline of business litigation is because business men in general have lost faith and patience with the courts on account of heavy court costs and long delays. Another and more potent factor in the reduction of business litigation is the growth of trade organizations, merchants' associations and other agencies which provide arbitration commissions to dispose of matters which were formerly litigated.

M. Gisnet, A Lawyer Tells the Truth (1931).

Similar perceptions of recoil from the courts recur contemporaneously with Macaulay's study. Writing in 1956, a New York judge observed that over the previous three decades:

Office practice has grown apace with the amazing growth of business on the commercial and industrial fronts. Commercial controversies have similarly increased, but they have not gone to court. Businessmen have set up their own tribunals for the adjudication of their disputes and withdrawn almost completely commercial litigation from the courts.


Businessmen everywhere resort to arbitration in preference to the courts. Government devises one type of administrative agency after another to handle the many disputes which require determination and which stem from the tremendous growth of regulatory statutes in our economy. When neither arbitration nor government agency is available, businessmen compromise their claims, usually taking less than what they are entitled to, rather than seeking redress in the courts.

with competitors, customers, and suppliers.

Macaulay's study also pointed to a key fact of commercial practice that simultaneously helped secure the availability of such informal mechanisms of governance and encouraged their use: the ubiquity of long-term-continuing-relations (LTCR) among firms. Putting the two points together, Macaulay's finding was that firms in LTCR generally found that the value at stake in any particular dispute, minus the costs of litigation and discounted by the probability of success, was exceeded by the expected value of the continuing relationship, and/or other relationships that might be affected adversely by litigation.

By underscoring the embeddedness of most business dealings in complex and enduring relational webs, Macaulay's study pointed up fundamental problems with the neoclassical model of contract as a series of discrete, episodic, bargained-for exchanges between faceless strangers. It shifted attention to the context of the trades as determinative both of the appropriate valuation of terms in dispute, and of the strategic opportunities available to disputing parties.\(^9\)

\(^9\)In the years since the publication of Macaulay's study, and with special urgency since the discovery in the early 1970s of serious problems in U.S. economic performance, attention to non-contractual business governance has increased enormously. Scholars from diverse fields have rediscovered the importance of those economic institutions -- which, once recognized at all, seem pervasive in modern capitalist economies -- that combine aspects of market and hierarchical forms of governance, while being reducible to neither. The practices associated with such institutions have been denoted as "relational contracting," (Macneil) "obligational contracting," (Williamson) "invisible handshakes," (Okun) "visible handshakes,"(Aoki) "networking," (Hollingsworth, Schmitter, and Streeck) or something else (Fiore and Sabel). However named, what is being described is a set of ongoing dealings, in which the content and enforcement of any particular exchange are inextricably bound up with relations not exhaustively described by that exchange.
More specifically, and put in the form of a hypothesis, a "Macaulayite" analysis would predict that the incidence of litigation will vary indirectly with the strength of alternative governance mechanisms, and in particular (and associated with those mechanisms) with the value that firms attach to LTCR. This hypothesis is not inconsistent with the abstract model of litigation economics considered in the last section. But it does direct our attention to other variables "worth looking at" in constructing a model of litigation with applicability to the real world.

2.3 Hypothetical Economic Changes

Instructed both by the traditional neoclassical model and Macaulay, in this section we indicate the sorts of economic changes that would tend to increase business litigation.footnote[92]

Again, we assume that firms make disputing decisions within the framework of established systems of governance relations (markets, formal associations, informal networks, the state). And again, increased litigation may be explained in either or both of two ways. Holding governance relations constant, such increase may reflect an increase in the number of transactions among firms (some percentage of which go sour, producing

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footnote[92]Two points of qualification are worth noting here. First, in abstracting from changes in legal rules, we are not making a judgment that changes in those rules play no important role in explaining the observed increase in litigation. We simply are concentrating on one set of variables that strike us as particularly important. Second, we are well aware of the fact that changes in legal rules can exert indirect effects on litigation, working through economic mechanisms. As discussed below, for example, changes in kind and degree of government regulation, in addition to providing "more" or "different" law for firms to dispute, can be expected to have had great effects on the stability of informal governance mechanisms.
perceived injury), and/or an increase in those sorts of transactions which, if they do go sour, firms are more inclined to redress through litigation. Alternatively, increased litigation may reflect changes in the relative efficacy of legal and informal governance mechanisms. Taking comparative efficacies into account, it may become more difficult to resolve disputes through informal means, and easier to resolve them through legal ones.

With a view to both of these possible explanations, we would suggest that increases in the following sort of economic factors, either in the broad environment of firms, or in the character of their specific transactions, have positive effects on the incidence of litigation: competition among firms, product specialization, turnover of parties to deals, the number of parties to and complexity of deals, spatial and cultural dispersion of parties, instability in prices, high-stakes transactions, the rate of economic change. Increases along these dimensions, we expect, both give rise to a vast increase in the number of disputes and erode the structures of continuing relations and their characteristic opportunities for sanction (e.g., exit threats and reputational harm) that permit the less contentious or more "non-contractual" dealing and dispute handling described by Macaulay.

Competition contributes to this erosion by increasing firm attention to bottom-line concerns. Given the structure of capital markets in the U.S., moreover, this can generally be expected to increase focus on the short-term bottom line. Firms can less easily afford to forgo opportunities for gain, and their
room for maneuver, and ability to sustain the costs of constructing and applying alternative sanctions, are reduced. Competition also increases the relative stakes in individual transactions by reducing margins of permissible error. Each deal becomes more "all or nothing," and less susceptible to compromise.

Product specialization has at least two litigation-enhancing effects. Grossly, it increases the number of subjects of dispute. By reducing the fungibility of products and services, it also limits an important escape valve in unsatisfactory relations. To recur to the ancient law school figure, if firm A contracts with firm B for the timely supply of 1,000 widgets, and firm B fails to provide them, it matters a great deal if widgets are standardized items, produced in long runs by a large number of firms. If they are, the dispute can be diffused by a substitute transaction, with promises of future correction. But if widgets are a highly specialized product, not widely produced, the dispute becomes unavoidable, more intense, with higher stakes, and possessed more of an "all or nothing" character.

The convergence of dealings toward non-repeat pairings of players has obvious consequences. It directly undermines the conditions of "non-contractual" dispute handling by removing the expectation of future dealings, and thus the force of a threat of discontinuance. If transactions converge toward the faceless strangers model, then the traditional recommendations of that model -- that parties should seek full and explicit advance specification of duties, and full legal sanctions on their nonperformance -- are increasingly applicable.
The number of parties to and complexity of deals increases transaction costs, opportunities for opportunism, and the gross number of items in potential dispute. Again the efficacy of non-legal sanctions will be less certain, and more detailed advance specification of duties will likely be desired by the parties.

The spatial and cultural dispersion of parties has similar effects. It conforms dealings more closely to the faceless strangers model, increases uncertainty, and reduces opportunities for non-legal sanctions.

Instability in prices has the effect of increasing uncertainty, and raising the relative stakes in particular deals. If prices at time $T_1$ are identical to those at time $T_2$, and are expected to remain at the same at time $T_3$, then the 1,000 widgets that A contracted to deliver to B at time $T_2$, but did not deliver, can be supplied from an alternative source, C, at negligible loss. Future dealings between A and B can be more easily corrected by, for example, an agreement to provide the widgets at some reduced price at $T_3$ -- to compensate for the earlier inconvenience. If the prices at the various times are unstable, then of course the loss associated with nonperformance may be greater, and it will be more difficult to devise informal remedies. In general, instability in prices leads to more gaming around particular negotiated prices; the price negotiated in a particular contract becomes relatively more important. This increases the parties' interest in specific performance of agreements, an effect identical to the loss of fungibility noted above.
Higher relative stakes of parties in deals have similar effects. Saying that a lot hangs on a particular deal amounts to saying that fungibility and opportunity for future informal remediation are absent. The model here might be called the "Hollywood transaction," where it matters a very great deal in the careers of the parties exactly how their duties and compensation are specified, since there is no assurance that there will future occasions to transact. "Bet your company" litigation would be example of acting on this perception in an inter-firm context.

The rate of economic change increases instability, and thus the temptations and opportunities for defection from present governance arrangements, the transaction costs of devising new ones, the uncertainty of parties, and the likely or anticipated ineffectiveness of informal sanctions. Again, advance and detailed specification of duties, and reliance on formal enforcement mechanisms, is likely to be enhanced.

Before leaving this still abstract discussion, and considering some changes in the actual American economy, we note three general points.

First, as should be evident from this exposition, many of these changes imply the others. Increased competition increases instability, which increases relative stakes; the combination of product diversification and instability increases the effective complexity of transactions, and the uncertainty of parties to them, and this in turn increases the cost of devising effective non-contractual governance arrangements; and so on. Thus there are multidimensional, overlapping, and to some degree
multiplying, erosion effects.

Second, the mix and intensity of these factors and effects can be expected to vary across sectors, with some more prone to general disturbance, or certain dimensions of disturbance, than others. Some sectors are more immune to competitive pressures than others; some deal generally in specialized products, while others continue mass production; some (e.g., finance) are marked by a higher incidence of very high stakes transactions, others by a lower one; and so on. Such sectoral variation should produce variation in the pressures toward litigation.

Finally, we note that it seems reasonable to assume that increases in litigation, or of factors that on the above account are "litigation-favoring," will themselves call forth a strategic business response to seek alternative means of dispute resolution. The intensity of that response, moreover, is likely to vary with the intensity of litigation or litigation-favoring factors in particular sectors. This variation and second order response, we think, is what explains scattered but growing efforts to construct new alternatives to costly litigation, and the evolution of new governance arrangements in the economy.\[93\]

An example of this last effect -- the construction of new governance relations in face of the collapse of the stability offered by old ones -- is provided by product specialization. We have just observed two ways in which such specialization increases pressures for litigation. It is important to keep in mind, however, that product specialization can itself be

\[93\]We return to this speculation below, in section 4.
understood as a response to competition. Firms, facing too many or too severe competitors in a mass market, seek to carve out a more stable market "niche" in which they will not face ruinous competition. In this more monopolistic setting, firms can better afford to make the investments in specialized capital that in turn underwrite their ability to service their niche. The investments in specialized capital, however, make the costs of sour deals so obvious that firms have powerful incentives to secure, often in advance of such investment, assurances of long-term dealings with customers and suppliers.94

What is true of particular sectors, moreover, may be thought to be true over time. Many of the factors that we point to as "litigation-favoring" can be summarized as increases in (and immediate firm response to) competition, uncertainty, and instability (CUI). Both across sectors, and over time, we would hypothesize, that this relationship is not linear, but curvilinear. At very low levels of CUI, we see the "non-

94Consider the U.S. automobile industry, where Big Three pressures to upgrade the quality and timely delivery of supplier products have gone hand-in-hand with a decline in multiple sourcing. In the 1970s, typical practice was to double or triple-source the outside supply of parts. Now, virtually all (98 percent is an industry estimate) parts made by outside suppliers are single-sourced. In addition to reflecting customer concerns about lowering transaction costs while assuring uniform quality, this arrangement reflects negotiations on both sides to secure sufficient order in supplier markets to justify the increased specialized expenditures needed to meet customer demand. On increased reliance on outside suppliers, and increased single-sourcing of those relied upon, see Industry Week "Doing it all yourself ... and ensuring worldclass 'underperformance'," 4 January 1988, pp. 31-36; idem., "Betting on a single source". 1 February 1988, pp. 11-36. On collaborative relations in auto manufacturing, see Sabel, Horst Kern, and Herrigel, "Collaborative manufacturing: new supplier relations in the automobile industry and the redefinition of the industrial corporation," 1989, unpublished.
contractual" pattern described by Macaulay. At intermediate levels (or shortly after its incidence), we see an increase in the level of litigation. At very high levels (or after its costs become apparent), we would see the establishment of new sorts of governance mechanisms to handle an unstable environment.

These speculations aside, our basic hypothesis is that increases in the factors just described can be expected to elicit, at least in the short run, and at least in the sectors where they are most pronounced, both an increase in the number of transactions and the sorts of transactions where a "sour deal" creates real injury (and thus an incentive to redress) and an erosion of informal governance mechanisms to provide that redress. The result is that, in an economy marked by these sorts of changes, we would expect more disputes to be resolved through litigation. We turn now to consider the actual environmental and strategic changes that have occurred in the American economy over the past generation.

2.4 Actual Changes

Over the past generation the structure of the American economy has changed in fundamental ways. Some of the most important changes reflect a change in the United States' position in the world. Others reflect new domestic initiatives, undertaken by business or government. Whatever their point of origin, these changes have altered both the environment of business firms and their characteristic strategies, with attendant effects on the "governance" of business relations. In conjunction, these changes in environment and strategy have
served to increase the values of the several factors just noted.  

Here we note six broad developments, each more pronounced since the early 1970s.

**Internationalization**

Probably the most important single change, which is particularly evident since the early 1970s, has been the increased integration of United States' product and capital markets into increasingly competitive global ones. At the time Macaulay observed them, American manufacturing firms operated in a huge and expanding domestic market (the world's first "common market") that was effectively insulated from international competitive pressure. Virtually all of these firms' customers, suppliers, and competitors were located in the United States. If they exported, "this was usually a secondary activity," and if they faced any international competition at all, "this was usually a minor irritant." 

Throughout the 1960s, this situation remained roughly the same. But then circumstances changed, in fundamental ways. To see the magnitude of the change, consider that over the half century preceding 1970, the share of Gross Domestic Product [GDP] taken by imports and exports remained slight (rarely more than 10 percent), and exceptionally stable. Then, between 1970 and 1980

---

95 Note that the developments we are about to summarize are not proxies for the different factors noted in the previous section, but simply broad economic changes that would tend to increase the salience of those factors.

their share suddenly doubled, before stabilizing in the 1980s (See Table 2). While price effects vary across product markets,

[Table 2 about here]

with imports and exports claiming 20 percent or more of domestic product, an overwhelming percent of United States firms -- 70 percent is the common estimate -- were suddenly exposed to international price pressures. Even where they retained market share, American firms were operating in a qualitatively more competitive environment.\textsuperscript{97} While somewhat more difficult to measure than the internationalization of product markets, the same period saw a massive increase in the integration of capital markets. Spurred by the collapse of the Bretton Woods monetary system in the early 1970s, the diffusion of a variety of new telecommunications technologies easing the rapid flow of capital around the world, and the dismantling of effective capital controls in most rich nations, banking exploded during the 1970s. As a percentage of world GDP, the international banking market soared from 6.2 to 15.3 percent over 1972-80 alone.\textsuperscript{98} The liberalization and integration of world capital markets increased ties between the financial structure of the United States and that of other countries. This was registered at increased


\textsuperscript{98}Ralph Bryant, International Financial Intermediation. (Washington, DC: Brooking Institution, 1987), Table 3-1.
### Table 2

**Imports, Exports and Internationalization as a Percentage of Gross Domestic Product**

($ in current billions of US dollars)

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP</th>
<th>Exports $</th>
<th>%GDP</th>
<th>Imports $</th>
<th>%GDP</th>
<th>Internationalization (Exp. + Imp.) as % GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>286.7</td>
<td>14.5</td>
<td>5.1%</td>
<td>12.3</td>
<td>4.3%</td>
<td>9.4%</td>
</tr>
<tr>
<td>1960</td>
<td>511.8</td>
<td>29.9</td>
<td>5.8%</td>
<td>24.0</td>
<td>4.7%</td>
<td>10.5%</td>
</tr>
<tr>
<td>1970</td>
<td>1,008.2</td>
<td>68.9</td>
<td>6.8%</td>
<td>60.5</td>
<td>6.0%</td>
<td>12.8%</td>
</tr>
<tr>
<td>1973</td>
<td>3,359.3</td>
<td>114.1</td>
<td>8.4%</td>
<td>97.3</td>
<td>7.2%</td>
<td>15.6%</td>
</tr>
<tr>
<td>1980</td>
<td>2,732.0</td>
<td>351.0</td>
<td>12.8%</td>
<td>318.9</td>
<td>11.7%</td>
<td>24.5%</td>
</tr>
<tr>
<td>1983</td>
<td>3,405.7</td>
<td>352.5</td>
<td>10.4%</td>
<td>358.7</td>
<td>10.5%</td>
<td>20.9%</td>
</tr>
<tr>
<td>1988</td>
<td>4,847.3</td>
<td>530.1</td>
<td>10.9%</td>
<td>605.0</td>
<td>12.5%</td>
<td>23.4%</td>
</tr>
<tr>
<td>1989</td>
<td>5,199.6</td>
<td>587.6</td>
<td>11.3%</td>
<td>643.9</td>
<td>12.4%</td>
<td>23.7%</td>
</tr>
</tbody>
</table>

**Rate of Growth as % of GDP per annum:**

<table>
<thead>
<tr>
<th></th>
<th>Exports</th>
<th>Imports</th>
<th>Internationalization</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950-73</td>
<td>2.20%</td>
<td>2.23%</td>
<td>2.21%</td>
</tr>
<tr>
<td>1973-80</td>
<td>6.08%</td>
<td>6.99%</td>
<td>6.51%</td>
</tr>
<tr>
<td>1973-88</td>
<td>1.61%</td>
<td>3.79%</td>
<td>2.70%</td>
</tr>
</tbody>
</table>

**Sources:** ER 1990.
foreign investment in the United States, and United States' investment abroad, which doubled during the 1970s.

[Table 3 About Here]

Together, the internationalization of U.S product and capital markets spelled the end of the insulated American economy of the 1960s variety and its replacement by a world economy.

The effects of this on the various litigation-favoring factors noted in the previous section are endlessly complex in detail, but fairly clear in broad outline. Internationalization tremendously increased competition, the number of parties to and complexity of deals, the spatial dispersion of parties, the pressures for product specialization. Internationalization of capital markets in particular, following on the collapse of Bretton Woods, increased the importance of the financial sector, and with it the incidence of discrete, high-stakes transactions.

**Declining Economic Performance**

Associated with this internationalization of the United States' economy has been a marked decline in United States' economic performance, again most pronounced since the early 1970s. Consider both international and domestic dimensions.

Internationally, the United States emerged from World War II as unquestionably the most powerful and competitive economy in the world. It was self-sufficient in energy and agriculture, had a huge financial sector that functioned as the world's banker, and was the leader in virtually all sectors that would contribute to major postwar growth -- from automobiles to airframes,
### Table 3

**Foreign Investment in the US and Vice Versa**

($ in current US dollars in billions)

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP</th>
<th>External assets other than those held by US government</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$</td>
<td>$%GDP</td>
</tr>
<tr>
<td>1952</td>
<td>349.5</td>
<td>22.7 6.5%</td>
</tr>
<tr>
<td>1960</td>
<td>511.8</td>
<td>49.4 9.7%</td>
</tr>
<tr>
<td>1970</td>
<td>1,008.2</td>
<td>117.5 11.7%</td>
</tr>
<tr>
<td>1973</td>
<td>1,343.1</td>
<td>169.2 12.6%</td>
</tr>
<tr>
<td>1980</td>
<td>2,684.4</td>
<td>516.4 19.2%</td>
</tr>
<tr>
<td>1983</td>
<td>3,355.9</td>
<td>761.1 22.7%</td>
</tr>
<tr>
<td>1987</td>
<td>4,497.2</td>
<td>1,033.6 23.0%</td>
</tr>
<tr>
<td>1988</td>
<td>4,847.3</td>
<td>1,120.0 23.1%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>External liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$%GDP</td>
</tr>
<tr>
<td>1952</td>
<td>20.8 6.0%</td>
</tr>
<tr>
<td>1960</td>
<td>40.9 8.0%</td>
</tr>
<tr>
<td>1970</td>
<td>97.7 9.7%</td>
</tr>
<tr>
<td>1973</td>
<td>174.9 13.0%</td>
</tr>
<tr>
<td>1980</td>
<td>486.1 18.1%</td>
</tr>
<tr>
<td>1983</td>
<td>785.6 23.4%</td>
</tr>
<tr>
<td>1987</td>
<td>1,536.0 34.2%</td>
</tr>
<tr>
<td>1988</td>
<td>1,786.2 36.8%</td>
</tr>
</tbody>
</table>

Rates of Growth as % of GDP per annum:

<table>
<thead>
<tr>
<th>Period</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1952-73</td>
<td>3.16%</td>
</tr>
<tr>
<td>1973-87</td>
<td>4.29%</td>
</tr>
<tr>
<td>1952-87</td>
<td>3.61%</td>
</tr>
</tbody>
</table>

**Sources:** ER 1990.
computers, and chemicals.

Reflecting this dominant position, in 1950, the United States accounted for fully 40 percent of world GNP, and 20 percent of world trade. Over 1950-60, these shares declined to 26 and 16 percent, respectively. Much of this decline was "natural" and welcome. It reflecting the rebuilding of the West European and Japanese economies after the devastation of the war, and reflected no particular decline in the competitiveness of United States manufacturing. In the years since, however, evidence of such competitive decline has accumulated, and at an increasing rate since the early 1970s. Thus, over 1960-80, the United States' share of world GNP declined to 21 percent, and its share of world trade dropped faster, falling to 11 percent.99 The United States' share of world manufactures fell from 26 to 18 percent over that period, and the United States lost its lead in R&D intensive manufactures.100 The merchandise trade balance turned negative in 1971 (for the first time since 1893), and with some brief interruptions has been negative ever since.101


100Scott at 26-27.

101We should note that while the general competitive position of the United States has dramatically declined, United States multinationals have preserved their world market shares. See Robert E. Lipsey and Irving Kravis, "The Competitiveness and Comparative Advantage of United States Multinationals, 1957-83," National Bureau of Economic Research (NBER) Working Paper No. 2051 (Cambridge, MA: NBER, 1986). Whether this should be cause of celebration remains in doubt. Roughly a quarter of the present United States' trade deficit is accounted for by United States multinationals' shipments back home from low-wage centers abroad.
Acceleration in the trade deficit in the 1980s has been particularly pronounced. One (albeit commonly abused) measure of this is that, at least on paper, the U.S. has wiped out the net positive international financial position it had accrued since World War I, and been converted almost overnight from the world's largest creditor to largest debtor nation. At present the United States is very far indeed from its postwar position as the world's pre-eminent manufacturing economy.

Economic performance has not only declined relative to international rivals, however. Indicators of United States domestic economic performance also show a sharp downturn since the early 1970s. Comparing 1948-73 with 1973-88, for example, average annual GNP growth slowed from 3.6 to 2.5 percent, and productivity growth dropped from 2.92 to 1.05 percent. After peaking in the mid-1960s at around 8 percent, the real rate of return to capital in the non-financial business sector dropped to as low as 2 percent in the early 1970s (1972), recovered to 4 percent by the late 1970s, dropped again during the massive 1981-82 recession, and has still not recovered to its late 1970s levels. General measures of popular economic well-being also have turned down. Thus, for example, real median family income, after doubling over 1947-73, and never going more than two years without setting a new record, has stagnated since then. In

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102 We are skeptical of this common claim, since the accounting is not done on a replacement cost basis, and thus tends naturally to inflate the holdings of more recent creditors. Still, there is no denying the tremendous increase in debt, considered on its own terms.

103 See, "Will It Fly?," The Nation, May 1988, for current projections.
constant (1987) dollars, median family income in 1987 was $30,853, virtually unchanged from its 1973 level of $30,820. Average real gross weekly earnings of American workers, which peaked in 1972, fell 15 percent over 1972-88, back to their lowest level since 1961.\textsuperscript{104}

The effect of declining economic performance on prior governance mechanisms is straightforward. Any major change in economic activity (boom or bust) has the effect of disturbing prior governance relations, simply by changing the actors involved. Declining economic performance, moreover, would reasonably be seen as increasing the incidence of injury, and perceived injury. Most simply, with a declining surplus, zero sum conflict increases. The number of issues in dispute, then, would be expected to increase, and the stakes in dispute would rise.

An Increased Role for Services, Particularly Finance

From 1960 to 1987, services increased from 38 to 51 percent of GDP, and from 39 to 50 percent of total employment, with growth in both cases accelerating after 1973. The growth of financial services was particularly strong.

[Table 4 About Here]

[Table 5 About Here]

Table 4

<table>
<thead>
<tr>
<th>Year</th>
<th>Tot W&amp;S #</th>
<th>Retail and Wholesale % tot</th>
<th>Finance, Ins &amp; R.E. % tot</th>
<th>&quot;Prof.&quot; Services % tot</th>
<th>Comb. as % of total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960</td>
<td>55.2</td>
<td>10.1 18.3%</td>
<td>2.6 4.7%</td>
<td>8.7 15.8%</td>
<td>38.8%</td>
</tr>
<tr>
<td>1970</td>
<td>70.6</td>
<td>13.0 18.4%</td>
<td>3.6 5.1%</td>
<td>11.7 16.6%</td>
<td>40.1%</td>
</tr>
<tr>
<td>1973</td>
<td>76.8</td>
<td>14.9 19.4%</td>
<td>4.2 5.5%</td>
<td>12.8 16.7%</td>
<td>41.6%</td>
</tr>
<tr>
<td>1980</td>
<td>90.0</td>
<td>18.0 20.0%</td>
<td>5.4 6.0%</td>
<td>17.0 18.9%</td>
<td>44.9%</td>
</tr>
<tr>
<td>1983</td>
<td>91.1</td>
<td>19.0 20.9%</td>
<td>5.8 6.4%</td>
<td>19.2 21.1%</td>
<td>48.4%</td>
</tr>
<tr>
<td>1987</td>
<td>102.4</td>
<td>21.3 20.8%</td>
<td>7.0 6.8%</td>
<td>23.0 22.5%</td>
<td>50.1%</td>
</tr>
</tbody>
</table>

Rate of growth as % of total wage & salary workers per annum:

<table>
<thead>
<tr>
<th>Year</th>
<th>Prof. %</th>
<th>Ins &amp; R.E. %</th>
<th>W &amp; S %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1948-73</td>
<td>0.19%</td>
<td>1.59%</td>
<td>1.03%</td>
</tr>
<tr>
<td>1973-87</td>
<td>0.49%</td>
<td>1.52%</td>
<td>2.13%</td>
</tr>
</tbody>
</table>

Table 5

Gross Domestic Product (GDP) by sector in billions of current $

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP</th>
<th>Retail and Wholesale $</th>
<th>% GDP</th>
<th>Finance, Ins &amp; R.E. $</th>
<th>% GDP</th>
<th>&quot;Prof.&quot; Services $</th>
<th>% GDP</th>
<th>Combined $</th>
<th>% GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1947</td>
<td>234.1</td>
<td>44.2</td>
<td>18.9%</td>
<td>23.8</td>
<td>10.2%</td>
<td>20.2</td>
<td>8.6%</td>
<td>37.7%</td>
<td></td>
</tr>
<tr>
<td>1950</td>
<td>286.7</td>
<td>51.5</td>
<td>18.0%</td>
<td>32.2</td>
<td>11.2%</td>
<td>24.2</td>
<td>8.4%</td>
<td>37.6%</td>
<td></td>
</tr>
<tr>
<td>1960</td>
<td>511.8</td>
<td>85.7</td>
<td>16.7%</td>
<td>72.8</td>
<td>14.2%</td>
<td>51.4</td>
<td>10.0%</td>
<td>40.9%</td>
<td></td>
</tr>
<tr>
<td>1970</td>
<td>1,008.2</td>
<td>168.7</td>
<td>16.7%</td>
<td>145.8</td>
<td>14.5%</td>
<td>120.2</td>
<td>11.9%</td>
<td>43.1%</td>
<td></td>
</tr>
<tr>
<td>1973</td>
<td>1,343.1</td>
<td>225.6</td>
<td>16.8%</td>
<td>190.5</td>
<td>14.2%</td>
<td>163.2</td>
<td>12.2%</td>
<td>43.2%</td>
<td></td>
</tr>
<tr>
<td>1980</td>
<td>2,684.4</td>
<td>438.8</td>
<td>16.3%</td>
<td>400.6</td>
<td>14.9%</td>
<td>374.0</td>
<td>13.9%</td>
<td>45.1%</td>
<td></td>
</tr>
<tr>
<td>1983</td>
<td>3,355.9</td>
<td>542.9</td>
<td>16.2%</td>
<td>536.4</td>
<td>16.0%</td>
<td>515.5</td>
<td>15.4%</td>
<td>47.6%</td>
<td></td>
</tr>
<tr>
<td>1987</td>
<td>4,497.2</td>
<td>740.4</td>
<td>16.5%</td>
<td>775.4</td>
<td>17.2%</td>
<td>793.5</td>
<td>17.6%</td>
<td>51.3%</td>
<td></td>
</tr>
</tbody>
</table>

Growth rates (of % of GDP) per annum:

<table>
<thead>
<tr>
<th>Year</th>
<th>Growth Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1947-73</td>
<td>-0.45%</td>
</tr>
<tr>
<td>1973-87</td>
<td>-0.13%</td>
</tr>
</tbody>
</table>

Source: ER 1989 Tables 8-8 and 8-10.
While precise measures are surprisingly hard to find, it seems generally correct to observe that the private sector of the American economy relies increasingly on debt as a tool of expansion. From 1960 to 1986 the ratio of interest income to pre-tax profits in the United States increased five-fold, rising from 9 percent to 51 percent.\footnote{ER 1988, Table B-12.} The ratio of external to internal financing used by non-financial corporations increased from 1.5 to 4.6.\footnote{ER, Table B-89.} The proliferation of new forms of trading debt (e.g., the increased use of securitized financing in recent years) increases its availability, and a variety of tax provisions encourage this as a method of corporate expansion. The massive restructuring of American firms over the last decade (mergers, buyouts, bankruptcies, etc.) has also, of course, fueled the demand for, and power of, financial intermediaries. And the increased global integration of capital markets has furthered both trends, while providing yet additional markets for financial arbitrage and speculation. As of 1986, approximately $250 billion was traded \textit{per day} in world foreign exchange markets ($60 trillion per year), or roughly 30 times the volume of world trade.\footnote{Levitch, in Feldstein 1988, 219. Other estimates put the volume even higher, perhaps has high as 50 times the volume of world trade.} The lowest volume trading day on the New York Stock Exchange saw more shares traded than any month in 1960; more value was traded during the first 15 minutes of trading on
October 19 and 20 than during any week in 1960.  

Again, the chief effect of this, quite powerful on an economy-wide basis given the growth of finance, is to increase the number of one-time, high-stakes transactions.

Changes in Government Regulation

There has been tremendous growth in governmental regulation of business over the past quarter century (again, accentuated since the early 1970s). There has been an increase in the gross volume and number of regulations, and increasing reliance on "new" categoric regulation of production processes across a wide variety of industries, as opposed to "old" regulation of rates and entry within specific industries. While growth has slowed precipitously over the last decade, from 1961 to 1977 the number of pages in the Federal Register devoted to regulations increased from 14,000 to 66,000 with more than two-thirds of that growth occurring during the 1970s. This extremely crude measure of the level of regulatory activity and enforcement almost surely understates its significance to business, since statutes may remain unchanged but be enforced more heavily, and governmental enforcement may be augmented by the activities of "private attorneys general". Moreover, even the dismantling of regulation is important for business, since it can be associated


110 The area of employment civil discrimination, based principally in Title VII of the 1964 Civil Rights Act, for example, provides instances of both phenomena.
with a large increase in competition (e.g., in trucking or airline deregulation), as well as the general scrambling of expectations about how business should be conducted. The advent of new law, of course, directly increases the level of uncertainty about the application of new rules — a factor highlighted by our consideration of the neoclassical model above. In addition, however, the mere fact of changes in regulation undermines the stability of prior informal governance mechanisms, which are always articulated against a particular legal frame.

**Industry Response**

As these changes combine to increase the competitiveness, instability, and uncertainty of the American business environment, business response to those changes has helped to consolidate them. Firms are engaging in a variety of new product and profit strategies, including: downsizing and outsourcing of production tasks to affiliates and subcontractors; alternative "sweating" and "cooperative" styles of labor relations to achieve flexibility in internal labor markets; increasingly specialized product strategies tailored to diverse "niche" markets; quality-competitive rather than price-competitive market strategies; firm-led industrial restructuring ("merger mania"); and increased use of financial instruments and opportunities as a supplement to or substitute for production ("paper entrepreneurialism"). Of particular interest here are changes in the structure of firms and their relations with suppliers and customers. Increased use of subcontractors, contingent workers, and other bids for "flexibility" reflect business attempts to adjust to increasingly specialized and unstable markets for goods, under highly
competitive conditions. The basic maxim is to "internalize scarcity and externalize risk." Recognition of these phenomena has in turn led to fledgling efforts to develop new "networks" of firms that pool risk. Thus far, however, the principal effect of such varied response appears to be largely negative -- the undermining of established governance relations, and the multiplication of sources of possible injury.

In sum, both the environment and structure of American business practice have changed in fundamental ways since the early 1970s. We expect to see business organize to counteract those aspects of change it regarded as unfavorable. But "business" is by no means a unitary actor. What is an unwelcome increase in competition for one firm is a profit opportunity for another; what is a costly breakdown of established governance mechanisms for a set of producers may be a welcome reduction in prices for their customers; and so on. We expect such fundamental changes will at least for a time outrun the ability to devise new private systems of governance. During this transitional period we would expect firms to rely more on formal mechanisms of governance to settling their disputes.iii

iii Large effects on litigation can be transmitted by small changes in governance mechanisms. We emphasize that we assert relative rather than an absolute decline in the efficacy of long term continuing relation (LTCR) as a form of governance. The increase in the volume of businesses and transactions makes it probable that there is an absolute increase in long-term continuing relations and in dealings that are regulated by them. What we assert is that in this larger total there are more dealings that are not regulated by LTCR and that go to litigation. One source of this growth is the growth of the sheer number of dealings. Even if there were a constant percentage of deals-- say 99%-- regulated by LTCR, a doubling of the number of deals would double the number of cases in the 1% that went to litigation. A second source of growth is from the decline in a percentage of all dealings that are effectively regulated by
Moreover, the particular character of change is, broadly speaking, in the direction of generating vastly greater numbers of disputes for business to handle.

3.5 Can This Hypothesis Be Tested?

We have conducted a preliminary statistical test of our basic intuition that changes in the incidence of business litigation reflect important changes in the American economy. As a surrogate for the incidence of business litigation, we took the filing of diversity contract cases in the federal courts. We constructed a simple statistical model of the determinants of a normalized (per 10,000 firms) measure of diversity contract filings for the 1960 to 1988 period. As a rough proxy for internationalization and attendant competitive pressures, we took the dollar value of exports plus imports as a percentage of GDP. As a proxy for general instability in the economy, we used a normalized business failure rate (per 10,000 firms). And as a proxy for the growth of finance and other services, we used the percentage of GDP accounted for by service firms.\textsuperscript{112} Using LTCR. Thus if the percentage of deals regulated by LTCR goes from 99\% to 98\%, the number of litigated cases also doubles. If the number of deals doubles and 98\% of the new higher total are regulated by LTCR, the amount of litigation will increase 300\% (from 1 to 4) at the same time that the number of deals effectively regulated by LTCR increases by 97\% (from 99 to 196)

\textsuperscript{112}While our basic model uses only a few variables, the full list of variables tested is:

<table>
<thead>
<tr>
<th>Variable</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>CASERATE</td>
<td># of diversity contract filings per 10,000 firms</td>
</tr>
<tr>
<td>INTERNATIONALIZATION</td>
<td>dollar value of exports plus imports divided by Gross Domestic Product (GDP)</td>
</tr>
<tr>
<td>FAILURE</td>
<td># of business failures per 10,000 firms</td>
</tr>
<tr>
<td>FLUIDITY</td>
<td># of business failures plus # of new business creation per 10,000 firms</td>
</tr>
<tr>
<td>SERVICE #1</td>
<td>% of Gross Domestic Product (GDP) accounted for by the Financial services, Professional services and Wholesale/Retail Trade sectors of the economy</td>
</tr>
</tbody>
</table>
ordinary least squares (OLS) regression, we then correlated movement in these variables with movement in our dependent variable of contracts filings, and found high correlation.\(^{113}\)

SERVICE #2 - % of GDP accounted for by the Financial services and Professional services sectors
SERVICE #3 - % of GDP accounted for by the Professional Services sector
SERVICE #4 - a broader definition, including all Services (versus Goods) as a % of GNP
FINANCE #1 - % of GDP accounted for by the Financial services sector
FINANCE #2 - the ratio of interest income to the profits of nonfinancial corporations, a rough proxy for the relative claim on income by the financial versus nonfinancial sectors of the economy
FINANCE #3 - the ratio of foreign claims on US assets to GDP
FINANCE #4 - the ratio of foreign claims on US assets plus private US claims on foreign assets to GDP
PGNP - the real rate of change in GNP
INVPGNP - the inverse of PGNP
PRODUCTIVITY - an index of productivity, measured in terms of "output per hour of all persons, business sector"
INVPROD - the inverse of PRODUCTIVITY
MERGER - an index of mergers and acquisitions activity
PROFITS - the rate of profit in the nonfinancial sector
INVPROFITS - the inverse of PROFITS

In the basic model reported in the text, the service measure we use is Service #4.

\(^{113}\)The results for three of the possible resulting equations follow:

<table>
<thead>
<tr>
<th>Equations</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
</tr>
<tr>
<td>(2)</td>
</tr>
<tr>
<td>(3)</td>
</tr>
</tbody>
</table>

| Constant |  -12.231332 |  -17.326862 |  -90.892923 |
|          | ( 4.088362)** | (2.493848)** | ( 8.956455)** |
| INTERNATION-ALIZATION | 264.805145 | 227.324864 | 104.752220 |
|          | (23.346085)** | (14.607257)** | (16.642293)** |
| FAILURE | .019152 | .008612 | .001880** |
|          | (.002636)** | (.001880)** |
| SERVICES #4 | 226.648585 | (27.296164)** |
For the non-statistically inclined,\textsuperscript{114} what this amounts to

<table>
<thead>
<tr>
<th></th>
<th>R square</th>
<th>F-statistic</th>
<th>Durbin-Watson</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>.82654</td>
<td>128.65442</td>
<td>.56352</td>
</tr>
<tr>
<td></td>
<td>.94276</td>
<td>214.12585</td>
<td>1.00498</td>
</tr>
<tr>
<td></td>
<td>.98477</td>
<td>538.77791</td>
<td>2.19188</td>
</tr>
</tbody>
</table>

Note: Standard errors in parenthesis; ** = significant at .01 level.

\textsuperscript{114}For the statistically inclined, we can summarize the results thus: Model \#1 has high R-square, significant variable and F-statistic, but Durbin-Watson is below lower bound at .05 level (1.341 for constant plus one variable and 29 cases) rejecting null hypothesis of no autocorrelation. Model \#2 an improvement on \#1 in terms of the partial F-test and a higher R-square, but Durbin-Watson is still below the lower bound (1.270 for two independent variables and 29 cases). Model \#3 an improvement on \#2 in terms of partial F-test, and Durbin-Watson exceeds upper bound (1.650 for three independent variables and 29 cases), accepting hypothesis of no autocorrelation. Other measures (see fn. 32, supra) of the service sector or financial sector were used to find an alternative "basic model". All of these alternative models except the one with FINANCE \#1 passed the partial F-test relative to the reduced model (i.e. just internationalization plus the failure rate). Since all of these measures involve general upward trends, they are highly correlated with both each other and with the dependent variable. In these cases, autocorrelation is held to be a particular problem, and the Durbin-Watson test is supposed to distinguish between trends which are spuriously related (thus involving autocorrelation) and those which are causally related. Only two of the alternative measures reached the lower bound (1.198), with the measure using interest income to profits (Finance \#2) still in the inconclusive zone but approaching the upper bound (1.650). The acceptance of Finance \#2 as an alternative depends about the stringency of the standard one wants to apply to the Durbin-Watson test.

<table>
<thead>
<tr>
<th>XXX Alternative Variable</th>
<th>R square</th>
<th>Durbin-Watson</th>
<th>F</th>
<th>Significant Variables (at least .05)</th>
</tr>
</thead>
<tbody>
<tr>
<td>SERVICE #1</td>
<td>.96217</td>
<td>1.15941</td>
<td>211.962</td>
<td>all</td>
</tr>
<tr>
<td>SERVICE #2</td>
<td>.95931</td>
<td>1.10832</td>
<td>196.451</td>
<td>all</td>
</tr>
<tr>
<td>SERVICE #3</td>
<td>.96628</td>
<td>1.24673</td>
<td>238.831</td>
<td>all</td>
</tr>
<tr>
<td>FINANCE #1</td>
<td>.94815</td>
<td>1.00128</td>
<td>152.378</td>
<td>all but Fin #1</td>
</tr>
<tr>
<td>FINANCE #2</td>
<td>.95921</td>
<td>1.53655</td>
<td>195.960</td>
<td>all but Fail.</td>
</tr>
<tr>
<td>FINANCE #3</td>
<td>.95643</td>
<td>1.04576</td>
<td>182.951</td>
<td>all</td>
</tr>
<tr>
<td>FINANCE #4</td>
<td>.95870</td>
<td>1.00153</td>
<td>193.455</td>
<td>all but Fin. 4</td>
</tr>
</tbody>
</table>
saying is that these three variables "predict" a pattern of case filings extremely close to the actual pattern, and might thus be thought to account for changes in that pattern. Correlation, however, should not be confused with cause, especially when so many steps are missed between the microfoundational level of individual firms, operating in diverse sectors, and the sorts of macro changes measured by our variables. The exercise reported here may point to some important relationship, but it hardly establishes that relationship. It might amount to no more than famous "predictions" of stock prices off of sun spots.

What would be needed to really test our hypothesis, again, would be data which permitted specification of the links between such macro trends, sectoral changes in private governance, and individual ("micro") firm decisions to litigate. Again, however, these data do not currently exist.\footnote{We are, however, in the process of trying to generate them, through the collaboration with Terry Dungworth on the litigation activities of large corporations, see note 11, supra, and through a series of sectoral studies of private governance and use of law since 1970. These efforts are described in Marc Galanter, Stewart Macaulay, Thomas Palay, and Joel Rogers, 1991, The Transformation of American Business Disputing: A Sketch of the Wisconsin Project. Special Report, Working Paper DPRP 10-6. (Madison, Wisconsin: Institute for Legal Studies Publication).}

3. Possible Futures

To conclude our discussion, we first summarize what we regard as our central findings, and then speculate briefly on their implications -- both for the "real world" of business dealings and legal practice and for research into these phenomena.

What we have argued here is straightforward enough. First,
by several measures on various dimensions, it appears that business "consumption" of legal services has increased both absolutely, and relative to other consumers of legal services.

Second, such an increase might be explained by an increase in the number of important disputes within business, or by a breakdown in conditions that foster non-litigious forms of dispute resolution, and there are reasons to think both have occurred. The business world of today is more complex than the business world of a generation ago: there are many more players, more products, more intense competition, more fine-grained calculations to be made about the distribution of risk, more uncertainty about the rewards to risk. This means both that the number of potential important disputes within business has likely increased, and that those disputes are of a kind that are not well-handled by the "traditional" forms of private governance, at least in the American economy.

We have indicated various ways in which, in theory, such increases in competition, uncertainty, and instability in the world of business might enter directly into the decision to litigate. We can say with considerable confidence that litigation has in fact increased. And at least an initial run at what data exist indicates strong correlation between two sorts of variables in our analysis -- the macroeconomic changes we have identified as generating litigation-promoting economic facts, and the incidence of commercial litigation. We decline, however, to draw any strong conclusions from this last exercise.

4.1 The Significance of These "Preliminary Observations"

Increased business disputing is significant because
businesses are, collectively, the most powerful set of actors in American society. How business orders its affairs inevitably affects the conditions of social order generally; how business expends its resources affects the total level and distribution of social well-being. The organization of business is particularly important at moments of massive transition such as the present. For all sorts of reasons -- from the competitive challenges offered by Western Europe and Japan, to changes in the American demographic structure, to growing realization of ecological limits on economic activity, to widespread rethinking of the relationship between work and family -- questions of public ordering of the private economy are again on the agenda. In debate on these questions the structure of private "business governance" will inevitably intrude, framing and limiting the possibilities for constructive social change.

Certainly, increased business litigation has also had a profound impact on the practice of law. In the short term, surely, it has helped corporate law firms to prosper. At the same time, however, it has induced a variety of cross-cutting pressures on traditional legal practice. The enormous changes within the world of corporate law firms -- increased size and specialization, a new emphasis on marketing, cross-firm raiding of talent, renewed concern about the future of legal professionalism -- attest to these pressures. So do the continued growth of in-house corporate legal departments, and the variety of business efforts to encourage alternatives to costly litigation.

The business-fueled surge of legal activity also has
implications for corporate legal expenditures and the attempts to control them. With business versus business litigation growing at the rates we have documented, we would expect to see intensified corporate efforts to address the causes and handling of these disputes. To date attention has focussed on the increased costs of tort and product liability litigation and the resultant efforts to restrain them. We would argue that the narrow focus on tort liability has obscured the realization of the widening scope of corporate litigation. Implicit in the first half of our paper is the point that even if the entire panoply of tort reform and "court reform" measures were enacted, litigation costs for businesses would remain substantial. Businesses are suing other businesses in greater numbers than ever before and over matters unrelated to torts. Controlling the costs of litigation will take more than proposals to cap liability payments and speed up court proceedings.

We emphasize, however, that there is no reason that business litigation must grow indefinitely at the rate it has in the recent past. Even putting aside the possibility of some absolute limit (as yet not reached) to business tolerance of litigation and its costs, it again seems unlikely that the relation between competition, uncertainty, and instability in the economy and the litigation is linear. Again, across economic sectors and over time, we may speculate that at very low rates of these factors, we have something like the universe observed by Macaulay; at higher ones, we have the business universe of today; but at still higher ones, we might see the generation of new forms of private
governance to address the increased risks and uncertainties.116

Much of the increase in litigation observable over the past 15 years, we have argued, owes to the fact of economic change. Old governance structures cracked under the pressure of new rivalries, product strategies, and uncertainties in demand. That business has responded to the apparent collapse of the sanctioning power of the these old structures by increasing resort to more formal, litigious forms of dispute handling seems altogether natural. Equally natural, however, is the thought that, as in the past, creative businesses will forge new ways of handling their internal sources of conflict in ways that do not so directly rely upon public regulation through law.

4.2 Directions for Future Work

116In at least some sectors marked by extremely high rates of uncertainty and instability and very high levels of competition -- from "cutting edge" high-tech communities to relatively low-tech cutting rooms in New York's garment district -- we note the existence of dense forms of social cooperation even more extensive than among the firms Macaulay observed. These networks and "regional" economies devise elaborate structures of risk-sharing to realize the contribution needed to profit in an increasingly risky world. Instead of merely squeezing sub-contractors, firms cooperate with them in the development of new capacities for production they cannot or do not wish to develop in-house; instead of concealing all activities from rivals, they share innovations in the hope that when rivals innovate, they will not be left behind; instead of "sweating" labor, they engage in cooperative labor relations.

What is most clearly discernible in sectors marked by extreme degrees of specialization and flexibility in production, moreover, is gradually becoming evident in more "mainstream" sectors. Even outside the "new" economies, old firms are experimenting widely with new forms of joint venture, reintegration of once functionally distinct departments (e.g., engineering, production, and marketing), more cooperative labor relations with unions, and the like. What all this experimentation points to is an attempt to refashion the "relations of competition" themselves, to establish new forms of private governance. If, over time, these new structures achieve some degree of stability, it is by no means clear what role litigation will play in them.
Promising directions for research are clearer.

First, as indicated repeatedly, we lack good data on disputing patterns at a sectoral and firm level, without which no theory of business disputing can be developed. This data needs to be collected -- through more refined excursions into existing aggregate data bases on litigation, selected surveys of firms in particular sectors, and field interviews and other techniques for reaching individual firms and business actors. With a detailed picture of patterns of disputing and use of law under particular "relations of competition," we can then construct and test a stronger theory of the determinants of litigation.

Second, it is important to develop a better understanding of business efforts to reorder its consumption of legal services, and to devise alternative systems of governing disputes. Attention should be paid to the growth of in-house corporate counsel, the growth of a range of "alternative dispute resolution" techniques, and associative efforts by business firms (industry consortia, trade associations, lobbying arms, etc.) that perform "hidden" governance functions.

Third, the predominant suppliers of corporate legal services, corporate law firms, should not be neglected. It seems

\textsuperscript{117}We are now involved in work of these kinds. On the mining of existing data bases for information on firm litigation, see Dungworth, Galanter, and Rogers, "Corporations in Court: Recent Trends in Large Firm Litigation in the U.S." (paper presented to the Law and Society Association Annual Meetings, 1990), and Dungworth, Galanter, and Rogers, "Corporations in Court," forthcoming. These studies consider litigation trends among the top 1,000 firms in the U.S. economy (500 industrials, 500 service firms) since 1971. On sectoral studies, see Macaulay and Rogers, "Plus ca change ...: Litigation and Other Business Use of Law in the Automobile Industry," forthcoming.
clear to us that the widely remarked transformation in the structure and operation of those firms over the past 15 years is made possible by increased demand for their services. But demand here is only a spur and limiting condition to growth. It does not determine the specific form that growth takes, and may itself be partly explained by increases in the supply of legal talent.\(^{118}\)

To understand the real world of corporate legal practice, we need to investigate more closely the links between demand and supply, exploring the ways in which the shifting pattern of business disputes encourage innovation in the provision of corporate legal services while posing new problems for the providers.

\(^{118}\) This could happen in at least two ways. First, increased supply could drive down price, leading to increased demand at the new lower price, with the magnitude of this effect depending straightforwardly on the price elasticity of demand. Sander and Williams report that the average "price" of lawyers, measured as their income, has in fact declined, but do not find that decline nearly sufficient (except on the most improbable of assumptions about demand elasticity) to account for increased consumption of legal services. This is to say nothing of the potentially anomalous price trend in the corporate law sector that concerns us here. The second way supply could affect demand takes cognizance of the interactive character of lawyering, and is captured in the old joke that "if there's one lawyer in town, he (she) starves; with two lawyers, they both get rich." More lawyers create more capacity for lawyering, and more lawyering begets yet more, since legal papers need to be answered. See Sander and Williams, supra note 69.
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