The Uneasy Case for Product Liability

Steven Shavell
Harvard Law School

A. Mitchell Polinsky
Stanford Law School
The Uneasy Case for Product Liability

A. Mitchell Polinsky and Steven Shavell

Hosted by The Berkeley Electronic Press
Overview

Social benefits of product liability appear limited

Social costs of product liability seem significant

Conclusion: the case for product liability is unclear

The law, academic writing, and popular opinion broadly endorse product liability, but do not reflect real consideration of its social benefits and costs
The Risk Reduction Benefit of Product Liability

• Market forces already reduce product risks (regardless of product liability)
  – Consumers may have information about specific products before making a purchase
  – Consumers may have information about a firm’s general reputation (across product lines)
  – Firms may value their reputations (due to the above)
Risk Reduction Benefit – continued

– Sales have often fallen sharply after product problems:

  • E.g., Audi cars; Tylenol; Odwalla juices; Rely tampons; recently, certain pet foods?

  • Suggests that firms want to avoid product problems
Comments on market forces

- Relatively important for widely sold products, especially for firms in business for long periods and offering multiple products

- Less important for solo businesses
Risk Reduction Benefit – continued

– Arguments apply to services as well as products

• but many services sold by single providers, not large firms
Risk Reduction Benefit – continued

– Contrast with firms whose products injure strangers

• E.g., truck runs someone over; tank spills oil

• Sales negligibly affected
Risk Reduction Benefit – continued

• Regulation already reduces product risks
  – Many products and services are subject to safety regulation
    • E.g., pharmaceuticals; cars; toys; medical care
  – Controls risk even without product liability
Risk Reduction Benefit – continued

• Product liability and risk reduction

  – Given market forces and regulation, product liability’s effect is incremental, not total

  – To the degree (which is great) that product liability is fault-based, courts need to have better knowledge than market and regulators about proper care in order to enhance safety desirably
Risk Reduction Benefit – continued

- Empirical evidence on the effect of product liability on safety does not suggest significant effects

  • Not a lot of evidence

    - Priest (1988)
    - Manning (1994)
    - Dewees, Duff, and Trebilcock (1996)
Risk Reduction Benefit – Conclusion

• Preliminary assessment:
  – simple considerations suggest that in principle product liability may have only a limited effect on product safety, especially for widely sold products
  – empirical evidence, which is weak, does not contradict this possibility
Compensation/Insurance Benefit of Product Liability

• Benchmark of optimal insurance coverage
  
  – What is expected utility maximizing coverage given its cost?

  – For monetary losses

    • Full coverage if no administrative costs of coverage (premium is expected value of coverage)

    • Partial coverage (deductible/coinsurance) if there are administrative costs

http://law.bepress.com/alea/17th/art69
Compensation/Insurance Benefit – continued

– For nonmonetary losses

• No coverage if losses do not affect the marginal utility of money (e.g., death of child)

• Coverage for monetary aspects of nonmonetary losses (cost of medical treatment for injury)
Compensation/Insurance Benefit – continued

- Insurance coverage for losses in the absence of product liability
  - Private coverage
  - Mainly for monetary losses or monetary costs associated with nonmonetary injury
  - Widely held and substantial; but many uninsured

http://law.bepress.com/alea/17th/art69
Compensation/Insurance Benefit – continued

– Social coverage

• Unemployment insurance
• Disability insurance
• Workers Compensation
• Social Security benefits (if death or injury)
• Medicare/Medicaid
Compensation/Insurance Benefit – continued

• Compensation due to product liability system is incremental
  – Only in addition to what is supplied already by private and social insurance coverage

• Note: in standard simple model, risk averse victims are fully covered regardless of whether they collect damages
  • then liability system has no effect on compensation
Compensation/Insurance Benefit – continued

- Often less than the face amount of an award or settlement
  - Award/settlement often paid back to insurer
    - to reimburse/under subrogation clause
  - Substantial fraction of award/settlement paid to lawyer
Compensation/Insurance Benefit – continued

– Areas where product liability most likely to increase existing compensation

• Nonmonetary losses (pain and suffering)

• Individually low losses (in class actions)
Compensation/Insurance Benefit – Conclusion

• Social value of added compensation due to product liability

  – With respect to losses that should be insured (significant monetary losses):

    • Cheaper to provide compensation via social insurance; or by subsidizing first party insurance
Compensation/Insurance Benefit – Conclusion

- With respect to losses that should not be insured (nonmonetary losses; low monetary losses):
  
  • Compensation through product liability may be of negative value
  
  • Cost of implicit coverage (higher prices) not worth the benefit
Compensation/Insurance Benefit – Conclusion

• Preliminary assessment:
  – effect of product liability on compensatory/insurance goals not great, due to presence of insurance
  – social value of additional compensation questionable, and quite possibly negative
The Cost of Product Liability

• The costs of the liability system appear to be substantial
  – Studies suggest that for every dollar received by victims, at least a dollar is incurred in costs
    • Costs comprised of litigation costs, lawyers’ fees
    • Based on both settled (supermajority) and litigated cases
    • No account of value of plaintiffs’ time (others too?)
Cost of Product Liability – continued

- Liability-induced increases in price may inefficiently reduce consumption.

  This is an indirect cost of inefficient expenditures on the liability system.
Is Product Liability Economically Worthwhile, Given Its Benefits and Costs?

• Preliminary assessment: quite possibly not, especially for widely-sold products
  – Risk reduction likely to be low, especially for widely-sold products
  – Compensatory value of product liability seemingly low or negative
  – Cost of system very high – for each dollar collected, at least a dollar spent
Benefit-Cost Comparison – continued

• Qualifications
  – Data needed, especially regarding risk reduction and costs
  – Where products/services are not widely sold, case for product liability may be different
  – We take status quo regarding insurance and regulation as given
  – We also take product liability system as we know it (rather than a refashioned, better, system)
Benefit-Cost Comparison – continued

• High level of product liability litigation is consistent with its undesirability

  – Victims will sue to obtain money, even if the risk reduction value of suit is negligible

http://law.bepress.com/alea/17th/art69
Our Analysis in Relation to the Prevailing Social Endorsement of Product Liability

• The law and legal doctrine favors product liability
  – History of product liability is one of expansion
    • abandonment of privity requirement; increasing grounds for negligence; rise of class actions; types and levels of damages
  – General justifications for product liability
    • negligence and harm; spreading of risk to wealthy firms from consumers; deterrence
Our Analysis and Social Endorsement – continued

- Not considered, or barely considered by courts: possible benefits and costs of liability system

  - Effect of liability on deterrence

    - empirical effects not considered

    - effects of market, regulation, usually not even informally considered
Our Analysis and Social Endorsement – continued

• Effect of liability on compensation
  – usual implicit assumption is that award is received by victim;
  – subrogation/reimbursement of insurer not considered

• Cost of liability system
Our Analysis and Social Endorsement – continued

- For the most part, would be unnatural for a court to consider the foregoing factors
  
  • little doctrinal scope to do that
Our Analysis and Social Endorsement – continued

- Academic commentary/analysis generally favors product liability
  - Much is doctrinal and mirrors judicial reasoning
Our Analysis and Social Endorsement – continued

– Some is policy-oriented

• But does not analyze deterrence in a critical or sustained way

• Does not give adequate attention to role of insurance

  – treats firms as better risk-bearers than individuals (as if individuals cannot insure)

• Mostly ignores the costs of the liability system
Our Analysis and Social Endorsement – continued

– Has not developed much empirical knowledge
Our Analysis and Social Endorsement – continued

- Popular opinion/view of the intelligentsia favors product liability
  - If a corporation has acted with fault and harmed individuals, it should pay as matter of fairness, especially if the corporation is large
  - Belief in deterrence
  - Consistent with views of courts and legal academics

http://law.bepress.com/alea/17th/art69
Our Analysis and Social Endorsement – continued

• Robust nature of product liability litigation suggests it is socially desirable
  – Amount of product liability litigation great
  – Seemingly implies that it is an important and valuable activity
    • plaintiffs pay for suits and win judgments and settlements
  – But as we explained above, litigation activity does not imply product liability is socially desirable
Conclusion

• Assessment of benefits and costs suggests product liability may be undesirable, especially for widely sold products:
  – deterrence/safety benefits attenuated
  – compensatory benefit low or negative
  – costs high
Conclusion – continued

• Social endorsement of product liability does not reflect a considered evaluation of its benefits and costs

• Serious study is called for

  – predict that it would lead to a skeptical conclusion about the value of product liability