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## ESTABLISHING NEW LEGAL DOCTRINE IN MANAGED CARE: A MODEL OF JUDICIAL RESPONSE TO INDUSTRIAL CHANGE

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*Courts are struggling with how to develop legal doctrine in challenges to the new managed care environment. In this Article, we examine how courts have responded in the past to new industries or radical transformations of existing industries. We analyze two historical antecedents, the emergence of railroads in the nineteenth century and mass production in the twentieth century, to explore how courts might react to the current transformation of the health care industry.*

*In doing so, we offer a model of how courts confront issues of developing legal doctrine, especially regarding liability, associated with nascent or dramatically transformed industries. Our model of doctrinal change includes five steps. The first step is the emergence of a nascent or transformed industry. In the second step, courts attempt to apply old doctrine to the nascent industry, resulting in a doctrinal mismatch with the realities of the new industry. When faced with this dilemma, the third step is that courts tend—implicitly or explicitly—to establish new legal doctrine that favors the industry. Then, in the fourth step, a backlash against the industry sets in while courts reassess rules favoring the industry. The last step is the emergence of a new doctrinal method of holding the nascent industry more fully accountable for its operations.*

*After setting forth the model and its limitations, we discuss the implications for how courts have responded to the advent of managed care. Our historical analysis suggests that courts are reluctant to interfere with emerging market arrangements, such as managed care's cost containment practices. Eventually, courts tend to find new ways to achieve greater accountability, largely arising from tort law concepts.*

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## INTRODUCTION

The stunning rise of managed care within the past decade has radically transformed health care delivery in the United States from a cottage industry largely controlled by physicians through the 1980s to a large industrial enterprise dominated primarily by institutional providers. The changes are both conceptual and practical. Conceptually, the entire structure of the health care enterprise resembles only vestigially the prior fee-for-service model that dominated health care after World War II until the late 1980s. Practically, health care is now delivered to patients by physicians operating within large institutions, and governed primarily by market-based arrangements.

These changes have both policy and legal implications. From a policy perspective, the country is debating the locus and extent of regulating the managed care industry relative to a market-based approach. The question is whether traditional state regulation should be the model for managed care or whether regulation should shift to the private sector with quasi-regulatory entities such as the National Commission on Quality Care (NCQC) playing a dominant regulatory role. At the federal level, Congress is considering patients' rights legislation that would, if enacted, amend the Employee Retirement Income Security Act (ERISA) preemption to allow greater state regulation of managed care organizations (MCOs) and to give patients the right to sue MCOs in state court.<sup>1</sup> The health policy concern is how to constrain the high cost of health care without unduly limiting individuals' access to needed services.

From a legal perspective, the courts are confronted with conflicting policy objectives, such as the trade-off between access to health care and cost containment, that were not present when the current medical liability rules were developed. These rules were formulated in an era where one patient sued one physician and then, perhaps, a hospital.<sup>2</sup> Now courts must determine liability in the context of potential conflicts between the interests of an individual patient and the interests of the entire managed care patient population over the allocation of plan resources. These policy objectives present fundamentally different legal questions than those addressed

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1. See Health Care Issues, 67 U.S.L.W. 2465, 2479 (1999) (describing current legislative efforts in this regard).

2. See generally Peter D. Jacobson, *Medical Malpractice and the Tort System*, 262 JAMA 3320 (1989) [hereinafter Jacobson, *Medical Malpractice*].

during the fee-for-service era. The development of legal doctrine will, in part, determine the extent to which managed care cost containment initiatives will be implemented.

In short, the United States is at a point of doctrinal change in how courts will react to the transformation of health care delivery. As in most periods of change, doctrine will develop on three inter-related axes. The first, and perhaps most important, question is what legal regime will predominate, tort or contract. The second inquiry is which liability standard will emerge. The third step occurs when courts must address the rules that are subsidiary to the chosen liability standard(s). How courts adjust previous doctrine—both tort and contract—will have important legal and policy ramifications. Legally, this adjustment will set the tone for how the courts determine accountability in the managed care era. On the policy side, the outcome will influence both the ability of MCOs to sustain their cost containment objectives and the receptivity of the courts to regulatory oversight.<sup>3</sup>

Despite the burgeoning scholarly literature propounding various normative approaches to developing doctrine in response to the rise of managed care, we have not found an article taking a historical look at how doctrine was developed during equally radical industrial transformations. In this article, we examine how courts have reacted to new industries or to radical transformations within existing industries. We explore two historical antecedents to the transformation in the health care industry, focusing on how courts adjusted existing doctrine to new factual scenarios raised by new industries, which seem particularly relevant in assessing how courts might think about ensuring accountability in managed care. Specifically, we examine and assess the doctrinal changes that occurred with the emergence of railroads in the nineteenth century and mass production in the twentieth century. We believe that a fresh look at these areas will provide insight into the doctrine courts must now fashion for managed care.

While neither event is, of course, analogous in every respect, the issues courts confronted in these two areas are remarkably similar to the issues courts must face now. We do not pretend that this review will provide easy or uncontroversial answers to this issue. In fact, as we discuss below, there is considerable controversy among scholars about how courts responded to previous industry

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3. See generally Peter D. Jacobson, *Legal Challenges to Managed Care Cost Containment Programs: An Initial Assessment*, HEALTH AFF., July/Aug. 1999, at 69 [hereinafter Jacobson, *Legal Challenges*]. At least for managed care doctrine, a fourth axis might be the interaction with the legislature. We will not explore that interaction in this Article.

transformations.<sup>4</sup> Nevertheless, our goal in this article is to assess the historical analogies to try to understand how doctrine changes and to stimulate further scholarly commentary about the most effective legal doctrine courts can develop to resolve managed care disputes.

We offer a model of how courts confront issues of developing legal doctrine, especially regarding liability, associated with nascent or dramatically transformed industries. The Article's genesis was earlier work we had done in health law (described below), particularly focusing on the managed care industry in the United States. In our survey of cases involving managed care entities in the courts, we have noticed a rather striking shift in judicial attitudes toward, and treatment of, managed care. Based on our observations, we constructed a model that captures the various stages of the courts' shift. We then asked ourselves whether this model was peculiar to managed care or, instead, more broadly reflected judicial approaches toward new industries across historical periods. Although our study is itself nascent, we can conclude, with some reservations, that our model seems adequately to describe a general, broadly applicable pattern.

Part I is a brief overview of scholarly thought on managed care and of our decision to analyze railroads and mass production. In Part II, we describe the five steps of the model, from birth of the industry to the doctrinal shift that holds the industry more fully accountable for injuries resulting from its operation. Parts III and IV examine the stories of, respectively, the birth of American railroads and the shift to mass production as historical counterparts to our emphasis on the health care industry. Part V applies the model to the managed care industry and suggests that managed care is now entering the fifth stage of our model. In Part VI, we discuss the limitations of our model, especially some relevant differences in the three nascent industries discussed. Focusing primarily on the contemporary managed care industry, Part VII sketches some avenues of future research, some ways courts might address the fifth stage, accountability, and the implications for the managed care field.

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4. See *infra* Part III.A.

## I. OVERVIEW

A. *The Scholarly Debate on Managed Care*

We will not attempt a comprehensive review of the scholarly debate over how the courts should respond to the changes in health care delivery, but we think that a brief summary of one aspect of that debate is important for the context of our historical analysis. Specifically, we refer to the philosophical and doctrinal dispute over the proper balance between tort and contract.

By far the dominant theme in the health care scholarly literature is that courts should use contracts to guide the legal relationships between stakeholders. These scholars, most prominently Professors Clark Havighurst, Richard Epstein, Haavi Morreim, and Mark Hall, argue that a contract-based approach will facilitate the transformation of health care into a market-driven industry. Professors Havighurst and Epstein go so far as to advocate that contracts alone should determine medical liability standards between the patient and the physician, although Havighurst has recently backed away from this in arguing in favor of enterprise liability,<sup>5</sup> and Morreim argues in favor of applying tort to sub-standard technical care. Each of these contract proponents shares the sense that the tort standard of care for medical liability is inefficient and that contracts would more efficiently represent consumer choices. In each author's view, retaining the current standard of care, which presumes a unitary standard of care that physicians owe their patients, undermines the market-based approach required to control health care costs and ensure more efficient health care delivery.

More recently, the literature favoring an expanded tort regime has revolved around applying enterprise medical liability (EML) to MCOs.<sup>6</sup> According to its proponents, the case for EML is that it is an efficient mechanism to shift control to institutions where quality of care can be closely monitored, yet it retains the role of the tort system as a means of accountability.<sup>7</sup>

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5. See generally Clark C. Havighurst, *Making Health Plans Accountable for the Quality of Care*, 31 GA. L. REV. 587 (1997) (arguing that managed care organizations should bear exclusive legal responsibility for their physicians' negligence).

6. See generally, Kenneth Abraham & Paul Weiler, *Enterprise Liability and the Choice of the Responsible Enterprise*, 20 AM. J.L. & MED. 29 (1994) (arguing that delivery-based enterprise liability would promote a sound tort system); William Sage, *Enterprise Liability for Medical Malpractice and Health Care Quality Improvement*, 20 AM. J.L. & MED. 1 (1994) (arguing that liability for medical malpractice should be refocused on the organizations).

7. See Abraham & Weiler, *supra* note 6, at 32.

*B. Why Look at Railroads and Mass Production?*

The common law generally develops incrementally in response to changing social and economic circumstances.<sup>8</sup> Sometimes, however, economic and social arrangements change so dramatically that the courts must adapt existing legal doctrine to a model of industrial change that has overtaken the context in which the original doctrine was developed.<sup>9</sup> In these instances, such as with the current transformation of health care delivery, there is an initial mismatch between existing legal doctrine and the reality of the newly developed industry. In other situations, new technology appears to emerge from an unrecognized industrial paradigm, requiring courts to make analogies to other areas of law to develop legal rules. An ongoing example of this is the emergence of the internet and related technologies.

In American legal history, two areas stand out as analogous to what the courts currently are confronting with managed care: the emergence of the railroads and the development of mass production techniques. Like managed care, both of these industries transformed from basically local activities to national markets. In the process, the developments radically altered consumer expectations of how goods and services would be delivered and dealt with the social problem of accidents. These are the same kinds of issues now being raised in the transformation of health care from a cottage industry based on fee-for-service payment to capitated managed care. Furthermore, our assessment of the process by which the courts developed doctrine in these areas suggests distinct parallels with how the courts are responding to the changes in health care delivery.

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8. See generally NORMAN F. CANTOR, *IMAGINING THE LAW* (1998) (explaining the historical development of the common law).

9. See generally Lawrence Lessig, *Erie-Effects of Volume 110: An Essay on Context in Interpretive Theory*, 110 HARV. L. REV. 1785 (1997) (describing a model of doctrinal change).

Therefore, the courts' responses to radical changes in the railroad and mass product contexts may illuminate how legal doctrine is developed and what lessons might be applicable to judges confronting the challenging legal issues in managed care.<sup>10</sup> In particular, the railroad experience offers a lesson in how courts settled on the appropriate legal regime to maintain legal accountability for accidents as the railroads grew. The mass production experience is insightful because courts had to analyze mass production's combined product and service delivery aspects, much as courts must now analyze the mixed financing and delivery aspects inherent in managed care.<sup>11</sup>

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10. From the start, we issue a word of caution: our analysis of the railroad and mass market manufacturing industries is drawn from studies by other scholars, most of whom have relied upon a review of appellate cases. In our study of the managed care industry, we have relied only upon published opinions, although they have come from both the trial and appellate levels. Necessarily, then, we are telling a story—really, three separate stories—which needs to be confirmed (or disproved) by further research, where possible.

11. A word about our research methods: the research project that forms the basis of this analysis is designed to explore the role of the courts in shaping health policy. Two particular aspects of the research are applicable to this Article. First, we conducted a comprehensive search and synthesis of the health services and law review literature dealing with the relationship between law and health care. Second, we conducted a case content analysis of trends in health care litigation. Using standard legal research tools such as Westlaw and Lexis/Nexis, we reviewed and coded a targeted sample of nearly 500 cases from a total universe of at least 3750 cases that included the terms "health maintenance organization," "HMO," "preferred provider," "utilization review," "managed care," and "IPA" (independent practice association). This search elicited a wide variety of cases, including antitrust disputes.

The purpose of the case content analysis was to provide insight into how courts have resolved the inherent conflicts presented by managed care, such as between cost containment and access to health care services; what analytical approaches judges use to resolve cases; whether there are different approaches across case types, such as utilization management, medical necessity, or antitrust; and the role policy considerations play in case outcomes. Each case was coded for the following indicators: whether the opinion discussed health care policy considerations; which policies were at issue; case outcome; procedural considerations, such as setting the burden of proof or the standard of review; reliance on the facts of the case; reliance on precedent; and deference to legislation or contractual obligations.

The case content analysis established the information base to categorize and explain trends and differences in the development of legal doctrine in managed care, as discussed in detail below. See *infra* Part V. Our statistical analysis will be reported in a subsequent article.

The information on the railroads and mass production, by contrast, is drawn from legal scholarship published primarily in leading law journals, including this one. Many of the authors of the articles on which we have drawn have used an empirical analysis somewhat similar to the one we have undertaken for managed care. See, e.g., Gary T. Schwartz, *Tort Law and the Economy in Nineteenth Century America: A Reinterpretation*, 90 YALE L.J. 1717, 1719–20 (1981) [hereinafter Schwartz, *Reinterpretation*]. Where there was disagreement in the literature on the results of such analyses, we tried to focus on broad areas of agreement rather than attempt to resolve continuing debates among scholars far more versed in their subject than we are.

## II. THE MODEL OF DOCTRINAL CHANGE

### A. *The Five-Step Model of Doctrinal Change*

The five steps of our model are:

1. Underlying Revolution and Birth of Nascent Industry
2. Doctrinal Mismatch
3. Period of Immunization and Strong Growth
4. Backlash Against Industry
5. Doctrinal Change with New Accountability

Nascent industries are rarely, if ever, born out of the ether.<sup>12</sup> Rather, some evolution of a familiar industry is so sudden, pervasive, or extensive that it amounts to a revolution. The result of this revolution is a “new” or “nascent” industry. The emergence of this nascent industry is the first step in our model.

One hallmark of the nascent industry is its uneasy fit within established parameters and doctrines of contemporaneous legal doctrine. Therefore, the first reaction, and second step of the pattern, is for courts to attempt to apply old doctrine, without changing it, to the nascent industry. Sometimes aspects of the old regime provide an acceptable fit that remains good law for years with few adjustments.<sup>13</sup> More often, however, there is some tension—a mismatch of established doctrine and new reality. One contemporary example of this mismatch is the application of First Amendment protections to the nascent Internet industry.

Courts are rarely blind to the mismatch. We suggest that courts faced with this dilemma tend—implicitly or explicitly—to perceive a policy favoring the nascent industry and to establish new legal doctrine which favors the industry.<sup>14</sup> Several sources may trigger this perception: the will of the legislature as expressed in statutory

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12. Cf. ARNOLD PACEY, *TECHNOLOGY IN WORLD CIVILIZATION: A THOUSAND YEAR HISTORY* 147 (1990) (“Few radically new inventions are made without some dependence on ideas already in circulation . . .”).

13. Common carrier liability rules for railroads were drawn from earlier English and American precedents applicable to stage coaches and other forms of transportation. See Robert J. Kaczorowski, *The Common Law Background of Nineteenth Century Tort Law*, 51 OHIO ST. L.J. 1127, 1150 (1990) (describing the application of common carrier liability rules to American railroads).

14. Identifying or “finding” a “public policy” is, of course, a familiar way for a court to legitimize its position in a democratic society. Cf. Lessig, *supra* note 9, at 1809 (noting the varying ways in which courts may respond to a need for change in doctrine required by the legal and factual context).

law and subsequent regulations; general policy considerations born out of the judge's (and as a somewhat homogenous group, the judges') understanding of the economic, political, and social context of the underlying industrial changes; and perhaps even the perceived tenor of popular opinion. Through doctrine, courts foster a period of at least partial immunity from liability for the new industry. This is the third step of our model. Immunized from liability, the new and favored industry is given a legally protected space in which to flourish. Contrary to other scholars,<sup>15</sup> we emphasize that the friendliness toward nascent industry may be animated as much by confusion as by design.

We step aside here briefly to discuss what we mean by immunity. As we use the term, immunity describes legal doctrine that tends to produce outcomes more protective of the industry than what might otherwise be expected from either the logic of precedent or statutory language. Immunity may not be the intent. Instead it may be the result of a change in one of three dimensions: in the legal regime (tort or contract), in the liability standard itself (no liability, negligence, strict liability, and absolute liability),<sup>16</sup> or in the rules subsidiary to a particular standard. *Res ipsa loquitor*, for example, is a rule subsidiary to the negligence standard of liability because it makes it unnecessary for the plaintiff to prove one of the elements of a negligence tort claim.<sup>17</sup> Subsidiary rules are those rules, then, that operationalize a particular liability standard and which are used by a court in applying a standard to a set of facts.

The fourth step is the backlash against the industry in general and against the industry's legal immunity in particular. The sources of the fourth step may be even more various than those from which the courts originally found a favorable policy. For example, the backlash may be expressed through public outcry, the media, scholars, or legislatures. Even before the backlash triggers any change in doctrine, courts may participate in it by decrying the state of the law in published opinions while simultaneously applying the law strictly, despite the perceived unfairness of doing so.

The fifth and final step of our model is the emergence of a new doctrinal method that holds the nascent industry more fully accountable for its operations. It has been suggested that this new accountability emerges at the point where the rhetorical cost of

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15. See MARTIN HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW, 1780-1860*, at 99-101 (1977) (describing his "Subsidy Thesis").

16. See Steven P. Croley & Jon D. Hansen, *Rescuing the Revolution: The Revived Case for Enterprise Liability*, 91 MICH. L. REV. 683, 692-94 (1993) (defining four liability standards).

17. See W. PAGE KEETON ET AL., *PROSSER AND KEETON ON THE LAW OF TORTS* § 28, at 257-62 (5th ed. 1984) (describing procedural effect of doctrine).

adhering to the old doctrinal regime, in the face of the backlash, becomes unbearable.<sup>18</sup> Within this greater accountability, we have also seen indications that courts may be advancing their own interests in one particular way. Often the doctrine courts derive when an industry is mature seems to reserve to the courts a fair amount of discretion by settling on flexible, rather than rigid, doctrinal forms.<sup>19</sup> Because we have not focused on this aspect of change, we will allude to it only in a perfunctory way, reserving greater elaboration for our future research.

### III. THE RAILROAD STORY

#### A. Introduction

There is no single railroad story. Historical distance and the fact that railroads tended to be creatures of the state in which they operated frustrate efforts to create an overarching theory. Therefore there are several stories. Each attempts to account for changes in the law at the time of the rise of railroads, roughly 1830 to 1870.

Professor Martin Horwitz's "Subsidy Thesis"<sup>20</sup> is a story which is particularly hospitable to our model. Professor Horwitz argues that nineteenth century judges, for the first time, used the common law in purposive, instrumental ways.<sup>21</sup> In particular, he argues that judges deliberately used the common law to benefit the existing economic and political powers.<sup>22</sup> Judges changed common law doctrine in order to benefit an industry with a judicial "subsidy" by shifting some of the costs of that industry to individuals, particularly poor and powerless individuals.<sup>23</sup> The railroads were chief among the industries so benefited.<sup>24</sup> Horwitz argues that courts achieved this result by shifting the liability standard from what (he claims) otherwise would have been applicable, i.e., from strict liability to negligence, which made it more difficult for plaintiffs to

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18. See Lessig, *supra* note 9, at 1795 (describing how doctrines change in light of new circumstances).

19. See *infra* text accompanying notes 105-08.

20. See HORWITZ, *supra* note 15, at 253.

21. See *id.*

22. See *id.* at 53.

23. See *id.* at 99-100; see also LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 473 (2d ed. 1985).

24. See HORWITZ, *supra* note 15, at 69-71 (describing railroads' complaints about damage and subsequent changes in law).

recover.<sup>25</sup> Courts also changed the subsidiary rules by promulgating such concepts as contributory negligence and the fellow servant rule.<sup>26</sup>

Horwitz's account has been widely criticized.<sup>27</sup> For example, in examining cases from five states, Professor Schwartz finds no evidence of a subsidy to industrial development in general or railroads in particular,<sup>28</sup> except perhaps in the fellow servant rule.<sup>29</sup> Instead, Schwartz argues that the negligence (fault-based) liability standard, far from being created by nineteenth century jurists, had a long tradition in the law.<sup>30</sup> Thus, Schwartz sees no shift in the liability standard. Moreover, Schwartz argues that subsidiary rules of the negligence liability standard were "applied with impressive sternness to major industries and that tort law exhibited a keen concern for victim welfare."<sup>31</sup> Schwartz has in turn been criticized for the time periods he employed, for his generalization from a limited sample of states, and for his exclusive use of appellate cases.<sup>32</sup>

As no definite consensus has emerged as to which, if either, of these accounts is correct, we have navigated a middle ground in fashioning our own account. From reviewing a wide selection of commentators, we hope to capture the common ground between Schwartz and Horwitz, while deferring to other commentators—or taking no position at all—where their disagreement is profound. For example, given the mixed historical evidence on whether the fault-based liability standard became newly widespread in the nineteenth century,<sup>33</sup> we focus instead on the subsidiary rules of that era. As a second example, unlike Horwitz we do not take a

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25. See *id.* at 85.

26. See *id.* at 209–10.

27. See, e.g., Kaczorowski, *supra* note 13, at 1199; Schwartz, *Reinterpretation*, *supra* note 11, at 1718 *passim*; Gary T. Schwartz, *The Character of Early American Tort Law*, 36 UCLA L. REV. 641, 641 *passim* (1989) [hereinafter Schwartz, *Tort Law*].

28. See Schwartz, *Tort Law*, *supra* note 27, at 664–65; Schwartz, *Reinterpretation*, *supra* note 11, at 1773–75.

29. See Schwartz, *Reinterpretation*, *supra* note 11, at 1720, 1767–72.

30. See *id.* at 1722–34 (tracing historical origins of negligence).

31. *Id.* at 1720 (footnote omitted).

32. See, e.g., James Logan Hunt, Note, *Private Law and Public Policy: Negligence Law and Political Change in Nineteenth Century North Carolina*, 66 N.C. L. REV. 421, 423 n.28 (1988) [hereinafter Hunt, *Private Law*]; James L. Hunt, *Ensuring the Incalculable Benefits of Railroads: The Origins of Liability for Negligence in Georgia*, 7 S. CAL. INTERDISC. L.J. 375, 381 (1998) [hereinafter Hunt, *Incalculable Benefits*] (“[I]nsistence on broad generalization, limited chronology, and a dichotomous winners and losers approach for the entire century may have distorted accounts of early negligence law.”).

33. See generally Schwartz, *Reinterpretation*, *supra* note 11, at 1773–75 (comparing his conclusions with those of other commentators).

strong position on how “deliberate” the changes in doctrine were. We turn now to the telling of our story.

### B. *Setting the Stage*

Keeping in mind the divergent scholarship, we begin by describing the state of doctrinal development before the advent of the railroad. Tort, insofar as we think of it as a regime imposing on strangers a general and mutual duty of care, was not a coherent concept prior to railroads and industrialization.<sup>34</sup> Suits for damages tended to be based on the relationship between the parties,<sup>35</sup> often arising out of status, property, or contract considerations.<sup>36</sup> Thus, courts would “discover”<sup>37</sup> duties based on relative status: employer-employee, innkeeper-guest, or passenger-carrier.<sup>38</sup> A common carrier, for example, was held strictly liable for injuries to his passenger, based on the relationship between them.<sup>39</sup>

Duties could also arise from the terms of a contract,<sup>40</sup> though courts did not evaluate the intrinsic fairness of contracts, as they would in later years through doctrines like unconscionability and the idea of contracts of adhesion.<sup>41</sup> Parties to a contract were presumed to have equal bargaining power, and the contract was enforced strictly according to its terms.<sup>42</sup>

Finally, property considerations led courts to imply duties.<sup>43</sup> Before the railroad, the owner of property was generally required to use his property so as not to hurt his neighbors. Conversely, to those entering the owner’s property, the owner’s duty was less rig-

34. See, e.g., FRIEDMAN, *supra* note 23, at 299; James R. Hackney, Jr., *The Intellectual Origins of American Strict Products Liability: A Case Study in American Pragmatic Instrumentalism*, 39 AM. J. LEGAL HIST. 443, 453 (1995); Hunt, *Incalculable Benefits*, *supra* note 32, at 397.

35. See Hunt, *Private Law*, *supra* note 32, at 424.

36. See Robert Rabin, *The Historical Development of the Fault Principle: A Reinterpretation*, 15 GA. L. REV. 925, 933–45 (1981).

37. See Lessig, *supra* note 9, at 1792–93 (noting that the common law was viewed as something “discovered” rather than fashioned).

38. See Rabin, *supra* note 36, at 933–45.

39. See Kaczorowski, *supra* note 13, at 1129–30 (noting that, at this time, contract and tort were not so distinct as concepts to permit a clear statement as to under which of the two theories plaintiff-passengers might be said to have recovered).

40. See HORWITZ, *supra* note 15, at 87.

41. See Rabin, *supra* note 36, at 947 (attributing certain tort doctrines to assumptions about freedom of contract).

42. Cf. *id.* at 946 (“The mere existence of a claim based on a defective product, rather than any actual bargaining involving the injured plaintiff, led the common law judge to draw on a contract analogue.”).

43. See HORWITZ, *supra* note 15, at 71, 95, 99 (discussing change from this principle).

orous and generally governed by status: he owed a higher duty to invitees than to strangers (trespassers).<sup>44</sup> Outside of these contract, property, and status-based duties, "the general principle of our law was that loss from accident must lie where it falls."<sup>45</sup> Into this doctrinal structure, the railroad industry was born.

### C. Applying the Model

1. *Birth of a Nascent Industry*—All the railroad stories share the fact that the railroad was revolutionary.<sup>46</sup> It decreased travel time and cost and was the key to economic development, connecting farms to cities and seaports.<sup>47</sup> The railroads' rise to dominance is reflected in the fact that the miles of track laid rose from 3000 in 1840 to 52,000 in 1870.<sup>48</sup> During this time, the railroad was in its relatively youthful stages and largely confined to areas of economic importance.<sup>49</sup> But the first transcontinental railroad was completed in 1869,<sup>50</sup> signaling perhaps the maturation of the industry. Part of the revolutionary nature of the railroads in this period was the drastic increase in the number of personal injuries they produced,<sup>51</sup> which courts were called upon to address.

2. *Doctrinal Mismatch*—The background doctrinal structure accommodated neither the nature nor the volume of railroad accidents.<sup>52</sup> "[T]he courts were confronted with recurrent injury situations having no close analogue in the earlier common law. Railroads and motor vehicles, for example, created a variety of risks to strangers that bore no obvious likeness to the harm caused by stampeding animals, stealthy poachers, or irresponsible innkeepers."<sup>53</sup> Such accidents included fires started from sparks thrown off by locomotives that burned both fields and houses, as well as collisions with wandering cattle and inattentive human beings. Railroad

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44. See Rabin, *supra* note 36, at 935–36.

45. OLIVER WENDALL HOLMES, *THE COMMON LAW* 94 (1881).

46. See also Rabin, *supra* note 36, at 928 ("[F]ault liability emerged out of a world-view dominated largely by no-liability thinking.").

47. See FRIEDMAN, *supra* note 23, at 468.

48. See *id.* at 471.

49. See THOMAS V. DIACCO, *MADE IN THE U.S.A.: THE HISTORY OF AMERICAN BUSINESS* 139 (1987).

50. See PACEY, *supra* note 12, at 150.

51. See FRIEDMAN, *supra* note 23, at 300, 468.

52. See *id.* at 300 ("Existing tort law was simply not designed to deal with [railroad] accidents . . .").

53. Rabin, *supra* note 36, at 947.

accidents also included injuries to passengers and, perhaps most dramatically, terrible injuries to railroad workers. The fires and collisions were doctrinally troublesome because they involved injury to strangers, who generally shared no contract, property, or status-based link to the railroad company. These concepts, based on a world view of ongoing, personal, and consensual relationships, did not give courts the conceptual tools to account for, or allocate the costs of, injuries. In addition, the personal injuries—to workers especially—were troublesome because of their volume, which was like nothing the courts had seen before. As an example of the carnage, consider that in a one year period from 1888 to 1889, one worker died for every 357 employed, and one out of thirty-five was injured.<sup>54</sup> Courts were troubled by the potential for ruinous, unchecked liability that could inhibit economic initiative and which threatened to clog the whole court system.<sup>55</sup> Lawsuits were seen as a threat to the health of a “precarious enterprise.”<sup>56</sup> The railroads’ novelty, therefore, confronted the courts with difficult doctrinal choices: “[W]hether railroads would be held to a standard of negligence, strict liability, or something in between was in doubt.”<sup>57</sup> Tort emerged as a coherent concept,<sup>58</sup> largely as a tool to enable courts to deal with the railroad issues.

3. *Period of Immunity*—There is no question, however, that in facing these questions, courts recognized the importance of railroads.

Railroad associations have become of great and growing importance; they afford hi-ways of incalculable value to commerce, and the ever ready means of social intercourse between distant communities. They are, at this moment, welding together, link after link, the conservative chain, which is to hold in firm union, more than six and twenty States. . . .<sup>59</sup>

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54. See FRIEDMAN, *supra* note 23, at 479.

55. See *id.* at 468.

56. *Id.*

57. Hunt, *Private Law*, *supra* note 32, at 426.

58. See FRIEDMAN, *supra* note 23, at 300 (attributing emergence of tort as a coherent concept to the rise of railroads); see also Percy H. Winfield, *The History of Negligence in the Law of Torts*, 42 L.Q. REV. 184, 195 (1926) (describing the emergence of the concept of negligence in torts).

59. *State v. Tupper*, 23 S.C.L. (Dud.) 135, 141 (1838), quoted in Schwartz, *Tort Law*, *supra* note 27, at 652.

In the context of justifying the emerging negligence regime, Oliver Wendell Holmes noted that "the public generally profits by individual activity,"<sup>60</sup> and "[a]s action cannot be avoided, and tends to the public good, there is obviously no policy in throwing the hazard of what is at once desirable and inevitable upon the actor."<sup>61</sup> Holmes's words suggest a certain concern for the continuing health of the railroad industry, which was nothing if not active and vigorous. The perceptions of judges like Holmes were probably bolstered by the fact that "[t]he plain people loved the railroad passionately."<sup>62</sup> Even Walt Whitman celebrated it in poetry.<sup>63</sup> The railroad was generally treated as a symbol of positive change.<sup>64</sup>

Courts acted to some degree on this recognition of a favorable attitude toward railroads by reducing the extent of their liability.<sup>65</sup> In Georgia, for example, the Supreme Court "was very concerned about 'excessive' liability, which was generally understood in economic terms: liability that would put railroads out of business."<sup>66</sup> Given the mixed historical evidence offered by Professors Horwitz and Schwartz, we are unable to comment with any certainty about whether, as a general matter, there was a shift in the liability standard from strict liability to negligence. However, absolute liability—which was a standard courts could have found applicable based on the maxim that one must use one's property so as not to injure another<sup>67</sup>—was rejected because of the specter of draining the coffers of industrious enterprises.<sup>68</sup> Arguably, then, notwithstanding any change or lack thereof with regard to the negligence liability standard in tort that ultimately emerged, the rejection of absolute liability alone may be seen as a judicially created immunity. In Georgia, courts justified the rejection of absolute liability expressly to protect railroads:

Besides its oppressive injustice, [absolute liability] would be grossly inexpedient, inasmuch as it would deny to the public the incalculable benefits of Railroads, for no company would

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60. HOLMES, *supra* note 45, at 97.

61. *Id.*

62. DAVID FREEMAN HAWKE, *NUTS AND BOLTS OF THE PAST: A HISTORY OF AMERICAN TECHNOLOGY 1776-1860*, at 232 (1988).

63. See PACEY, *supra* note 12, at 165 (describing poetry of Whitman).

64. See *id.* at 164-65.

65. See HAWKE, *supra* note 62, at 219 (stating that Massachusetts Supreme Court Chief Justice Lemuel Shaw "led the way in adapting the common law to the needs of the railroad enterprise") (internal quotations omitted).

66. Hunt, *Incalculable Benefits*, *supra* note 32, at 427.

67. See Hunt, *Private Law*, *supra* note 32, at 427.

68. See *Ryan v. New York Cent. R.R. Co.*, 35 N.Y. 210, 216-17 (1866).

long exercise franchises thus encumbered . . . Railroads, by virtue of their charters, are exempted from the operation of the Common Law, as to liabilities for injuries done to property.<sup>69</sup>

The subsidiary rules offer better mechanisms for analysis in this regard. One example is the fellow servant rule, which was adopted in many jurisdictions. Created at the birth of the railroad industry, the fellow servant rule prevented a railroad employee from recovering from the railroad for personal injury due to the negligence of one of his co-workers.<sup>70</sup> Because any negligent conduct resulting in injury was likely to be that of a fellow servant, the railroad was relieved of the burden of one possible heavy cost.<sup>71</sup> The rule may be seen as an immunity because of this benefit and because the rule was contrary to the general rule of agency, in which a principal is liable for the acts of his agent.<sup>72</sup> Thus, given a choice and unconstrained by clear precedent, courts that adopted the fellow servant rule effectively granted an immunity at the time of the railroad's incipient development.<sup>73</sup>

The following evidence from several states also seems to reflect courts' favorable treatment of railroads when the existing doctrine met new factual scenarios caused by the new industry. In Maryland, courts were resistant to choosing a liability regime that would impose the greatest duties and costs on railroads.<sup>74</sup> The courts several times interpreted liability statutes considerably more leniently than the legislature intended,<sup>75</sup> leading to immediate statutory amendments that expressly required the higher standard that the courts had rejected.<sup>76</sup> In Georgia, courts resisted the higher liability standards that legislatures preferred.<sup>77</sup> Moreover, Georgia courts endorsed a shift away from absolute common carrier liability. By enforcing contractual disclaimers of liability to which they had previously given no effect, the Georgia courts also put the burden of proving railroad negligence on the plaintiff.<sup>78</sup> In North Carolina,

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69. *Macon & W.R.R. Co. v. Davis*, 13 Ga. 68, 85–87 (1853), quoted in Hunt, *Incalculable Benefits*, *supra* note 32, at 395. In the *Davis* case, the court was interpreting legislation that chartered railroads to determine the appropriate standard of liability.

70. See FRIEDMAN, *supra* note 23, at 301–02.

71. See *id.* at 301–02.

72. See *id.* at 301.

73. See *id.* at 301–02.

74. See Schwartz, *Tort Law*, *supra* note 27, at 656.

75. See *id.*

76. See *id.*

77. See Hunt, *Incalculable Benefits*, *supra* note 32, at 386.

78. See *id.* at 401.

the doctrine also tended to produce verdicts for the railroad defendants,<sup>79</sup> and the language and reasoning of the railroad cases were clearly pro-railroad.<sup>80</sup>

Nationwide, the doctrine of assumption of risk also immunized railroads from much liability,<sup>81</sup> and some historians attribute the doctrine's growth to "spoon-feeding [the railroad] enterprise, the blind desire for economic growth."<sup>82</sup> Assumption of risk provided that railroad employees, by agreeing to employment in a dangerous industry, assumed the risk of their injuries and therefore could not recover from the railroad.<sup>83</sup> The doctrine was also applicable to those who willingly put themselves in a position of danger.<sup>84</sup> Its use increased drastically in cases from the dawn of the railroad era.<sup>85</sup> Finally, the once legally moribund idea that a tort action was personal, and ended when the injured person died, was resurrected for the purpose of protecting railroads from wrongful death actions.<sup>86</sup> "The thrust of the rules, taken as a whole, approached the position that corporate enterprise should be flatly immune from actions for personal injury."<sup>87</sup>

Yet the period of immunization did not entail complete immunity. Courts characterized the railroads in a manner similar to other common carriers. Indeed, the idea of liability for common carriers with respect to guests (passengers), one of the oldest ideas in the law,<sup>88</sup> easily transferred to railroads.<sup>89</sup> Despite this, the nineteenth century saw the rise of the contributory negligence rule in most jurisdictions.<sup>90</sup> Contributory negligence barred recovery for passenger and employee alike in the event that the injured person

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79. See Hunt, *Private Law*, *supra* note 32, at 429.

80. See *id.* at 429–30 (describing the court's reasoning).

81. See FRIEDMAN, *supra* note 23, at 473.

82. *Id.* at 472–73.

83. See KEETON ET AL., *supra* note 17, at 161 (describing doctrine and citing cases).

84. See FRIEDMAN, *supra* note 23, at 472.

85. See *id.*

86. See *id.* at 473–74 (citing *Carey v. Berkshire R.R.*, 55 Mass. (1 Cush.) 475 (1848)).

87. FRIEDMAN, *supra* note 23, at 475.

88. See KEETON ET AL., *supra* note 17, § 28, at 161.

89. See Nathan Honson, Note, *Iowa Tort History, 1839–1869: Subsidization of Enterprise or Equitable Allocation of Liability?*, 81 IOWA L. REV. 811, 818–20 (1996) (describing how courts applied principles derived in pre-railroad common carrier liability cases in railroad cases).

90. See FRIEDMAN, *supra* note 23, at 471 (citing Wex S. Malone, *The Formative Era of Contributory Negligence*, 41 U. ILL. L. REV. 151 (1946) (generalizing from many jurisdictions)); Hunt, *Incalculable Benefits*, *supra* note 32, at 413–14 (addressing case of Georgia). *But see* Honson, *supra* note 89, at 819–20 (arguing that in Iowa the contributory negligence rule did not favor carriers over passengers).

was at fault to any degree,<sup>91</sup> thus insulating the railroad from liability in these situations.<sup>92</sup>

4. *Backlash*—In time, however, came the backlash. “Politically, the rage of the victims counted for very little in 1840, not much in 1860; by 1890, it was a roaring force.”<sup>93</sup> In North Carolina, for example, the general assembly changed the law regarding burden of proof so that plaintiffs began to win more personal injury cases.<sup>94</sup> Railroads began to lose public favor,<sup>95</sup> and relatedly, public funding. Farmers organized in anti-railroad movements like the Grangers and the Populists.<sup>96</sup> Legislatures imposed more liability on railroads by statute,<sup>97</sup> and some judges began to speak of the “hardship and injustice” for which the fellow servant doctrine was responsible.<sup>98</sup>

5. *Doctrinal Change Toward Increased Accountability*—The fifth stage of our model followed: while still fearing that too much liability might ruin commercial life, the courts adjusted doctrine to favor railroads less.<sup>99</sup> In some jurisdictions, ideas of comparative negligence replaced contributory negligence.<sup>100</sup> Courts created exceptions to mitigate the effect of the fellow servant rule and developed new counter-rules.<sup>101</sup> For example, in cases where the defendant’s fault greatly outweighed that of the plaintiff, some courts modified the contributory negligence rule to allow a plaintiff’s recovery<sup>102</sup>—arguably the first step toward a more forgiving comparative negligence rule. Also, the Supreme Court refused to allow railroads to contract out of common carrier liability for negligence committed by their employees.<sup>103</sup> By the second half of the

91. See FRIEDMAN, *supra* note 23, at 302.

92. See *id.* at 471 (describing the rise in the use of contributory negligence doctrine from 1850 to 1880).

93. *Id.* at 476.

94. See Hunt, *Private Law*, *supra* note 32, at 429.

95. See *id.* at 433.

96. See DiBACCO, *supra* note 49, at 142.

97. See FRIEDMAN, *supra* note 23, at 478–79 (listing and describing example statutes from the various states).

98. *Id.* at 481.

99. See Hunt, *Private Law*, *supra* note 32, at 431–32. Professor Friedman points out, however, that the courts did not go as far as they might, given that the famous case of *Rylands v. Fletcher*, L.R., 3 H.L. 330 (1868), if adopted in this country, might have called for a rule of absolute liability for industrial accidents. See FRIEDMAN, *supra* note 23, at 485. Fear of crippling the new industries helped prevent the adoption of such a rule. See *id.* at 486.

100. See FRIEDMAN, *supra* note 23, at 476.

101. See *id.* at 483–84.

102. See KEETON ET AL., *supra* note 17, § 67, at 469–70 (describing doctrinal experiments in Illinois and Kansas).

103. See *Railroad Co. v. Lockwood*, 84 U.S. (17 Wall.) 357, 384 (1873), construed in *Kaczorowski*, *supra* note 13, at 1155.

century, negligence was fixed as the proper rubric under which to analyze the cases.<sup>104</sup>

An interesting corollary to the widespread use of the negligence regime was the emergence of somewhat vague concepts like proximate cause and due care,<sup>105</sup> as well as the somewhat ad hoc assignment of burdens of persuasion.<sup>106</sup> Both vague doctrine and ad hoc practice suggest that courts reserved to themselves a certain amount of discretion that they did not have with more hard-and-fast rules like the fellow servant doctrine. Thus, an incidental benefit of the doctrine developed around railroads was the courts' allocation to themselves of additional discretionary power, in which pro- or anti-railroad approaches (or pro- or anti-plaintiff approaches) might exhibit themselves as time went on, and the industry matured.<sup>107</sup> Certainty was out, accountability was more or less in, and a body of doctrine had now formed around the newly matured industry.<sup>108</sup>

#### IV. THE MASS PRODUCTION STORY

##### A. Introduction

Mass production is a name for "the method of producing goods in large quantities at low cost per unit . . . . The mass production process itself is characterized by mechanization to achieve high volume, elaborate organization of materials flow through various stages of manufacturing, careful supervision of quality standards, and minute division of labour."<sup>109</sup> The story of mass production that we tell is also necessarily complex, although for different reasons than the railroad case. First, we did not find much

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104. See KEETON ET AL., *supra* note 17, § 28, at 161.

105. See Thomas C. Galligan Jr., *Contortions Along the Boundary Between Contracts and Torts*, 69 TUL. L. REV. 457, 468 (1994) (stating that proximate cause, for example, has been used "not only to protect defendants from unlimited liability but also to shield defendants from full liability").

106. See Hunt, *Private Law*, *supra* note 32, at 435-36 (describing essentially ad hoc approach to burdens of persuasion that reflected judges' ideological stance as much as doctrine).

107. See *id.* at 436-38.

108. As to railroad employees, at the beginning of the twentieth century, state and federal statutes such as FELA and worker's compensation began to replace the state tort rules. See FRIEDMAN, *supra* note 23, at 484.

109. Melvin Kranzberg, *History of the Organization of Work: Organization of Work in the Industrial Age: The Coming of Mass Production*, Britannica CD, Version 97, Encyclopedia Britannica, Inc. (1997) [hereinafter Kranzberg, Britannica CD].

disagreement on what actually happened; mass manufacturing entailed changes in two types of liability—contract and tort. Second, in mass manufacturing the immunity arose not simply from doctrinal change but also from the failure of doctrinal change in the face of a changing world.<sup>110</sup> Third, pinpointing the relevant beginning and ending dates of the nascent and mature periods of mass production doctrine is much more difficult. Part of the problem is our own strategic decision not to focus on a particular industry that mass produced—a decision forced on us by the paucity of scholarship in any particular industry. We had to find a combination of practices and advancement sufficient to be labeled “mass production.”

### B. Setting the Stage

With these limitations in mind, we begin our story with an explanation of the background doctrinal context. Although tort was coming together as a coherent subject in the years immediately preceding the mass production era,<sup>111</sup> there was no history of tort-like recoveries for injuries due to bad products.<sup>112</sup> Where available, recoveries came in contract.<sup>113</sup> Such contract recoveries provided for strict (i.e., no fault) liability once breach of contract was shown.<sup>114</sup> As we noted in setting the stage for the railroad cases, contracts were strictly construed: an express warranty as a term of the contract was necessary in order to recover for product-based injury.<sup>115</sup> The baseline rule where the contract was silent was caveat emptor—let the buyer beware.<sup>116</sup> Moreover, the operation of express warranties was further limited: only those in privity with the

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110. Cf. Lessig, *supra* note 9, at 1795 (arguing that the contestability of legal practice arises from change in practice, change in understanding of practice, or both).

111. See *supra* Part III.B (describing how the railroads drove the formation of tort as a coherent concept in the law).

112. See Rabin, *supra* note 36, at 936–38. Liability for such production (loosely, products liability) began against a background of non-liability; that is, the early nineteenth century saw the flowering of the concept of caveat emptor—let the buyer beware. See KEETON ET AL., *supra* note 17, § 95A, at 679.

113. See KEETON ET AL., *supra* note 17, § 95A, at 679–80 (describing origin of products liability in contract).

114. See JOHN D. CALAMARI & JOSEPH M. PERILLO, *CONTRACTS* § 14-2, at 588 (3d ed. 1987) (noting that typically showing a breach of contract alone entitled plaintiff to a remedy, regardless of fault).

115. See Croley & Hansen, *supra* note 16, at 696.

116. See KEETON ET AL., *supra* note 17, § 95A, at 679.

producer could recover from him.<sup>117</sup> Thus, for the most part, there was neither tort nor contract recovery for defective products except on express warranty, and even then only for those in privity. Even before the mass production era, however, there were exceptions to the no-tort-like-liability rule for items that were imminently or inherently dangerous to human safety.<sup>118</sup> This was the doctrinal background existing at the birth of the mass production industry.

### C. Applying the Model

1. *Birth of an Industry*—It is difficult to pinpoint when mass market manufacturing began; certainly by the third quarter of the nineteenth century, some mass market manufacturing had begun in isolated industries.<sup>119</sup> These industries included sewing machines (1846), Yale locks (1855), and typewriters (1868).<sup>120</sup> None of these products appear to have presented inherent dangers. Furthermore, efforts to use scientific management to cut costs were still in a primitive stage prior to the turn of the century.<sup>121</sup> In 1899, Ransom E. Olds began mass production of cars in Detroit.<sup>122</sup> However, mass production only came to its full fruition when Henry Ford's assembly line mass-produced the Model T in 1913.<sup>123</sup>

2. *Doctrinal Mismatch*—Mismatch occurred because the world changed, but the doctrine did not.<sup>124</sup> Contract recovery doctrines, such as privity, were premised on a world in which transactions tended not to involve numerous middlemen, but instead involved personal, face-to-face encounters in the course of a continuing relationship. In this period, a majority of purchases were for items of necessity, and the consumer was reasonably familiar with what constituted acceptable quality of the items purchased.<sup>125</sup> Without a doubt, there were power inequities in this pre-mass-production

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117. See *Winterbottom v. Wright*, 10 M&W 109, 114, 152 Eng. Rep. 402 (Ex. 1842), cited in Rabin, *supra* note 36, at 936-38.

118. See KEETON ET AL., *supra* note 17, at 682.

119. See Kranzberg, Britannica CD, *supra* note 109.

120. See PACEY, *supra* note 12, at 146.

121. See DiBACCO, *supra* note 49, at 142.

122. See *id.* at 174.

123. See Kranzberg, Britannica CD, *supra* note 109.

124. Cf. Lessig, *supra* note 9, at 1793-95 (noting that as the federal general common law came to include a broader range of law, the "emerging impropriety" created pressure to restructure federal common law practice).

125. See EARL W. KINTER, A PRIMER ON THE LAW OF DECEPTIVE PRACTICES 9 (2d ed. 1978) (detailing the early growth of advertising in parallel to mass production growth).

world, but they did not compare with the vast wealth, power, and informational inequality existing between today's consumers and mass product manufacturing corporations.<sup>126</sup> Systems of advertising were personal, and systems of distribution were underdeveloped in comparison to the mass production era. Both a privity limitation and a requirement of express warranties made sense in light of the conditions of production and exchange. Because most exchanges occurred face-to-face, privity was often present and thus did not function so often as a limitation. Additionally, in the absence of power inequalities, requiring express warranties was not unfair.

But courts failed to adapt the old doctrine to the realities fostered by the new industry. Judges were familiar with treating product defects as contract issues. Thus, judges largely abjured a tort analysis, apparently feeling these cases arose under contract doctrine to the exclusion of tort doctrine.<sup>127</sup> Yet the old contract doctrines that had been developed in a bygone world of face-to-face encounters did not fit the conditions which existed in the early mass production era. By the time of the mass production era, the railroad industry had fully matured, facilitating distribution in a timely fashion over great distances.<sup>128</sup> Advertising in the mass production era became increasingly national in scope.<sup>129</sup> Mass production separated the producer from the end-user,<sup>130</sup> weakening personal concerns of the seller that might have forced producers to consider more carefully the safety of their products.<sup>131</sup>

3. *Period of Immunity*—The result of the doctrinal mismatch was that contract liability, which had been relatively effective in obtaining recoveries in the pre-mass production era (and entailed strict liability regardless of fault in the event of a breach), became much less powerful with the onset of mass production. Rarely did the privity required for contract recoveries exist, given the system of exchange in the mass production era.<sup>132</sup> As a consequence, the privity doctrine—although itself stable—became a powerful source of

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126. See *Henningsen v. Bloomfield Motors, Inc.*, 161 A.2d 69, 95 (N.J. 1960) (describing this change).

127. See Rabin, *supra* note 36, at 937 (describing this phenomenon and attributing this reason to it).

128. See Kranzberg, *Britannica CD*, *supra* note 109.

129. See *Henningsen*, 161 A.2d at 77 (describing this change); see also KINTER, *supra* note 125, at 3–5.

130. See THORSTEIN VEBLEN, *THE THEORY OF BUSINESS ENTERPRISE* 51–53 (1904), cited in Hackney, *supra* note 34, at 465.

131. See Hackney, *supra* note 34, at 465.

132. See KEETON ET AL., *supra* note 17, § 96, at 681–82.

immunity for the nascent industry.<sup>133</sup> Moreover, courts at this time enforced disclaimers of warranty liability, which further prevented contract recoveries, even for those in privity.<sup>134</sup> This was the general rule for the early decades of the mass marketing era,<sup>135</sup> so prior to 1960 few recovered on a contract theory.<sup>136</sup> As was the case with the railroad industry, the immunity was not total, but it was effective. Few cases were brought,<sup>137</sup> thereby achieving one of the acknowledged purposes of this immunity—to safeguard manufacturers against extensive liability to strangers, which was seen as too heavy a burden for industry to bear.<sup>138</sup>

Immediately before the mass production era, as noted above, there already existed some tort-like liability for products that were imminently or inherently dangerous to human safety.<sup>139</sup> At the same time, the *idea* of tort law (in areas other than products liability) had begun to coalesce on account of the railroads, resulting in the dominance of a negligence regime.<sup>140</sup> These two trends came together in *MacPherson v. Buick Motor Co.*,<sup>141</sup> where Judge Cardozo imported a general rule of negligence liability from railroad-driven tort law and applied it to products, regardless of privity or its absence.<sup>142</sup> This general rule, according to Judge Cardozo, merely recognized that the exceptions for products that were imminently or inherently dangerous to human safety were so numerous as to eclipse the previous rule of no tort-like liability for products.<sup>143</sup> Although *MacPherson* is often cited as a watershed case,<sup>144</sup> it may readily be seen to have done exactly what it purported to do:<sup>145</sup> it simply united the negligence-dominated field of tort with tort-like liability for products imminently or inherently dangerous to human safety.<sup>146</sup>

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133. See Robert L. Rabin, *Tort Law in Transition: Tracing the Patterns of Sociolegal Change*, 23 VAL. U. L. REV. 1, 7 (1988) [hereinafter Rabin, *Tort Law*] (arguing that requiring that the victim of a product injury be in contractual "privity with the defendant served as an effective damper on litigation against product manufacturers").

134. See KEETON ET AL., *supra* note 17, § 95A, at 681; see also John W. Wade, *Strict Product Liability: A Look at Its Evolution*, THE BRIEF, Fall 1989, at 8, 53.

135. See *id.*

136. See *id.* at 684.

137. See Gary T. Schwartz, *New Products, Old Products, Evolving Law, Retroactive Law*, 58 N.Y.U. L. REV. 796, 797 (1983) [hereinafter Schwartz, *New Products*].

138. See KEETON ET AL., *supra* note 17, § 96, at 682.

139. See *id.*; see also *supra* text accompanying note 118.

140. See HOLMES, *supra* note 45, at 76–77; see also *supra* text accompanying note 60.

141. 111 N.E. 1050, 1052–53 (N.Y. 1916).

142. See *id.* at 1052–53.

143. See *id.* at 1052 (noting the "trend of judicial thought").

144. See, e.g., Croley & Hansen, *supra* note 16, at 697.

145. See Schwartz, *New Products*, *supra* note 137, at 798.

146. See *id.* at 798–99.

Although at first glance Cardozo's opinion appeared hostile to the nascent mass production industry,<sup>147</sup> and although it found general acceptance,<sup>148</sup> its actual effect was not that great.<sup>149</sup> Actual recoveries for negligence on a tort theory were small: "[P]roduct defect claims, even after *MacPherson*, seem to have made modest demands on the legal system and to have gone unnoticed in the political forum."<sup>150</sup> *MacPherson* did not trigger a substantial increase in product liability litigation.<sup>151</sup> The negligence doctrine retained teeth that made recovery difficult.<sup>152</sup> For example, *res ipsa loquitur* was unavailable to plaintiffs because traditionally it required exclusive control by the manufacturer, which was obviously not the case when the product was put in the consumer's hand via a third party.<sup>153</sup> Negligence was therefore difficult to prove.<sup>154</sup> Also, the tort rule was mutable by contract, at least as it applied to purchasers: mass producers could disclaim liability, and courts would enforce the disclaimers.<sup>155</sup> Acceptance of Cardozo's opinion actually cut off a line of authority developing toward strict liability and thus in itself represented a kind of immunity.<sup>156</sup> Notwithstanding this abbreviated line of authority, recovery on a contract theory—had there been no subsidiary rules such as privity and disclaimers—would have been preferable to plaintiffs, because in theory breach of contract meant a standard of strict (i.e., no-fault) liability.<sup>157</sup> The inability to recover on a contract theory remained a form of immunity for mass market manufacturers from 1916 to 1958.<sup>158</sup> An indication of this immunity is the fact that insurance premiums for

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147. It was issued three years after Ford opened his assembly line and appeared to shift the liability standard from no liability to negligence. See *MacPherson*, 111 N.E. at 1050.

148. See KEETON ET AL., *supra* note 17, at 683.

149. See Rabin, *Tort Law*, *supra* note 133, at 7–8.

150. *Id.* at 8.

151. See Richard Epstein, *The Unintended Revolution in Product Liability Law*, 10 CARDOZO L. REV. 2193, 2199 (1989).

152. See *id.* at 2200.

153. See Schwartz, *New Products*, *supra* note 137, at 798.

154. See *id.*

155. See Croley & Hansen, *supra* note 16, at 697.

156. See Wade, *supra* note 134, at 11 (noting early products liability line of authority that tended toward strict liability but was cut off by development of negligence); see also Galligan, *supra* note 105, at 467. This kind of immunity was not a necessary outcome, occasioned by the immaturity of doctrine and/or social and legal thinking. Even before *MacPherson*, there were decisions imposing strict liability for one mass marketed product: food for human consumption. See, e.g., *State v. Kelly*, 43 N.E. 163 (Ohio 1896) (interpreting an Ohio food products statute that no knowledge of adulteration of the product necessary to incur liability); RESTATEMENT (SECOND) OF TORTS § 402A cmt. b (1965).

157. See Schwartz, *New Products*, *supra* note 137, at 801–02.

158. See KEETON ET AL., *supra* note 17, § 97, at 690.

product liability remained flat in the decades that followed *Macpherson*.<sup>159</sup>

4. *Backlash*—The backlash in the mass production industry came from judges and legal academics.<sup>160</sup> For example, in a powerful concurrence in *Escola v. Coca-Cola Bottling Co.*,<sup>161</sup> Justice Traynor of the California Supreme Court articulated the theory of strict products liability. He based his argument in large part on a sense of innate justice.<sup>162</sup> Legal academics in the 1940s and 1950s also emphasized ideas of fairness; their discussion of contracts of adhesion would strongly influence the court in *Henningsen*, a case that marked doctrinal change.<sup>163</sup> There was also a shift in viewing product injuries: they were regarded less as “accidents” and more “as an inevitable consequence of routine activities.”<sup>164</sup> This change called for a corollary change from notions of fault to notions of stricter liability indifferent to morality-based corrective justice concepts.<sup>165</sup> In other words, there was a call for greater accountability through enterprise liability.

5. *Doctrinal Change and New Accountability*—Doctrinal change in this industry took place both in the subsidiary rules and in the liability standard itself. The subsidiary rules changed gradually.<sup>166</sup> For example, beginning with the American Law Institute’s promulgation of the Restatement of Torts in 1934,<sup>167</sup> courts more willingly applied negligence principles to product design, in addition to product defects.<sup>168</sup> Also, in 1944, the Supreme Court of California permitted the use of *res ipsa loquitur* for product defect cases, relieving plaintiffs of having to prove one element of their tort actions.<sup>169</sup> These changes in the subsidiary rules created a system with a pro-plaintiff tendency that valued full accountability, even

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159. See Epstein, *supra* note 151, at 2199.

160. We have been unable to find substantial evidence of a popular backlash.

161. 150 P.2d 436, 440 (Cal. 1944).

162. See *id.* at 443–44.

163. See Epstein, *supra* note 151, at 2200–01; see also Friedrich Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 631–32 (1943).

164. Rabin, *Tort Law*, *supra* note 133, at 8–9, 12.

165. See *id.* at 12.

166. See Schwartz, *New Products*, *supra* note 137, at 799–804 (describing process of gradual change). Schwartz argues that it was not strict liability itself, but the demise of subsidiary rules (contributory negligence, assumption of risk) and the extension of the duty to warn of design defects that has resulted in the pro-plaintiff, full-accountability posture of post-1960s products liability law. See *id.* at 802–03.

167. See RESTATEMENT OF TORTS § 398 (1934).

168. See Schwartz, *New Products*, *supra* note 137, at 799–800 (describing development of new theories of recovery).

169. See *Escola v. Coca-Cola Bottling Co.*, 150 P.2d 436, 438–39 (Cal. 1944).

before the more abrupt changes in liability standard that occurred at the beginning of the sixties.<sup>170</sup>

The revolutionary changes of the 1960s arose most prominently in *Henningsen v. Bloomfield Motors, Inc.*<sup>171</sup> In *Henningsen*, the court held both a manufacturer and a dealer strictly liable by finding an implied warranty between the manufacturer and the consumer, despite the lack of privity.<sup>172</sup> Equally, if not more importantly, the court also refused to enforce a disclaimer of liability.<sup>173</sup> Among the reasons the New Jersey Supreme Court gave for its decision were the changed conditions of production and distribution associated with the maturing mass production field, including the economic and informational power imbalances.<sup>174</sup> Within three years the “implied warranty” approach essentially gave way to strict liability in tort.<sup>175</sup> Strict liability, of course, was accountability at its extreme. The shift between warranty and tort says something about legal change. First, it addressed the needs of the courts by providing a doctrine that was “more adaptable” than contract,<sup>176</sup> much as occurred in railroads, with the use of terms like proximate cause and foreseeability. Second, it simplified matters for the court by jettisoning doctrinal baggage associated with contract.<sup>177</sup> In light of what we have seen, it is not surprising that at the maturity of the mass production industry, courts would turn from warranty (contract) rules which had been developed with an eye to the purposes of commercial transactions, to enterprise liability in tort that had other goals.<sup>178</sup> Such goals included accounting for lack of consumer information about defects, loss spreading, and the difficulty of determining which injuries are attributable to product defects.<sup>179</sup> Nor is it surprising that with greater accountability we also see a

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170. See Schwartz, *New Products*, *supra* note 137, at 804–06.

171. 161 A.2d 69 (N.J. 1960).

172. See *id.* at 84. Although the concept of implied warranty has its origins in warranty (contract) law, it is really quasi-contractual and somewhat tort-like, in the sense that the “implied warranty” is not found “in” the contract but rather in the law of contract. However, prior to *Henningsen*, implied warranties could be negated by disclaimers (unlike tort rules in the usual case). See KEETON ET AL., *supra* note 17, at 690–91.

173. See Croley & Hansen, *supra* note 16, at 699–700.

174. See *Henningsen*, 161 A.2d at 78–79.

175. See KEETON ET AL., *supra* note 17, § 98, at 692–93 (offering three reasons for the change).

176. *Id.* at 693.

177. See *id.*

178. See Croley & Hansen, *supra* note 16, at 701.

179. See generally Roger J. Traynor, *The Ways and Meanings of Defective Products and Strict Liability*, 32 TENN. L. REV. 363 (1965) (explaining bases for expanding manufacturer’s liability). Loss spreading in particular marks an intellectual shift from Holmes’ statement that the general policy of law is to let loss lie where it falls. See *supra* text accompanying notes 59–60.

move toward judicial flexibility. This move is apparent in the choice of strict liability through flexible tort doctrine rather than strict liability through implied warranty, which might have constrained courts with the baggage of contract doctrine.

## V. THE MANAGED CARE STORY

### A. Introduction

Prepaid health care has been around since the colonial period, but only since the late 1980s has it achieved any widespread success. Before the late 1980s, fee-for-service medicine was the dominant paradigm. In fee-for-service medicine, patients paid fees for each visit and service provided. Financing was provided either by the patient or, more typically after World War II, through the patient's employer by a third-party commercial indemnity insurer. As an industry, fee-for-service medicine was hostile to the idea of prepaid health care,<sup>180</sup> a hostility reflected in part by laws prohibiting the corporate practice of medicine.<sup>181</sup> In fee-for-service medicine, neither patients, who were insured, nor physicians, who controlled the allocation of resources, had any incentives to limit services or costs.

Managed care revolutionized this paradigm by combining the financing and health care delivery aspects in one system.<sup>182</sup> Instead of paying a fee for each service, a patient subscribes to a managed care plan for a monthly fee that covers a defined set of benefits. For each visit or service, patients make an additional co-payment of five or ten dollars. At the heart of managed care is the promise that this approach could lower costs by imposing restraints on the amount of care provided without sacrificing quality of care. To do so, managed care initiated the widespread use of cost-containment techniques, ranging from aggressive utilization management (either prospective, concurrent, or retrospective) to selective contracting with providers.<sup>183</sup> While these techniques are now also used

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180. See Emily Friedman, *Capitation, Integration, and Managed Care: Lessons from Early Experiments*, 275 JAMA 957, 959 (1996) (noting that although corporate practice acts were not originally aimed at MCOs, they were used to discourage their operation).

181. See *id.*

182. This is a far more transformative departure than the shift from in-office physician care to hospitals as the locus of health care delivery, because it changes all aspects of the health care enterprise. See, e.g., *Darling v. Charleston Community Mem'l. Hosp.*, 211 N.E.2d 253, 257 (Ill. 1965).

183. See generally Jacobson, *Legal Challenges*, *supra* note 3.

by commercial insurers, managed care providers have been much more aggressive in using them to reduce costs.

### B. Setting the Stage

As recently as the late 1960s and early 1970s, health care litigation was dominated by medical liability claims governed by a reasonably stable set of legal rules.<sup>184</sup> Both sides could predict the nature and scope of the litigation because the essential rules establishing the standard of care and the types of litigation initiated varied little during this period.<sup>185</sup> A typical court case involved one patient suing one physician, guided by liability rules that reflected judicial deference to physicians in setting the standard of care.<sup>186</sup> Although there were constant complaints from physicians about the intrusiveness of medical malpractice law and an incipient rise in medical liability claims, litigation was confined largely to the caregiver-patient relationship.<sup>187</sup>

Several legal scholars have argued persuasively that throughout this period a symbiotic relationship existed between law and medicine, with the courts actually upholding physician dominance over health care delivery and acting as a conduit for the expansion of the medical industry. In this sense, the courts reinforced what has been termed the professional dominance model (where physicians essentially controlled the health care delivery system).<sup>188</sup> This concept meant that courts generally deferred to the treating physician's judgment in deciding what services should be provided and how the clinical encounter should be conducted.<sup>189</sup> Both case law and legislation prohibited the corporate practice of medicine,<sup>190</sup> sharply reducing the ability of alternative organizational forms, such as prepaid health care, to expand.<sup>191</sup>

In most states, prior to the mid-1960s, charitable immunity prevented the patient from suing the hospital for medical injuries occurring there.<sup>192</sup> Reflecting changes in how health care was deliv-

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184. See Jacobson, *Medical Malpractice*, *supra* note 2, at 3323, 3325.

185. See *id.*

186. See *id.*

187. See generally Peter D. Jacobson & Edward Goldman, *Health Care and the Law: How It's Changed and Why It Matters* (1999) (unpublished manuscript, on file with the authors).

188. See *id.* at 3.

189. See *id.*

190. See *id.*

191. See *id.*

192. See *id.* at 4.

ered, namely the increasing importance of the hospital as the center of health care delivery, courts began adapting medical liability principles to hospitals. Following the precedent-setting case of *Darling v. Charleston Community Memorial Hospital*<sup>193</sup> in 1965, courts around the country began to impose liability on hospitals for actions that were previously the exclusive domain of physicians.<sup>194</sup>

### C. Applying the Model

1. *Birth of an Industry*—In March 1970, the Nixon administration decided to offer an HMO option under Medicare and Medicaid. After various stops and starts, Congress passed the Health Maintenance Organization Act of 1973,<sup>195</sup> designed in part to require employers covered by the Fair Labor Standards Act to offer an HMO option to their employees. Although the Nixon administration had ambitious plans for the new health care financing option, the bill initially hobbled the HMOs with regulation.<sup>196</sup> Consequently, growth was slow.<sup>197</sup> Meanwhile, political pressure to reduce the increasingly exorbitant cost of health care continued to mount,<sup>198</sup> and in 1978 Congress amended the laws to increase federal aid to HMOs.<sup>199</sup> In this climate, managed care began to flourish, first in specific regions of the country such as California, the upper Midwest, and certain cities in the Northeast, and then in a broader fashion.<sup>200</sup> The expansion of managed care coincided with a political and intellectual push for less regulation and a “market-based” approach to health policy and health care delivery.<sup>201</sup> By the mid to late 1980s, health care delivery was shifting from a cottage industry dominated by medical professionals and non-market-based (charitable) considerations to an industry

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193. 211 N.E.2d 253 (Ill. 1965).

194. *See id.* at 253.

195. 42 U.S.C. § 300e-300e-17 (1973).

196. *See* PAUL STARR, *THE SOCIAL TRANSFORMATION OF AMERICAN MEDICINE* 407 (1982).

197. *See id.* at 407-08.

198. *See id.* at 411-17.

199. *See* Barry R. Furrow, *Managed Care Organizations and Patient Injury: Rethinking Liability*, 31 GA. L. REV. 419, 429 (1997).

200. *See* STARR, *supra* note 196, at 415.

201. *See id.* at 418-19. As Professor Havighurst has noted, “[a]lthough the legal system originally bolstered the old medical regime and embodied most of its tenets, changes in legal rules and doctrine eventually contributed to the old system’s demise and its replacement by a more chaotic, partly market-driven system.” CLARK C. HAVIGHURST ET AL., *HEALTH CARE LAW AND POLICY*, at xii (2d ed. 1998).

increasingly guided by traditional market rules and arrangements.<sup>202</sup> Correspondingly, health care law has moved from an exploration of the caregiver-patient relationship (primarily around medical liability) to a set of rules governing the entire method of delivering and paying for health care.<sup>203</sup> The result is a nearly complete transfer of power within the health care industry from doctors to corporate managed care entities.<sup>204</sup>

2. *Mismatch and Confusion*—The changes in the health care environment have inevitably resulted in a new set of issues to be litigated. New features of the managed care environment raise novel issues likely to emerge, particularly the conflict between population-based cost containment and access for individual subscribers (sometimes to experimental procedures), the multiplicity of actors in a given case, and the evolving nature of the organizational structures.<sup>205</sup> Just as the courts had to adapt medical liability principles to hospitals,<sup>206</sup> the same process is now underway with regard to the emerging organizational forms comprising managed care.<sup>207</sup> There is inevitably a learning curve as courts become educated about the underlying changes and begin to adapt principles derived for a different model to the new arrangements. For example, instead of the simple model of litigation involving one physician and one patient, managed care litigation may include the patient, the physician, the health plan, the utilization review firm, and the administrator of an ERISA-covered plan.<sup>208</sup> Sorting out which party is legally responsible for delayed or denied care and determining the acceptable level of care resulting from cost containment strategies remains a work in progress.

Courts are only recently becoming comfortable with the idea that MCOs are more than financiers of health care (that is, as entities which provide mixed functions as insurer and provider).<sup>209</sup> The

202. See Jacobson & Goldman, *supra* note 187, at 10.

203. See *id.* at 1.

204. See STARR, *supra* note 196, at 428. See generally Jacobson & Goldman, *supra* note 187.

205. See Jacobson, *Legal Challenges*, *supra* note 3, at 71.

206. See *supra* text accompanying notes 193–94.

207. See *id.*

208. See, e.g., *Danca v. Emerson Hosp.*, 9 F. Supp. 2d 27, 29 (D. Mass. 1998) (challenging liability claim against an insurer, a claims administrator, two hospitals, and three physicians).

209. Compare *Lancaster v. Kaiser Found. Health Plan, Inc.*, 958 F. Supp. 1137, 1139 n.2 (E.D. Va. 1997) (stating that HMOs perform two “independent” functions), with *Corcoran v. United HealthCare, Inc.*, 965 F.2d 1321, 1331–34 (5th Cir. 1992) (noting the functions are inextricably intertwined), *Crocco v. Xerox Corp.*, 956 F. Supp. 129, 140 (D. Conn. 1997) (stating that medical benefits plan administrators necessarily make medical decisions), *aff’d. in relevant part*, 137 F.3d 105 (2d Cir. 1998), and *Murphy v. Board of Med. Exam’rs*, 949 P.2d 530, 538 (Ariz. Ct. App. 1997) (holding that MCO decisions are medical, not financial).

symptoms of discomfort and lack of familiarity showed early on: courts routinely referred to MCOs and prepaid health plans as "insurance" and seemed unsure how to characterize utilization review for liability purposes.<sup>210</sup> As late as 1991, courts felt it necessary to define in their opinions what exactly this strange beast known as a "health maintenance organization" was.<sup>211</sup>

*McClellan v. Health Maintenance Organization of Pennsylvania*<sup>212</sup> demonstrates one court's uneasiness with the HMO concept.<sup>213</sup> The case addressed whether an independent practice association (IPA)<sup>214</sup> fell within the statutory definition of a professional health care provider for purposes of a motion to compel the disclosure of certain documents to ascertain liability.<sup>215</sup> The court upheld the lower court's decision that an IPA did not meet the statutory definition.<sup>216</sup> The judges voting to affirm viewed the IPA strictly in relation to the older forms of health care delivery, stating that an IPA cannot be regarded as a health care provider because it "cannot oversee patient care within its walls."<sup>217</sup> In contrast, one of the three dissenting judges noted that this conclusion "ignores the reality of health care today."<sup>218</sup> A corporation operating a health care facility may not be in a place where it can oversee patient care "within its walls."<sup>219</sup>

In the context of utilization review (UR),<sup>220</sup> courts also seem unable to come to grips with the reality that utilization review entails clinical decision making.<sup>221</sup> For this reason, they either deny that

210. Compare *Wota v. Blue Cross & Blue Shield*, 820 P.2d 1137 (Colo. Ct. App. 1991) (referring to prepaid health plan as "insurance" throughout), with DONALD K. FREEBORN & CLYDE R. POPE, *PROMISE AND PERFORMANCE IN MANAGED CARE: THE PREPAID GROUP PRACTICE MODEL* 53 (1994) ("When people join an HMO, they are not just buying health insurance. They are buying access to a health care system and have a contractual right to medically necessary services.").

211. See *Chase v. Independent Practice Ass'n*, 583 N.E.2d 251, 252 n.3 (Mass. App. Ct. 1991) (defining a health maintenance organization as "an entity that both insures for the cost and provides for the delivery of health care services, through negotiated contractual arrangements with selected hospitals and physicians, to a defined, voluntarily enrolled patient population . . . in exchange for periodic, prepaid, per capita premiums").

212. 686 A.2d 801 (Pa. 1996).

213. See *id.*

214. An IPA is a group of physicians (such as a multi-specialty group) that contracts with managed care firms and commercial insurers to provide medical services.

215. See *McClellan*, 686 A.2d at 804.

216. See *id.* at 806-07.

217. *Id.* at 806.

218. *Id.* at 809 (Nigro, J., dissenting).

219. *Id.* (internal quotations omitted).

220. See *Andrews-Clarke v. Travelers Ins. Co.*, 984 F. Supp. 49, 50 n.9 (D. Mass. 1997) ("Utilization review refers to an external evaluation of the appropriateness of a given course of treatment based upon established clinical criteria.").

221. See Jacobson, *Legal Challenges*, *supra* note 3, at 75-76.

UR decisions are medical,<sup>222</sup> or they recognize the hybrid nature of UR but hold that the administrative aspect trumps the medical aspect.<sup>223</sup> Furthermore, in reviewing plan decisions to deny treatment under ERISA, for example, courts have employed flawed thinking with regard to conflict-of-interest analysis.<sup>224</sup> That is, courts have failed to acknowledge the shift from individual patient-physician relationships to multi-entity disputes that focus on patient populations.<sup>225</sup> As we will see below, both confusions have benefited MCOs by shielding them from liability.

Perhaps the primary doctrinal mismatch has been the attempt to apply liability principles derived under fee-for-service medicine to managed care. For health care litigation, traditional legal doctrine conforms to a medical practice regime dominated by fee-for-service medicine in which the physician's preeminent concern is for the individual patient.<sup>226</sup> In a managed care environment, that individual relationship must be balanced with the allocation of plan resources to the entire patient population. Conflicts emerge when patients' desires for unlimited care clash with managed care cost containment initiatives. As several scholars have noted, these cases are conceptually different from the traditional liability principles.<sup>227</sup>

3. *Period of Immunity*—Managed care can harm patients by placing limits on access to hospital and specialty care, making poor drug choices, delaying diagnosis, and denying care.<sup>228</sup> From a liability perspective, MCOs face the same risks as insurance companies, i.e., litigation over what is covered and excluded. MCOs, however, face additional potential liability for the conduct of their employees and bureaucratic structure in, among other things, UR decision making, and they face potential vicarious or direct liability for the actions of their physicians in terms of malpractice.<sup>229</sup>

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222. See generally *Jass v. Prudential Health Care Plan, Inc.*, 88 F.3d 1482, (7th Cir. 1996) (holding that utilization review is a benefits determination under ERISA).

223. See *Corcoran v. United HealthCare, Inc.*, 965 F.2d 1321, 1331 (5th Cir. 1992).

224. See E. Haavi Morreim, *Benefits Decisions in ERISA Plans: Diminishing Deference to Fiduciaries and an Emerging Problem for Provider-Sponsored Organizations*, 65 TENN. L. REV. 511, 523–33 (1998) (arguing that courts wrongly construe conflicts of interests to exist where they are more accurately described as conflicts of interest and conflicts of obligation—the former involving a conflict between fiduciaries' duties to beneficiaries and their personal welfare; the latter, a conflict between fiduciaries' duties to individual beneficiaries and their duties to other beneficiaries).

225. See *Jacobson & Goldman*, *supra* note 187, at 12–13.

226. See *id.*

227. See, e.g., E. Haavi Morreim, *Medicine Meets Resource Limits: Restructuring the Legal Standard of Care*, 59 U. PITT. L. REV. 1, 17 (1997); E. Haavi Morreim, *Stratified Scarcity: Redefining the Standard of Care*, 17 L. MED. & HEALTH CARE 356, 358 (1989).

228. See *Furrow*, *supra* note 199, at 425.

229. See *id.* at 443–44.

Court decisions have generally favored MCOs' attendant cost containment initiatives, implicitly, and sometimes even explicitly, assuming that the MCOs are legal, desirable, and favored by public policy. For example, in *Weiss v. Cigna Healthcare, Inc.*,<sup>230</sup> the court rejected the claim that incentive arrangements with physicians were violative of ERISA per se because such a holding would render managed care illegal—a result the court found absurd given federal and state laws encouraging managed care.<sup>231</sup> In *Hartmann v. Northern Services, Inc.*,<sup>232</sup> the court assumed the underlying legality of managed care to defeat a claim using a curiously circular argument with a three-part syllogism: every plan does it this way, every plan cannot be illegal, therefore this plan is not illegal.<sup>233</sup>

The courts' confusion and the identification of policies favoring managed care have given MCOs a partial immunity from liability. Like the railroads' immunity, managed care's immunity is not complete. Rather, liability for familiar functions remains nearly the same, much like common carrier liability did in the railroad context. In the managed care context, for instance, courts appear generally unsympathetic to HMOs in regard to the familiar insurance-type functions,<sup>234</sup> except that, on account of ERISA's not-very-demanding breach of fiduciary duty rule, courts give a great deal of deference to an MCO's interpretation of policy terms and exclusions when the MCO is operating in conjunction with an ERISA-covered health plan.<sup>235</sup>

Just as we have already seen with railroads and mass production, early MCO cases provided considerable doctrinal immunity. We will explore three specific case types where courts protected the emerging cost containment innovations: ERISA, antitrust, and the corporate practice of medicine.

*a. ERISA*—ERISA has served as a liability shield for MCOs that contract with employers to provide health care for beneficiaries of

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230. 972 F. Supp. 748 (S.D.N.Y. 1997).

231. *See id.* at 753.

232. No. C1-96-135, 1996 WL 438810 (Minn. Ct. App. Aug. 6, 1996).

233. *See id.* at \*3. In concept, this is similar to Bovbjerg's argument that the standard of care for an MCO should be the care provided by a similar MCO. *See* Randall J. Bovbjerg, *The Medical Malpractice Standard of Care: HMOs and Customary Practice*, 1975 DUKE L.J. 1375, 1408-09 (1975).

234. *See* Furrow, *supra* note 199, at 447-48; *see also* Davis v. Selectcare, Inc., 834 F. Supp. 197, 198 (E.D. Mich. 1993) (adopting *contra proferentem* as a matter of federal common law in an MCO case).

235. *See, e.g.*, Reinert v. Giorgio Foods, Inc., 15 F. Supp. 2d 589, 595 (E.D. Pa. 1998) (employing very deferential review of a decision to deny benefits and an interpretation of plan terms); Doe v. Travelers Ins. Co., 167 F.3d 53, 57 (1st. Cir. 1999) (citing "reasonability" of denial as the basic touchstone).

employee welfare benefit plans.<sup>236</sup> According to recent Department of Labor estimates, ERISA applies to approximately 125 million Americans covered by employer-sponsored health plans.<sup>237</sup> Because so much of the population is enrolled in ERISA plans, immunity under ERISA amounts to immunity for a significant portion of managed care business.<sup>238</sup>

It is important to note that we are not simply claiming that the statutes favor MCOs, but rather that courts, given a choice between interpretations that favor MCOs and interpretations that allocate additional liability to MCOs, inevitably have chosen the favorable approach.<sup>239</sup> This choice has been based, at least in part, on a perception of public policy as favoring MCOs.<sup>240</sup>

ERISA limits liability through three statutory provisions: its preemption clause, its scheme of limited remedies, and the limited nature of the fiduciary duties it imposes on MCOs.<sup>241</sup> The primary immunity mechanism is ERISA's preemption clause,<sup>242</sup> which has largely insulated MCOs from liability under state tort law despite the numerous theories under which plaintiffs have sought recovery.<sup>243</sup> Because of preemption, for instance, utilization review

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236. See Scott D. Pomfret, *Emerging Theories of Liability for Utilization Review Under ERISA Health Plans*, 34 TORT & INS. L.J. 131, 131 (1998).

237. See *Federal Legislation Relating to Health Care Quality: Hearing Before Senate Committee on Labor and Human Resources*, 105th Cong. 2d. Sess. (1998) (statement of Meredith Miller, Deputy Assistant Secretary, Pension and Welfare Benefits Administration).

238. See *id.*

239. See Peter D. Jacobson & Scott D. Pomfret, *Form, Function and Managed Care Torts: Achieving Fairness and Equity in ERISA Jurisprudence*, 35 Hous. L. Rev. 985, 1023 (1998) [hereinafter Jacobson & Pomfret, *Managed Care Torts*] (describing interpretive missteps and alternatives of ERISA analysis).

240. It is possible to argue that courts are much more constrained by statutes here than in the common law railroad era, and that is of course true. But the self-perception has changed, perhaps more so than the reality. The kind of decision that was perceived as "for the legislative arena" perhaps has also changed. Thus, the rise of a less active, or possibly less political, judiciary was timed with the rise, possibly statute driven, of managed care to produce the constrained effect. We argue, however, that even within this restriction, courts, when faced with interpretive choices, seemed to choose the one favoring managed care.

241. See Peter Jacobson & Scott Pomfret, *ERISA Litigation and Physician Autonomy*, (1999) (unpublished manuscript, on file with the authors) [hereinafter Jacobson & Pomfret, *Physician Autonomy*].

242. 29 U.S.C. § 1144(a) (1994).

243. See, e.g., *Corcoran v. United HealthCare Inc.*, 965 F.2d 1321, 1329-33 (5th Cir. 1992) (arguing improper UR); *Farlow v. Union Central Life Ins. Co.*, 874 F.2d 791 (11th Cir. 1989) (alleging fraudulent misrepresentation of the terms of health care coverage contract); *Lancaster v. Kaiser Found. Health Plan, Inc.*, 958 F. Supp. 1137 (E.D. Va. 1997) (alleging negligence under state law for the establishment and operation of an "Incentive Program" that encouraged physicians not to prescribe certain expensive tests and not to refer); *Dukes v. United States Health Care Sys., Inc.*, 848 F. Supp. 39 (E.D. Pa. 1994) (arguing malpractice on a theory of vicarious liability), *rev'd*, *Dukes v. U.S. Healthcare, Inc.*, 57 F.3d 350 (3d Cir. 1995); *Altieri v. Cigna Dental Health Inc.*, 753 F. Supp. 61, 63-65 (D. Conn. 1990) (holding

decisions are rarely subject to state tort law,<sup>244</sup> and until 1995, medical malpractice liability on a theory of ostensible agency was also often subject to preemption.<sup>245</sup>

Injured patients fare no better with claims under ERISA's fiduciary duty clause,<sup>246</sup> which is limited in scope. The combination of the preemption clause and this limited obligation means that a change in an MCO's physician compensation arrangement—no matter how disruptive of the physician patient-relationship—may not be challenged under state law<sup>247</sup> as a breach of ERISA's fiduciary duties.<sup>248</sup> Likewise, courts generally are not particularly aggressive in using the breach of fiduciary duty clause to assess liability for improper denial of benefits.<sup>249</sup>

Even in those instances where personal injury claims have been brought under ERISA as a claim for an improper denial of benefits, courts have read the remedial provisions so narrowly that only extremely limited remedies are available.<sup>250</sup> Often, injured claimants are left with no remedy at all,<sup>251</sup> and MCOs thus are legally

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that ERISA preempts negligent supervision claim against HMO); *see also* Karen A. Jordan, *Travelers Insurance: New Support for the Argument to Restrain ERISA Preemption*, 13 YALE J. ON REG. 255, 259–60, 271–72 (1996) (discussing state actions in the health care field that lower courts have held to be preempted by ERISA).

244. *See* Pomfret, *supra* note 236, at 131.

245. *See, e.g.*, *Butler v. Wu*, 853 F. Supp. 125, 129–30 (D.N.J. 1994) (holding that ERISA preempts state law tort claim premised on vicarious liability); *Ricci v. Gooberman*, 840 F. Supp. 316, 317–18 (D.N.J. 1993) (holding that ERISA preempts claim alleging HMO's vicarious liability for medical malpractice); *Altieri*, 753 F. Supp. at 64 (preempting all of plaintiffs state action claims because of ERISA).

246. 29 U.S.C. § 1104(a)(1) (1994).

247. *See* Jacobson, *Legal Challenges*, *supra* note 3, at 72–75.

248. *See* *Maltz v. Aetna Health Plans, Inc.*, 114 F.3d 9, 11–12 (2d Cir. 1997) (holding that HMOs' changing method of compensation for physicians from fee-for-service to capitation did not breach any fiduciary duty to enrollee).

249. *See, e.g.*, *Bast v. Prudential Ins. Co. of Am.*, 150 F.3d 1003, 1010 (9th Cir. 1998) (declining to award damages for breaches of fiduciary duty under ERISA's equitable remedies provision).

250. *See* *Mertens v. Hewitt Assocs.*, 508 U.S. 248, 260 (1993). Commentators have blasted this narrow misreading of the statute. *See, e.g.*, George Lee Flint, Jr., *ERISA: Extracontractual Damages Mandated for Benefit Claims Actions*, 36 ARIZ. L. REV. 611, 624–25 (1994); Andrea Koutoulogenis, *The Invisible Man: A Call to Empower Individual Participants and Beneficiaries Against Fiduciary Breaches in ERISA Plans*, 31 J. MARSHALL L. REV. 553, 556 (1998); Dana M. Muir, *ERISA Remedies: Chimera or Congressional Compromise?*, 81 IOWA L. REV. 1, 30 (1995); Richard Rouco, *Available Remedies Under ERISA Section 502(A)*, 45 ALA. L. REV. 631, 632–33 (1994). It is another example of where, given the choice, courts chose immunity in the form of limited remedies over a more beneficent interpretation of the statutory language.

251. *See, e.g.*, *Bast*, 150 F.3d at 1007–11 (holding that ERISA preempted state law claims, even though there was no ERISA remedy).

unaccountable for their conduct.<sup>252</sup> We have demonstrated extensively elsewhere that this shield of immunity was not a necessary outcome of ERISA's statutory language or structure but rather the product of the Supreme Court's interpretive choices, which have favored the managed care industry.<sup>253</sup> The courts were citing a policy for this immunity—that permitting such suits would raise costs and perhaps keep employers from offering any benefits at all<sup>254</sup>—which had been largely abandoned in the retreat from charitable immunity in the medical field.<sup>255</sup> Such resurrection of moribund doctrine poignantly recalls the railroad-era courts' resurrection of the wrongful death statute.<sup>256</sup>

*b. Antitrust*—In the new health care order, physicians have attempted to use antitrust doctrine through private litigation to block cost containment initiatives, and competing organizations have attempted to use antitrust doctrine to force competitors to open their physician panels to competition. Neither effort has generated much support in the courts, thus creating a second source of protection from liability.

First, courts have dismissed antitrust actions attacking selective contracting and the like, with explicit deference to the managed care form. In *Ambroze v. Aetna Health Plans of New York, Inc.*,<sup>257</sup> for instance, anesthesiologists brought a restraint of trade action under Section 1 of the Sherman Act, challenging the defendant's exclusive contracting arrangement with another physicians' group.<sup>258</sup> After determining that a valid antitrust violation had not been alleged, the court attacked the heart of the plaintiffs' case:

[I]t is worth repeating the fact that the plaintiffs' principal target here . . . is the very concept of managed care. . . . The

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252. See Clark C. Havighurst, *Making Health Plans Accountable for the Quality of Care*, 31 GA. L. REV. 587, 589 (1997) (arguing that, to date, "most MCOs have opportunistically sought to manipulate legal rules to insulate themselves from such liability").

253. See Jacobson & Pomfret, *Managed Care Torts*, *supra* note 239, at 989–90.

254. See, e.g., *Rice v. Panchal*, 875 F. Supp. 471, 473 (N.D. Ill. 1994), *rev'd*, 65 F.3d 637 (7th Cir. 1995) (remanding the case to state courts for lack of federal subject matter jurisdiction).

255. See KEETON ET AL., *supra* note 17, § 133, at 1070 (discussing abrogation of charitable immunity doctrine).

256. See *supra* text accompanying note 86. Interestingly, but hopefully coincidentally, courts have interpreted ERISA, too, to prohibit dead persons or their relatives from suing under its remedial provisions, see *Turner v. Fallon Community Health Plan, Inc.*, 953 F. Supp. 419, 424–25 (D. Mass. 1997), thereby making it less expensive for an MCO to kill you than to maim you, much like in the old railroad days. See Friedman, *supra* note 23, at 473–74.

257. No. 95 Civ. 6631, 1996 WL 282069 (S.D.N.Y. May 28, 1996), *vacated on other grounds*, 107 F.3d 2 (2d Cir. 1997).

258. See *id.* at \*4–5.

fact that HMOs have their critics does not obligate the courts to create . . . a novel application of the antitrust laws. . . . [J]udicial restraint in this highly charged area of law and policy is the best recourse.<sup>259</sup>

Second, courts have given MCOs wide authority to determine staff privileges, an area now dominated by contractual interpretations.<sup>260</sup> MCOs have argued that an important aspect of controlling health care costs is limiting the number of physicians that are eligible to participate in the plan and applying economic criteria to staff selection and retention decisions. For the most part, courts have sanctioned the use of economic credentialing and the use of selective contracting. In *Maltz v. Aetna Health Plans*,<sup>261</sup> for example, the court upheld an MCO's change in network physicians solely for cost containment reasons, despite the disruption to long-term physician-patient relationships.<sup>262</sup> In this instance, physician-patient autonomy yielded to cost containment dictates.

There has also been a decline in per se analysis of the antitrust laws, expressly because courts do not have much experience in dealing with new managed care organizational forms.<sup>263</sup> Instead, courts have focused on using the rule of reason analysis,<sup>264</sup> in part responding to the guidelines issued by the Department of Justice and the Federal Trade Commission.<sup>265</sup> Often, a rule of reason analysis means no antitrust liability, especially in merger cases.<sup>266</sup>

As we have seen with the other industries, however, immunity is not complete. An important issue confronted by antitrust cases is how to characterize MCOs for purposes of defining the relevant product markets to analyze competition. Two recent cases have ruled that MCOs (either HMOs or IPAs) do not constitute a separate health care market for antitrust analysis, in part because

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259. *Id.* at \*10 (citation omitted).

260. See Jacobson, *Legal Challenges*, *supra* note 3, at 78.

261. 114 F.3d 9 (2d Cir. 1997).

262. See *id.* at 12.

263. See *Levine v. Central Fla. Med. Affiliates, Inc.*, 72 F.3d 1538, 1550 (11th Cir. 1996); *Retina Assoc. v. Southern Baptist Hosp., Inc.*, 105 F.3d 1376, 1382 (11th Cir. 1997).

264. For a full discussion of "rule of reason" analysis, see HERBERT HOVENKAMP, *FEDERAL ANTITRUST POLICY 226-40* (1994) (comparing per se and rule of reason analysis).

265. DEPARTMENT OF JUSTICE & FED. TRADE COMM'N, *STATEMENTS OF ANTITRUST ENFORCEMENT POLICY IN HEALTH CARE* (1996).

266. In general, courts have applied traditional antitrust principles to health care markets, see generally, e.g., Thomas L. Greaney, *Night Landings on an Aircraft Carrier: Hospital Mergers and Antitrust Law*, 23 AM. J.L. & MED. 191 (1997), helping to stimulate the movement toward more efficient organizational forms. Recent merger decisions, along with the federal antitrust guidelines, for instance, have focused on systems integration and economic efficiencies to determine whether an activity violates the antitrust laws.

physicians have other market alternatives for selling their services to insurers and MCOs.<sup>267</sup> These cases indicate that courts are not protecting MCOs from other providers (and vice versa) or from competitive pressures in the health care market.

*c. Other Immunities*—For cases outside of ERISA, MCOs suffer greater potential liability,<sup>268</sup> but immunity has been achieved in other ways, such as through laws barring the corporate practice of medicine. Originally enacted at a time when corporate provision of medical care was thought unethical<sup>269</sup> and used to preserve physicians' power within the medical field, these laws have been used to shield MCOs from liability. In *Williams v. Good Health Plus, Inc.—Healthamerica Corp.*,<sup>270</sup> for example, plaintiff sued HMO Health America for negligent treatment.<sup>271</sup> The court dismissed the suit on the grounds that because the HMO was legally barred from the practice of medicine it could not be sued for medical malpractice under a theory of ostensible agency.<sup>272</sup> This logic is, to put it charitably, suspect.

Recently, however, courts have begun to reconsider the corporate practice of medicine doctrine. For example, in *Berlin v. Sarah Bush Lincoln Health Center*,<sup>273</sup> the Illinois Supreme Court ruled that the doctrine no longer retained viability, despite still appearing on the books.<sup>274</sup> As such, the court refused to invoke the doctrine to void a contract between a physician and the health plan.<sup>275</sup> Just as important, the court recognized that the organization of health care into large integrated systems rendered the corporate practice of medicine doctrine obsolete.

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267. See *Blue Cross & Blue Shield United v. Marshfield Clinic*, 65 F.3d 1406, 1411 (7th Cir. 1995); *U.S. Healthcare, Inc. v. Healthsource, Inc.*, 986 F.2d 589, 598 (1st Cir. 1993) (“One can monopolize a product as either a seller or a buyer; but as a buyer of doctor services, Healthsource could never achieve a monopoly (monopsony is the technical term), because doctors have too many alternative buyers for their services.”).

268. See *Wickline v. California*, 239 Cal. Rptr. 810, 819 (Ct. App. 1986) (permitting MCOs to be held accountable when “medically inappropriate decisions result from defects in the design or implementation of cost containment mechanisms as, for example, when appeals made on a patient’s behalf for medical or hospital care are arbitrarily ignored or unreasonably disregarded or overridden”); *Petrovich v. Share Health Plan, Inc.*, 696 N.E.2d 356, 360–64 (Ill. App. 1998) (permitting vicarious liability malpractice suits against MCOs in appropriate circumstances).

269. See *Jacobson & Goldman*, *supra* note 187, at 17.

270. 743 S.W.2d 373 (Tex. App. 1987).

271. See *id.* at 374.

272. See *id.* at 378.

273. 688 N.E.2d 106 (Ill. 1997).

274. See *id.* at 112–13.

275. See *id.* at 114.

4. *Backlash*—Now, at the beginning of the twenty-first century, the once nascent managed care industry is maturing. Managed care has become the dominant approach to providing health care.<sup>276</sup> Even many indemnity plans have adopted managed care cost-containment techniques.<sup>277</sup> Consolidation among existing MCOs has created tremendous economic power.<sup>278</sup> In some areas, MCOs “have aggregated to the point that some are moving toward monopoly.”<sup>279</sup>

Backlash has followed. Studies have appeared that compare quality of care in MCOs with fee-for-service medicine.<sup>280</sup> Patients have reported increasing dissatisfaction with MCOs.<sup>281</sup> Doctors and nurses suggest that proper care has taken a backseat to corporate profits.<sup>282</sup> The press has joined the bandwagon.<sup>283</sup>

In the legislative arena, Congress has begun to consider legislation that removes MCO immunity.<sup>284</sup> In the Senate, the Patient Access to Responsible Care Act of 1997 (still being debated in Congress as of this writing) contains a provision amending ERISA’s express preemption clause to prevent courts from “preclud[ing] any State cause of action to recover damages for personal injury or wrongful death against any person that provides insurance or administrative services to or for an employee welfare benefit plan.”<sup>285</sup> President Clinton has contributed to the discussion by directing federal agencies to implement a Patient Bill of Rights for participants in Medicare, Medicaid, and various other federal health insurance programs.<sup>286</sup> Legal scholars have criticized the MCOs’ favored position in the ERISA doctrine.<sup>287</sup>

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276. See Jon Gabel, *Ten Ways HMOs Have Changed During the 1990s*, HEALTH AFF., May/June 1997, at 134.

277. See *id.*

278. See *id.* at 138.

279. Friedman, *supra* note 180, at 960.

280. See Gabel, *supra* note 276, at 144.

281. See *id.*

282. See, e.g., The Ad Hoc Committee to Defend Health Care, *For Our Patients, Not for Profits: A Call to Action*, 278 JAMA 1733 (1997).

283. See, e.g., George J. Church, *Backlash Against HMOs*, TIME, Apr. 14, 1997, at 32.

284. See 67 U.S.L.W. 2479 (1999) (describing current legislative effect in this regard).

285. Patient Access to Responsible Care Act of 1997, S. 644, 105th Cong. § 4 (1997).

286. See Memorandum on Federal Agency Compliance with the Patient Bill of Rights, 34 WEEKLY COMP. PRES. DOC. 298 (Feb. 23, 1998); see also Robert Pear, *Clinton Orders Rights Action in Health Care*, N.Y. TIMES, Feb. 21, 1998, at A7.

287. See generally Jay Conison, *ERISA and the Language of Preemption*, 72 WASH. U. L.Q. 619 (1994) (arguing that current law is based on flawed assumptions of ERISA’s preemption provision); Joseph F. Cunningham, *ERISA: Some Thoughts on Unfulfilled Promises*, 49 ARK L. REV. 83 (1996) (arguing that federal courts wrongly associate ERISA preemption with a lack of any court remedy at all); Torin A. Dorros & T. Howard Stone, *Implications of Negligent Selection and Retention of Physicians in an Age of ERISA*, 21 AM. J.L. & MED. 383 (1995) (arguing

Without significantly changing ERISA doctrine, courts have been a vocal part of the backlash. For example, court opinions—“in light of modern health care”<sup>288</sup>—have begun to condemn laws which insulate MCOs from liability, especially for improper utilization review or other practices that delay or deny medically necessary care.<sup>289</sup> Skeptics on the bench have denounced the effects of ERISA preemption:

This [result], of course, is ridiculous. The tragic events set forth in [Plaintiff’s] Complaint cry out for relief. . . . Under traditional notions of justice, the harms alleged—if true—should entitle [Plaintiff] to some legal remedy. . . . Nevertheless, this Court had no choice but to pluck [Plaintiff’s] case out of the state court in which she sought redress . . . and then, at the behest of [Defendant MCO], to slam the courthouse doors in her face and leave her without any remedy.<sup>290</sup>

Some courts have seemed to criticize the “management” aspect of medical care in general.<sup>291</sup>

5. *Change in Doctrine?*—Consistent with the backlash—and our model—there have been hints that courts are changing the doctrine in ways that may result in greater accountability for managed care organizations. For example, after years of interpreting ERISA preemption broadly, the Supreme Court in *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Insurance Co.*<sup>292</sup> permitted New York State to impose a tax on all insurers except Blue Cross and Blue Shield, reasoning that a uniform tax only tangentially relates to ERISA plan administration.<sup>293</sup> This signaled a scaling back of the breadth of ERISA preemption, particularly in

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that ERISA ought not to preempt negligent selection and retention claims); Paul O’Neil, *Protecting ERISA Health Care Claimants: Practical Assessment of a Neglected Issue in Health Care Reform*, 55 OHIO ST. L.J. 723 (1994) (arguing that courts misapply ERISA by interpreting it to protect health insurers); Larry J. Pittman, *ERISA’s Preemption Clause and the Health Care Industry: An Abdication of Judicial Law-Creating Authority*, 46 FLA. L. REV. 355 (1994) (arguing that courts should recognize limits to ERISA’s broad preemption clause in the context of medical malpractice lawsuits).

288. *Pomerooy v. Johns Hopkins Med. Servs., Inc.*, 868 F. Supp. 110, 116 (D. Md. 1994).

289. See Robert Pear, *Hands Tied, Judges Rue Law That Limits HMO Liability*, N.Y. TIMES, July 11, 1998, at A1.

290. *Andrews-Clarke v. Travelers Ins. Co.*, 984 F. Supp. 49, 52–53 (D. Mass. 1997) (footnote omitted).

291. See *Herdrich v. Pegram*, 154 F.3d 362, 375–78 (7th Cir. 1998). Recently, the full circuit denied review of the *Herdrich* decision over a forceful dissent by Judges Easterbrook, Posner, Flaum, and Wood. See *Herdrich v. Pegram*, 170 F.3d 683 (7th Cir. 1999).

292. 514 U.S. 645 (1995).

293. See *id.* at 658–62.

determining whether the challenged law or practice actually burdens the administration of plan benefits or has only a remote impact. After *Travelers*, lower courts have been less vigorous in finding ERISA preemption.<sup>294</sup>

Following *Travelers* and largely inspired by it, lower courts have created a critical distinction between claims addressing the quality and those addressing the quantity of ERISA health care benefits.<sup>295</sup> This distinction has permitted courts to find that state actions for the vicarious liability of MCOs for medical malpractice by providers associated with the MCO are not completely preempted by ERISA.<sup>296</sup> The federal courts now remand such actions to state court.<sup>297</sup> Prior to the *Dukes* decision, federal courts had been split on the vicarious liability issue;<sup>298</sup> they are now uniformly against complete preemption,<sup>299</sup> which would otherwise permit federal jurisdiction over the suits and probable dismissal.<sup>300</sup> Defendant MCOs, seeking a more amenable federal forum, are therefore likely to find their cases returned to the states. Thus, potentially more patient-friendly state courts will decide whether such suits "relate to" an employee benefit plan. No court has yet found such a relation, which permits these cases to be heard on the merits.<sup>301</sup> As a consequence, with the quality-quantity distinction—a distinction only tenuously based in the reality of managed care decision making<sup>302</sup>—and similar narrowing of ERISA preemption doctrine, lower courts have chipped away at the preemption shield, increasing the likelihood of full MCO accountability to injured patients.<sup>303</sup>

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294. See, e.g., *Pappas v. Asbel*, 724 A.2d 889, 893 (Pa. 1998) (finding no preemption of state law claims against HMO, based in large part on *Travelers*).

295. See, e.g., *Dukes v. U.S. Healthcare, Inc.* 57 F.3d 350, 355 (3rd Cir. 1995) (holding that claims brought against HMO fell outside the scope of ERISA, and therefore ERISA did not completely preempt it).

296. See *id.* at 355–56.

297. See *id.* at 361.

298. Compare, e.g., *Ricci v. Gooberman*, 840 F. Supp. 316, 317–18 (D.N.J. 1993) (holding that vicarious liability claim against HMO is preempted by ERISA) with *Independence HMO, Inc. v. Smith*, 733 F. Supp. 983, 987–89 (E.D. Pa. 1990) (holding that action against HMO is not preempted by ERISA).

299. See, e.g., *Jackson v. Roseman*, 878 F. Supp. 820, 826 (D. Md. 1995) (concluding that vicarious liability claims are not completely preempted).

300. See, e.g., *Jass v. Prudential Health Care Plan, Inc.*, 88 F.3d 1482, 1495 (7th Cir. 1996) (holding that vicarious liability claim is preempted by ERISA, though not completely preempted by civil enforcement scheme).

301. See *Tufino v. New York Hotel & Motel Council & Hotel Ass'ns of the N.Y. City AFL-CIO Local 6*, 223 A.D.2d 245 (N.Y. App. Div. 1996).

302. See *Jacobson & Pomfret, Managed Care Torts*, *supra* note 239, at 1028–29.

303. See *Pomfret*, *supra* note 236, at 131 n.2 (citing articles finding a weaker shield). Indeed, in practice, the quantity/quality distinction is difficult to maintain. Many clinical decisions involve both quality and quantity aspects. For instance, discharging a patient two days early may represent a clinical decision or it may be based on a benefits determination.

There has also been a smattering of renegade decisions curtailing MCO immunity in ways arguably inconsistent with precedent.<sup>304</sup> To the extent these decisions are upheld,<sup>305</sup> we may see new doctrine emerging. The scaling back of broad preemption may have begun to erode plan immunity even for the design of a health plan. In *Moreno v. Health Partners Health Plan*,<sup>306</sup> plaintiff alleged that an MCO was liable for creating a “substandard” health care plan and that she suffered from medical malpractice caused by implementation of the substandard plan.<sup>307</sup> The court decided that this state law tort action was not completely preempted and could go to trial in the state court.<sup>308</sup> The court said, “Congress has expressed no desire that ERISA be used to degrade the quality of health-care.”<sup>309</sup>

Preemption is not the only area where the trend toward greater accountability may be emerging. Some courts have found a duty to disclose to patients the financial incentives that exist between MCOs and their physicians.<sup>310</sup> In *Shea v. Esensten*,<sup>311</sup> the court held that the HMO’s financial incentives, including incentives discouraging treatment referrals, constituted material facts which must be

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The flexibility of this distinction may enable courts to circumvent MCO immunity in egregious cases, much as courts in the nineteenth century used inherently vague tort concepts in a flexible fashion. See *supra* text following note 138; see also, e.g., *Hoyt v. Edge*, No. Civ.A.97-3631, 1997 WL 356324, at \*2 (E.D. Pa. June 20, 1997) (characterizing MCO’s negligence in failing to supervise physician as a “quality” claim, even though it arguably involved administration of the health plan and thus had implications for nationwide administrative uniformity); *Whelan v. Keystone Health Plan E.*, No. CIV.A.94-5733, 1995 WL 394153, at \*4 (E.D. Pa. June 25, 1995) (remanding wrongful death and direct negligence claims against MCO as quality claims, even though they arguably involved administrative decision making).

304. See, e.g., *Washington Physicians Serv. Ass’n v. Gregoire*, 147 F.3d 1039, 1045 (9th Cir. 1998) (holding that a state act which regulates a product that ERISA may buy does not allow ERISA preemption); *Corporate Health Ins. Inc. v. Texas Dept. of Ins.*, 12 F. Supp.2d 597, 625 (S.D. Tex. 1998); *Pappas v. Asbel*, 724 A.2d 889, 893 (Pa. 1998) (concluding that “negligence claims against a health maintenance organization do not ‘relate to’ an ERISA plan”).

305. See *Pappas*, 724 A.2d at 889.

306. 4 F. Supp. 2d 888 (D. Ariz. 1998); see also *Ouellette v. Christ Hosp.*, 942 F. Supp. 1160, 1165 (S.D. Ohio 1996) (demonstrating similar allegations and result).

307. See *Moreno*, 4 F. Supp. 2d at 889.

308. See *id.* at 893.

309. *Id.*

310. See *Drolet v. Healthsource, Inc.*, 968 F. Supp. 757, 759–60 (D.N.H. 1997); see also *Muller v. Maron*, No. CIV.A.94-5052, 1995 WL 605483, at \*3 (E.D. Pa. Oct. 13, 1995) (remanding claim charging fraud and misrepresentation in failing to inform patient of incentive arrangements to state court as not completely preempted).

311. 107 F.3d 625 (8th Cir. 1997).

disclosed as part of ERISA's fiduciary duties.<sup>312</sup> The existence of such a duty remains controversial.<sup>313</sup>

In recent years many suits charging MCO misconduct that resulted in delayed or denied care have been cast as breaches of fiduciary duty under ERISA rather than as potentially preempted state law torts.<sup>314</sup> In *Herdrich v. Pegram*,<sup>315</sup> the court held that a patient could sue for breach of ERISA's fiduciary duty based on an allegation that the nature of incentive arrangements between the MCO and the physicians caused her to be deprived of proper medical care and that the MCO and physician reaped economic gain from this deprivation.<sup>316</sup> Although the *Herdrich* court specifically noted that the existence of economic incentives would not automatically be tantamount to a breach of fiduciary duty,<sup>317</sup> this case is a potentially significant extension of the rationale advanced in non-ERISA cases. If other courts follow and rule that the existence of economic incentives may constitute a breach of fiduciary duty under ERISA, these incentives will be increasingly vulnerable to legal challenge. It should be noted, however, that *Herdrich* represents a legal theory which is viable only in an extreme case: "where a fiduciary jettisons his responsibility to the physical well-being of beneficiaries in favor of 'loyalty' to his own financial interests."<sup>318</sup> No patient has yet recovered a judgment in such a case,<sup>319</sup> and the U.S. Supreme Court has agreed to review the *Herdrich* decision.

Even the question of remedies has revealed hints of an emerging judicial reluctance to stick to ERISA's strict terms. In *Mertens v. Hewitt*,<sup>320</sup> for example, the Supreme Court held that ERISA limited plaintiffs' possible relief for breach of fiduciary duty to "categories of relief that were *typically* available in equity (such as injunction,

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312. See *id.* at 628-29.

313. See *Ehlmann v. Kaiser Found. Health Plan*, 198 F.3d 552 (5th Cir. 2000) (finding no duty under ERISA to disclose physician compensation arrangements); see also *Weiss v. Cigna Healthcare, Inc.*, 972 F. Supp. 748, 753-55 (S.D.N.Y. 1997).

314. See *Ince v. Healthsource Ark., Inc.*, 977 F. Supp. 948, 951 (E.D. Ark. 1997) (permitting plaintiff whose state law claim for negligent utilization review was preempted to amend her complaint to plead breach of fiduciary duty under ERISA).

315. 154 F.3d 362 (7th Cir. 1998). In an en banc rehearing, Judge Easterbrook wrote a vigorous dissent to the majority opinion upholding the three-judge panel's decision. See *Herdrich v. Pegram*, 170 F.3d 683 (7th Cir. 1999) (Easterbrook, J., dissenting).

316. See *id.* at 372-73.

317. See *id.* at 373.

318. *Id.*

319. See Pomfret, *supra* note 236, at 164.

320. 508 U.S. 248 (1993).

mandamus, and restitution, but not compensatory damages).<sup>321</sup> In *Varity Corp.*, the Court cited *Mertens* favorably in regard to the question of what relief was available to individuals suing for breach of fiduciary duty.<sup>322</sup> Nevertheless, since *Varity* there has been a move toward broader recoveries.<sup>323</sup> Lower courts appear to be stretching the limits imposed by the Court.<sup>324</sup> As such, MCOs may not be able to rely any longer on limited recoveries, although several federal circuit courts have rigorously enforced the limited recoveries, refusing even to force entities who make bad faith denials of coverage to disgorge what they should have paid for denied care.<sup>325</sup>

In sum, the evidence suggests that the managed care industry is in stage four, the backlash, and that some tentative movement toward stage five is perhaps imminent. We hasten to note, however, that there is no change as of yet. In the context of ERISA, MCOs remain largely immune, and courts' antitrust analysis remains very deferential to managed care arrangements.

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321. *Id.* at 256 (emphasis in original); see also *McLeod v. Oregon Lithoprint Inc.*, 102 F.3d 376, 378 (9th Cir. 1996) (holding that "equitable relief" is limited to injunction, mandamus, or restitution).

322. See *Varity Corp. v. Howe*, 516 U.S. 489, 515 (1996).

323. See Karl J. Stoecker, *ERISA Remedies After Varity Corp. v. Howe*, 9 DEPAUL BUS. L.J. 237, 253-56 (1997).

324. See generally *Fotta v. Trustees of United Mine Workers of Am. Health Retirement Fund of 1974*, 67 U.S.L.W. 1392 (3d Cir. December 18, 1998) (permitting recovery of interest for period of which benefit was improperly denied, even though not specifically authorized in ERISA); *Pickering v. USX Corp.*, Civ. Nos.87-C-8387, 88-C-763j, and 91-C-636j, 1995 WL 584372, at \*34 (D. Utah May 8, 1995) (stating that relief is restitutionary and thus equitable in nature where it "restore[s] the status quo and return(s) the amount rightfully belonging to another"); *Reid v. Gruntal & Co.*, 763 F. Supp. 672 (D. Me. 1991) (permitting recovery of consequential damages under ERISA § 502(a)(3)); *Weems v. Jefferson-Pilot Life Ins. Co.*, 663 So. 2d 905, (Ala. 1995) (permitting extracontractual and punitive damages under ERISA), *cert. denied*, 516 U.S. 971 (1995); see also *Russell v. Northrop Grumman Co.*, 921 F. Supp. 143, 152 (E.D.N.Y. 1996). The *Russell* court indicates:

While restitution is generally awarded to prevent unjust enrichment to the defendant, this is not required in every case. Additionally, it is not necessary that restitution be made in kind, "for a court may restore the plaintiff to the position he formerly occupied 'either by the return of something which he formerly had or by the receipt of its equivalent in money.'"

*Id.* (citations omitted).

325. See, e.g., *Bast v. Prudential Ins. Co. of Am.*, 150 F.3d 1003, 1011 (9th Cir. 1998) (refusing to impose a constructive trust to hold ill-gotten gains from a breach of fiduciary duty).

## VI. LIMITATIONS OF THE ANALYSIS

While we are comfortable with our conclusion that the three industries we have studied are compatible with our model, we reiterate that our purpose in this article is only to sketch a theory. More research is necessary, and we acknowledge the potential limitations of the analysis. We recognize, for example, that our analysis of the first two industries relies on the work of other scholars and does not come from analysis of the underlying cases themselves. Our focus, therefore, was whether the evidence could plausibly support our model, not whether our model was a better description of the evidence than those presented by other scholars. Also, many have pointed out that an analysis of only appellate opinions, particularly with regard to the railroads and mass production, is flawed by the fact that the needs and history of each state were different.<sup>326</sup> At a time when the railroads were in favor in the West, for instance, they were subject to backlash in the East.<sup>327</sup> It is not clear that we, or the scholars before us, have paid adequate attention to this issue, which may undermine any global conclusions.

As to the managed care industry, our work is not yet complete. We have analyzed large numbers of cases but have not yet done a statistical analysis of the results. Thus, we are susceptible to the criticism that our results are as yet only impressionistic.

There are two possible ways in which the managed care industry may diverge from the patterns seen in the earlier examples. First, we live now in the "Age of Statutes,"<sup>328</sup> with significant, byzantine, and growing regulation of health care delivery.<sup>329</sup> Though statutes influenced the direction of doctrine in the other two industries, particularly with regard to the railroads, regulation was not as pervasive. Doctrinal change—at least to the extent it is the product of judicial initiative—may be altered in the managed care context by legislative intervention, perhaps marking a different trajectory of development.

Jurisprudential theory and style has probably also changed from the heyday of railroads and mass production. For example, courts may now be more subject to one particular interpretive constraint that may curb judicial creativity and activism: their perception of the judicial role.<sup>330</sup> Indeed, the refrain in ERISA cases in which

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326. See Rabin, *supra* note 36, at 955.

327. See FRIEDMAN, *supra* note 23, at 512.

328. See generally GUIDO CALABRESI, *COMMON LAW FOR THE AGE OF STATUTES* (1985).

329. See generally Jacobson & Goldman, *supra* note 187.

330. See Jacobson & Pomfret, *Physician Autonomy*, *supra* note 241, at 13–15, 20–21.

MCOs achieve immunity from liability, despite evidence of their wrongful conduct, is that the injustice must be curbed by Congress, not the courts.<sup>331</sup> The legitimacy of a judge's "imposition" of his own "policy" choices is under sustained attack.<sup>332</sup> In particular, we speculate that this perception of the judicial role may result in a preference for more rigid rather than more flexible doctrine in which discretion is allocated to the elected legislature rather than the judiciary.

## CONCLUSION

The advantage of studying historical analogies is that they offer a different perspective on current judicial doctrine that is otherwise controversial and unsettled. By looking at how courts developed legal doctrine for previous shifts in the railroads and industrial goods and services, we have a better understanding of where we are in the development of legal doctrine for managed care. This perspective might also aid judges in achieving a more sustainable legal regime for the challenging policy conflicts created by managed care.

### *Lessons Learned*

If our analysis of the development of legal doctrine at points of significant industrial change is correct, several lessons follow. First, our analysis suggests one way in which courts adjust legal doctrine to meet changing social and organizational arrangements. Given the interactive nature of developing legal doctrine between the courts, stakeholders, and legislators, this suggests that legislators and other stakeholders can play an important role in shaping the direction and outcome of the courts' deliberations.

Second, the model we propose can be used to predict the various stages courts will go through before arriving at a stable set of rules. While our model does not predict the doctrinal outcome of

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331. See *Turner v. Fallon Community Health Plan, Inc.*, 127 F.3d 196, 200 (1st Cir. 1997); *Kuhl v. Lincoln Nat'l Health Plan, Inc.*, 999 F.2d 298, 304 (8th Cir. 1993); *Corcoran v. United HealthCare, Inc.*, 965 F.2d 1321, 1338–39 (5th Cir. 1992);.

332. Cf. *Lessig*, *supra* note 9, at 1793–95 (noting shifts in courts' perceptions of their own role in interpreting the common law, from an approach reflective of private understandings to one that was normative and rationalizing).

the process, it will help scholars place the development in a broader context that could assist judges in achieving stable rules. It does, however, predict that eventually courts will select a set of principles and stable rules to impose more legal accountability on the mature industry than on the industry in its nascent phase.

Third, this analysis suggests that because courts are reluctant to interfere with emerging market arrangements, they end up protecting new industries. The common law is generally reflective of a pattern of favoring markets and thereby facilitating innovation. To suggest that courts tend to favor the innovation of new industries is not to imply a Marxist analysis where courts simply favor the ruling class. For one thing, it takes courts time to understand the policy and market implications of the new industry. For another, at least to some extent, courts may be taking a wait-and-see approach to assess the implications of the market transformation. As we have seen in each of our examples, courts have trouble initially in understanding the new innovations. Further complicating the courts' doctrinal response is that they inevitably must respond to the early cases by using legal doctrine developed for a previous set of circumstances. Over time, as judges become more comfortable with the language and arrangements of the new industry, courts begin to set limits on the new industry and impose rules that constrain how freely the industry actors can behave without accountability.

Fourth, this inevitably raises the question of which legal regime, and which liability standard and subsidiary rules, is most appropriate for holding the industry accountable—tort or contract, or a mix of both. To be sure, our analysis suggests that it is not an either/or question. For the most part, tort and contract operate in tandem, allowing courts to choose from a variety of legal options depending on the goals sought to be achieved. But since one approach is likely to be used to establish baseline principles for judicial thinking, it is important to understand how and why tort or contract rules become the operative legal regime. Just as important, even within tort or contract, choices need to be made both as to the liability standard and its subsidiary rules. For example, courts could have imposed strict liability in the railroad example and negligence for mass products, resulting in very different accountability outcomes.

In both of the selected historical examples, tort law emerged as the dominant—but by no means exclusive—method for achieving accountability. For railroads, the courts adopted a negligence liability standard; for mass production, the courts chose strict liability. This suggests that courts will eventually select some form

of tort to hold MCOs accountable. So far, however, courts in managed care cases have generally deferred to market arrangements, usually based in contract, and to the legislatures.<sup>333</sup> Although courts have applied hospital liability principles to MCOs, they have not yet adopted tort doctrine in considering challenges to cost containment initiatives.

How and why one regime emerges instead of the other remains an important and inconclusive area of legal scholarship. It is also important for stakeholders. In managed care, for instance, the assignment of liability rules will affect the power balance between physicians and MCOs, as well as the ability of plan subscribers to challenge cost containment initiatives. If courts shift to a contract-based legal regime, this will most likely restrict the subscriber's ability to challenge cost containment initiatives, while a tort-based regime will most likely be more patient-friendly.

### *Research Implications*

We view this Article as a first step in developing a workable model for understanding the development of legal doctrine in nascent or radically changing industries. From a research perspective, it will be important to monitor how courts rule in the more contentious managed care legal issues likely to arise over the next few years. For instance, we expect courts to face more directly the conflict between individual health care needs and the resources available to the patient population as MCOs continue to seek ways to control health care costs. Our continuing work in producing a statistical analysis of trends in managed care cases will supplement the qualitative analysis offered in this article.<sup>334</sup>

Scholars should also compare the development of legal doctrine in managed care to how courts resolve issues related to new information technologies, especially the expansion of the internet. If a similar pattern holds as we have described here, then our model will have additional salience.

This confirmation (or perhaps refutation) of our approach would be important because judges are aware of the need for new approaches to these types of problems. Several years ago, for example, Judge Jack Weinstein, who has presided over many

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333. See Jacobson, *Legal Challenges*, *supra* note 3, at 79.

334. We agree with Judge Richard Posner that quantitative analysis is an important complement to traditional legal scholarship.

important mass tort cases, proposed that judges apply a framework based on communitarian theory in deciding the social policy issues now confronting the courts.<sup>335</sup> Although Judge Weinstein did not specify how the communitarian theory could be operationalized by judges, he argued that judges currently lack an adequate conceptual framework for balancing complex policy tradeoffs between individual litigants and the collective interests of other affected groups.<sup>336</sup> Regardless of the merits of the communitarian framework, the Weinstein article suggests that judges are searching to devise and apply innovative models to problems that courts have had difficulty resolving.

Finally, our brief survey may help illuminate, but will certainly not resolve, the controversies surrounding the rise of railroads and mass products and the judicial response. Nor is our approach necessarily the correct set of lessons to be derived from a historical analysis. We invite further scholarly inquiry and commentary on our interpretation and alternative lessons that would help understand the development of legal doctrine in these areas.

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335. See Jack B. Weinstein, *Ethical Dilemmas in Mass Tort Litigation*, 88 NW. U. L. REV. 470, 485-93 (1994).

336. See *id.* at 472, 540.

