

Product Liability Handout

The excerpt below is from the Restatement of Torts. Restatements are summaries of the law written by teams of experts, including professors and practicing lawyers. They are not binding authority, but many judges find them helpful and persuasive.

RESTATEMENT OF TORTS, SECOND (1965)

§ 402A. Special Liability of Seller of Product for Physical Harm to User or Consumer

(1) One who sells any product in a defective condition unreasonably dangerous to the user or consumer or to his property is subject to liability for physical harm thereby caused to the ultimate user or consumer, or to his property, if

(a) the seller is engaged in the business of selling such a product, and

(b) it is expected to and does reach the user or consumer without substantial change in the condition in which it is sold.

(2) The rule stated in Subsection (1) applies although

(a) the seller has exercised all possible care in the preparation and sale of his product, and

(b) the user or consumer has not bought the product from or entered into any contractual relation with the seller.

Caveat:

The Institute expresses no opinion as to whether the rules stated in this Section may not apply

(1) to harm to persons other than users or consumers;

(2) to the seller of a product expected to be processed or otherwise substantially changed before it reaches the user or consumer; or

(3) to the seller of a component part of a product to be assembled.

Comment:

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c. * * * [T]he justification for the strict liability has been said to be that the seller, by marketing his product for use and consumption, has undertaken and assumed a special responsibility toward any member of the consuming public who may be injured by it; that the public has the right to and does expect, in the case of products which it needs and for which it is forced to rely upon the seller, that reputable sellers will stand behind their goods; that public policy demands that the burden of accidental injuries caused by products intended for consumption be placed upon those who market them, and be treated as a cost of production against which liability insurance can be obtained; and that the consumer of such products is entitled to the maximum of protection at the hands of someone, and the proper persons to afford it are those who market the products.

ARTICLES

MODERN TORT LAW AND ITS REFORM

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I. INTRODUCTION: THE CURRENT CONTEXT OF TORT LAW REFORM

In 1960, progressive members of the state judiciary, joined later by the American Law Institute, commenced upon a revolution in the conceptual basis of tort law of a dimension previously unknown in the history of civil common law.¹ Modern tort law was transformed from a modest set of rules directed chiefly to dispute resolution into a powerful engine of social reform with the twin ambitions to reduce the accident rate by fine-tuned control of all corporate operations and to provide a system of injury compensation with benefit levels exceeding those of any compensation system in the Western world. Today, we are beginning to learn that the presuppositions upon which this conceptual revolution was built are flawed, and that this transformation of the law has adversely affected the welfare of U.S. citizens.

~~Until modern times, tort law has been chiefly the domain of specialists. The tort law revolution of the 1960s was instituted by visionary jurists, but~~

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1. For a detailed history, see Priest, *The Invention of Enterprise Liability: A Critical History of the Intellectual Foundation of Modern Tort Law*, 14 J. LEGAL STUD. 461 (1985) [hereinafter Priest, *Invention*].

II. MODERN TORT LAW REANALYZED

A. *The Rationale of Modern Tort Liability Explained*

Since the mid-1960s, corporate tort liability for accidents resulting from product or service use has been vastly extended. The rationale for the extension of liability has been that providers²⁷ of products and services—chiefly corporations—are almost always in a better position than consumers to prevent accidents and to provide insurance for those accidents that cannot be prevented.

First, according to this view, the accident rate can most effectively be reduced by alterations of the product or service itself. Except in cases of flagrant product misuse, consumers will do what they can to prevent injury simply to protect themselves. Most product- and service-related injuries, as a consequence, stem from defects, either as a result of inadequate quality control or of mistakes in product design. The rate of injuries can be reduced if incentives are established to encourage greater provider investments in design and production. Provider tort liability establishes such incentives and the greater the liability, the greater accident reduction incentives will be.

Secondly, according to this view, with respect to injuries which cannot be prevented, the corporate provider can obtain insurance more effectively than can the set of product or service consumers. The corporate provider can either self-insure because of its size and scope of operations or can purchase a single market insurance policy covering all of its consumers, passing a proportionate share of the insurance premium along to consumers in the product or service price. In this way, insurance can be provided for product- or service-related injuries to individuals who may not purchase first-party insurance themselves, in particular the poor and low-income. Corporate provider liability, thus, enlists the provider in the process of spreading the risk of injuries broadly over the population of consumers as a whole.

This rationale for expanded corporate tort liability—to achieve accident reduction and insurance—provides the basis for virtually all modern legal decisions.²⁸ The initial adoption of the strict liability standard for product defects,²⁹ ~~the substitution of comparative for contributory negligence,³⁰ the abolition of the relevance of the victim's status in landowner~~

27. The term provider refers to producers of goods (manufacturers) and services (other than insurers), including government entities.

28. For a brief review, see Priest, *Invention*, *supra* note 1.

29. *Greenman v. Yuba Power Prods., Inc.*, 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1963).

30. *E.g.*, *Daly v. General Motors Corp.*, 20 Cal. 3d 725, 575 P.2d 1162, 144 Cal. Rptr. 380 (1978).

accident rate and to provide coherent compensation insurance.

C. *The Means Criticized*

Accident reduction and insurance, however, are only goals. Central to modern law are presumptions about the means by which these goals can best be implemented. As mentioned above, it is my view that the implementation of the goals, rather than the goals themselves, generates the problems of modern law. These problems stem from two sources. First, although in the 1960s judges drastically reformulated the goals of tort law, they sought to achieve these goals largely through the structure of the law in place, with minimum adjustment to then-existing legal doctrine. Part III will show in greater detail that there is a very poor fit between the new instrumental goals that courts adopted and the formal law through which these goals were expressed.⁴³ The common law heritage of the 1960s obstructs the ability of courts to see the effects of modern law on accident reduction and insurance and, thus, necessarily obstructs the ability of courts to achieve these goals.

Secondly, and more importantly, the modern implementation of the goals of accident reduction and compensation insurance is built upon two empirical presuppositions which the founders thought to be true but which, regrettably, are false, indeed dangerously false. Modern tort law presumes that the corporate provider is always in a better position than the consumer both to prevent injury and to provide insurance for injuries that cannot be prevented. As we shall see, these presuppositions impair the ability of modern law to effectively reduce the accident rate and to provide for injury compensation. As a consequence, modern law is much less effective than it might be in creating incentives to reduce the injury rate. Moreover, as evidenced by the recent insurance crisis, modern law has disrupted liability insurance markets and has led to a reduction in the total level of accident insurance available in the society.

1. Accident Reduction Reconsidered

Modern tort law's failure to adequately control the accident rate derives from the faulty judicial presumption that corporate product- and service-providers are almost always better able than consumers to prevent accidents. This presumption was silently adopted in the beginnings of the modern regime in the 1960s, largely because the initial judicial focus was to define new rules for what are now known as manufacturing defects.⁴⁴ The presumption was later reaffirmed, however, with the continued judicial at-

43. See *infra* notes 81-114 and accompanying text.

44. See generally G. PRIEST, ORIGINAL INTENT, *supra* note 2.

tention on the design and manufacturing process to the exclusion of the wide range of other sources of product and service-related injuries; and because to base rules on the condition of the product versus the provider's conduct has proven the most convenient way to distinguish strict liability from negligence.⁴⁵

The presumption of superior provider control over the accident rate is not absolute. Even modern law incorporates some provider defenses relating to consumer injury prevention, such as defenses of consumer misconduct, product misuse, product alteration and assumption of risk.⁴⁶ But the role of these defenses has been vastly restricted under modern law. In the years since 1960, the concept of the victim's contributory negligence has changed drastically. In most jurisdictions it has been supplanted by comparative negligence, delegating to the jury the attribution of proportionate injury contribution. In products liability cases, many jurisdictions refuse to consider the contributorily negligent actions of the product user at all beyond malevolent or intentionally self-inflicted injuries.⁴⁷ Similarly, the defense of assumption of risk has been drastically redefined, in large part as the obligation of providers to give warnings has been extended.⁴⁸ In warning cases, many courts presume, as a matter of law, that the user would have carefully read, evaluated, and relied upon warnings if they had been offered.⁴⁹

The presumption that product- and service-providers are vastly superior to consumers in the power to prevent injuries has justified the unidirectional expansion of provider liability, and it has generated many of the problems of modern law:

1) As explained above, although it is very commonly believed that the expansion of provider liability will enhance incentives to reduce the accident rate, there is a clear limit to the injury-prevention investments that any provider will make. No provider (or, for that matter, consumer) will continue to invest in injury prevention if the expected costs of further prevention exceed the injury costs themselves.⁵⁰ Put slightly differently, in a competitive economy, consumers will put out of business any provider that makes inefficient investments in accident reduction. Tort liability beyond

45. See, e.g., *Phillips v. Kimwood Machine Co.*, 269 Or. 485, 525 P.2d 1033 (1974).

46. Emphasized in HENDERSON & TWERSKI, *PRODUCTS LIABILITY* 115-16 (1987).

47. See, e.g., *Luque v. McLean*, 8 Cal. 3d 136, 501 P.2d 1163, 104 Cal. Rptr. 443 (1972).

48. See *Heil Co. v. Grant*, 534 S.W.2d 916 (Tex. Ct. App. 1976).

49. See *Phillips*, 269 Or. 485.

50. I am putting aside consideration of greater than compensatory damages, such as punitive damages. Punitive damages may encourage greater manufacturer investments, but it is not clear that the imposition of punitive damages in fact is sufficiently non-random to guarantee greater investments. In some cases, the imposition of punitive damages may reduce the total level of safety, even though it may increase manufacturer investments.

concept of products or services unreasonably dangerous per se—providers' design decisions become gambles on the legal process. The provider can calculate that the adoption of the safer and more costly design will increase current manufacturing costs and will reduce future liability costs (because the product or service will be safer). The gamble, however, is whether the certain increase in current costs is greater or less than the uncertain future decrease in liability costs. The increase in manufacturing costs from the adoption of the safer design becomes a sunk investment. Subsequent liability costs, however, are not only discounted for the future, but are manipulable, by future provider delays in settlement or litigation or, in the case of increasing numbers of products and services, by the prospect of future insolvency because of the scope of liability.

This example, of course, is academic, and I have no reason to believe that any provider would consciously select a less safe product or service design on these grounds. But the design selection process is a subtle one, and courts have been insufficiently sensitive to the complexity of product or service design choices. The greatest incentive effect provided by the law derives from the prospect that complying fully with the applicable legal standard reduces legal liability *totally*.⁵⁶ The absence of immediate gain from choosing the most advanced practicable design is very likely to influence the extent to which providers search for alternative designs or try to develop alternatives based upon design methods or safety innovations in related, but not identical, product or service lines. Search incentives of this nature would be enhanced, however, if a provider were assured that it would escape legal liability by choosing the most practicably safe design available at the time of manufacture.

3) Finally, the unidirectional expansion of provider liability has ignored the many ways in which consumers can be enlisted in the accident reduction function beyond the now-largely restricted doctrines of misuse and assumption of risk. There is no meaningful way to consider any product, accident or defect without reference to consumer investments in selection, maintenance, and use of the product.⁵⁷ Consumers influence the rate of product accidents by the initial choice of a product suitable for their expected use, by the nature and extent of maintenance of the product over its useful life, and by the manner of product use in specific contexts. There is growing empirical evidence that, for many products, the consumer's role in accident prevention swamps any effects of differential technological investments by providers.⁵⁸ Moreover, recent studies show wide variations in the

56. Cooter, *Unity in Tort, Contract, and Property: The Model of Precaution*, 73 CAL. L. REV. 1 (1985).

57. For a further discussion of this point, see Priest, *A Theory of the Consumer Product Warranty*, 90 YALE L.J. 1297 (1981).

58. See, e.g., W. VISCUSI, *CONSUMER PRODUCT SAFETY REGULATION* (1984);

characteristics and preferences of consumers which make the product safety question extremely complex.⁵⁹ The continued focus of courts on technological provider investments ignores these issues entirely and, thus, neglects substantial opportunities to define accident reducing incentives.

2. Compensation Insurance Reconsidered

Insurance is a method of reducing the net costs of expected risks. For purposes of the tort law comparison, there are three principal ways in which an insurance system reduces expected risks. First, an insurance system aggregates into insurance pools uncorrelated risks for which error terms cancel out. This is the most obvious meaning of risk spreading. Second, an insurance system controls moral hazard by the design of insurance benefits. Third, an insurance system controls adverse selection by risk segregation.

The second empirical presupposition of modern tort law is that the corporate provider is always in a better position than the consumer to provide insurance for product or service-related injuries. According to this view, providers can easily perform the insurance function because they can very cheaply aggregate risks and spread them over a broad population. Incidentally, providers can offer this insurance service without requiring a specific consumer choice to purchase insurance. Thus, those without separate first-party health or disability insurance purchase such coverage along with the product.

The founders of our modern tort law regime believed that the advantage to provider third-party insurance through tort law derived from the ease with which providers could aggregate risks because they had access to a large pool of consumers to form a risk pool. There are two separate provider advantages here. First, there were thought to be transaction cost advantages from provider insurance. It seems cheaper for a single provider to enter one insurance contract (or to self-insure) than for each consumer to separately obtain insurance for product injury.⁶⁰ Second, the founders emphasized that, for purposes of spreading, the set of consumers of a product or service was much larger than the set of those injured from product- or service-related use. Thus, for each affected person, the burden of potential injury would be smaller if the provider were made the insurer.⁶¹

Peltzman, *The Effects of Automobile Safety Regulation*, 83 J. POL. ECON. 677 (1975); J. MASHAW & D. HARFST, *REGULATING THE FREEDOM MACHINE* (1987) (unpublished manuscript on file with author).

59. FEDERAL TRADE COMMISSION, *WARRANTIES, RULES, CONSUMER FOLLOW-UP STUDY*, Draft Final Report (1983).

60. James, *General Products—Should Manufacturers Be Liable Without Negligence?*, 24 TENN. L. REV. 923 (1957).

61. James, *Contribution Among Joint Tort Feasors: A Pragmatic Criticism*, 54 HARV. L. REV. 1156 (1941).

These propositions are clearly empirical in nature. Yet, although they seem plausible (perhaps, in part, because they have been inculcated in modern law), there are reasons to be suspicious of their validity. The transaction cost comparison, for example, is not fully worked out. The empirical question is whether transaction costs are greater or less by requiring each provider to obtain third-party insurance for its customers or by requiring (by denying tort law recovery) consumers to seek health and disability compensation from first-party insurance policies or government-provided sources. Again, because it was presumed that large numbers of consumers did not possess first-party health and disability coverage (another empirical assumption discussed below),⁶² the pure transaction cost comparison was never carefully evaluated. Obviously, to the extent that consumers already possess first-party coverage, requiring providers to obtain duplicative third-party liability insurance unambiguously increases transaction costs.⁶³

The second purported provider advantage in risk aggregation is equally questionable. The aggregation of many individuals into a risk pool reduces net expected risks where the aggregation leads to the cancelling out of risk terms associated with each member of the pool. An insurer's aggregation function derives from operation of the law of large numbers, according to which the probability function of average loss tends to become concentrated around the mean as the sample number increases.⁶⁴ Risk reduction by aggregation operates in exactly the same manner as opinion polling by random sampling. Like opinion polling, however, effective risk spreading can occur with very low numbers of risks aggregated into a single pool, as long as the risk of injury of each member of the pool is uncorrelated. Thus, it is not necessary to aggregate pools of the dimension of the total set of product consumers to achieve optimal spreading.⁶⁵

Moreover, provider insurance through tort liability may serve to increase, rather than reduce, risks through the aggregation function. For some product- and service-related injuries, the risks brought to the pool by consumers are not independent and uncorrelated, but are highly correlated. Risks related to design defects are an example. With respect to design defects, the risks of the set of consumer pool members are highly correlated: if the design proves injurious, *all* consumers are vulnerable. For risks of this nature, aggregation by the product- or service-provider increases rather

62. I discuss the effects of the mandatory insurance provided through tort law, *infra* notes 81-114 and accompanying text.

63. I shall show below that third-party liability insurance increases insurance costs in other dimensions as well. See *infra* notes 65-76 and accompanying text.

64. See Marshall, *Insurance Theory: Reserves Versus Mutuality*, 12 *ECON. INQUIRY* 476 (1974).

65. For a further explanation of this point, see G. PRIEST, *THE ROLE OF THE GOVERNMENT IN RISK SPREADING* (1987) (unpublished manuscript on file with author).

than reduces total risks. The risks, however, could be spread—that is, reduced by cancelling-out error terms—if consumers subject to the risk were joined in first-party insurance pools with individuals subject to different, uncorrelated risks. The point is that, in circumstances of this nature, the insurance premium is greater for provider third-party tort law insurance than for first-party insurance even though the underlying probability of injury is the same.

Thus, the empirical presumption of modern law that providers have a substantial advantage in risk aggregation is also highly suspect. But there are further reasons to believe providers have, not a comparative advantage, but a serious disadvantage in insurance provision. Even if provider third-party insurance through tort law were equally effective in terms of risk aggregation as consumer first-party insurance, it is far less effective in terms of the two other important insurance functions: the control of moral hazard through benefit design, and the reduction of adverse selection by risk segregation.

Moral hazard is the effect of the existence of insurance on the level of insurance claims. Insurers control moral hazard, in some cases by direct risk monitoring but, more generally, by setting deductible and coinsurance levels which allow premiums to be kept attractively low for low-risk insureds. Though seemingly paradoxical, by restricting some set of insurance recoveries, deductibles and coinsurance increase the availability of insurance for more basic losses.⁶⁶

Insurance provided through tort law is far less effective than first-party insurance in controlling moral hazard. Tort law incorporates both accident control and compensation objectives. To obtain optimal accident control, a party that has violated a legal standard must pay full losses to the victim, including both pecuniary and non-pecuniary losses such as pain and suffering. For purposes of insurance, however, an award of this dimension is far greater than the level of compensation insurance benefits that any consumer would want. First, there is no consumer demand for pain and suffering coverage in any insurance market in the world because pain and suffering losses do not affect the marginal value of wealth which is the purpose of insurance.⁶⁷ In addition, unlike all forms of first-party compensation insurance, third-party tort law insurance never incorporates victim deductibles or coinsurance to constrain moral hazard. Victim moral hazard is just as serious a problem in third-party as in first-party contexts. It follows that third-party premiums will be necessarily higher than first-party premiums for the same level of coverage.

66. For a further discussion, see Priest, *Insurance Crisis*, *supra* note 11.

67. For a further elaboration of this point, see *id.* at 1547.

Third-party tort law insurance is also substantially less effective in reducing risks through risk segregation and the control of adverse selection. Adverse selection refers to the tendency of low-risk members to drop out of insurance pools because insurance premiums are higher than the risks that they bring to the pools. Adverse selection plagues every insurance context. Insurance premiums must be set equal to the average risk of pool members and, so, are necessarily higher than the risks brought by low-risk insureds. Insurers attempt to constrain adverse selection by segregating insureds into narrow risk pools. Careful segregation of risks increases the availability of insurance because it makes insurance relatively more attractive to low-risk insureds.

It is very difficult for providers to segregate risks in the insurance offered through tort law. First-party insurers, through the insurance application process, obtain large amounts of information about individuals which allows substantial risk segregation. For example, in the context of insuring injuries from auto accidents, first-party insurers create risk pools according to the driver's age, driving level, and by moving violation and accident experience. None of these distinctions, however, can be implemented by the third-party auto manufacturer providing insurance for non-preventable accidents in the price of the auto. Tort law insurance must be provided indiscriminately, at the same premium to high-risk and low-risk alike.

The disadvantage of third-party tort law insurance in terms of risk segregation adds even further to the cost difference of third-party over first-party premiums. But there is even a more serious shortcoming of third-party insurance. The risk segregation disadvantages of third-party tort law insurance are inflicted most seriously on the poor and low-income of the consumer population. Where insurance is provided by tort law, the poor and low-income of the society are almost always low-risk members of the insurance pool. Individuals bring risks to an insurance pool in two dimensions: first, in terms of the likelihood of suffering a loss; second, in terms of the magnitude of the expected loss. There is no reason to believe and no evidence to support that the poor are more accident-prone per product than the high-income or wealthy. Yet tort damage payouts to the poor and low-income are certainly lower than tort loss payouts to the wealthy and high-income. Tort law damages are dominated by lost income and by pain and suffering, which is highly correlated with lost income. The expected damage recovery of a low-income or poor individual is substantially less than that of a high-income or wealthy individual. Thus, the poor and low-income are the low-risk members of tort law insurance pools.

It follows necessarily, therefore, that tort law's lumping of low-income consumers and high-income consumers into the same insurance pool and charging each of them a similar premium for the insurance, forces low-income consumers to subsidize high-income consumers. Tying insurance to

the sale of a product or service has exactly this effect. The insurance premium attached to the sale of any product is higher than the expected loss to the low-income consumer and lower than the expected loss to the high-income consumer. Thus, in addition to disadvantages in terms of risk aggregation, the control of moral hazard, and general segregation by risk level, third-party tort law insurance inflicts a regressive redistributive effect.

As a consequence, providing insurance through tort law is an extremely unsavory public policy. Who could support, for example, a policy of providing nationwide disability insurance at a single, uniform premium, irrespective of income, if high-income individuals were allowed to recover high disability payments and low-income individuals were constrained to recover low disability payments? Who could support a policy of providing home casualty insurance set at a uniform premium nationwide, irrespective of home value, if people who live in expensive houses were allowed to recover high casualty payments, and people who live in modest houses were constrained to recover low casualty payments. In these contexts, those with low incomes and those living in modest houses would be disadvantaged by the uniform nationwide premiums. To establish such an insurance regime would seem outrageous given our society's commitment to helping, not encumbering, the poor. Yet charging a uniform premium for differential coverage is exactly how insurance is provided through tort law. Tort law insurance premiums are set at a uniform level, tied to the sale of each unit of the product. The tort insurance payout, however, differs according to whether the income and pain and suffering loss is suffered by a low-income consumer or a high-income consumer. As a consequence, insurance through tort law both harms the poor and reduces the availability of insurance in the society.

First-party insurance is a much more effective method of providing insurance broadly and of reducing the disadvantage to low-income consumers who bring low risks to the insurance pool. In contrast, third-party insurance provided through tort law undermines insurance markets. I have set forth in a separate paper how our modern insurance availability crisis derives from the increasing use of tort law to provide insurance.⁶⁸

The founders of our modern insurance regime justified expanding tort liability to provide insurance in order to make insurance available to those who might not buy insurance otherwise. The most important empirical assumption of our modern regime is that there are large numbers of injured consumers who would lack compensation if they could not recover under expanded corporate tort liability. This empirical assumption, too, is highly questionable. While there may have been large numbers of uncompensated individuals in the 1930s and 1940s when the founders first developed this

68. *Id.*

cisely, it is implausible that it is sensible public policy to suffer the many disadvantages of our current regime of expanded liability—on the accident rate, on insurance aggregation, on the control of moral hazard and adverse selection, and on the financial positions of the poor and low-income—in order to provide potential compensation to those few who fall through social insurance gaps and are injured by products or services.

To extend insurance most broadly, a society must facilitate effective risk aggregation, it must encourage the segregation of high-risk from low-risk insureds, and it must foster the control of moral hazard. Competitive first-party insurance markets, supplemented by government-insurance benefits for the poor, achieve those ends far more effectively than third-party tort law insurance.⁷⁵ Indeed, as I have shown elsewhere, the expansion of third-party tort law insurance has disrupted liability insurance markets and reduced, rather than increased, the extent of compensation insurance available to the society.⁷⁶

It follows that our society would benefit if the insurance features of modern tort law were excised. Tort law is an extremely perverse method of providing compensation insurance to consumers and is an indefensible method given that, today, there are not large numbers of injured individuals who would be denied compensation but for expanded tort liability. To excise the insurance function from tort law, however, is not to render tort law irrelevant or to return to the tort law of the 1950s. I believe strongly that tort law can be transformed into a new and improved instrument of social policy if the goals of tort law were rigorously redirected toward more effective accident control. Tort law can benefit society by establishing effective accident control incentives. Our current tort law regime, as I have described above, does a poor job of accident control, in large part because of confusion over the insurance function. If tort law were redirected to adopt a single focus on accident reduction, it could substantially improve consumer welfare. The next section will suggest how this redirection might take place.

D. Modern Law Redirected: Controlling the Accident Rate

If the principal goal of modern law is to be accident control, how can it best be achieved? Controlling the accident rate is a very simple proposition. There is now a voluminous literature in the law and economics field unanimous in its conclusion that the accident rate can be reduced to the level optimal for the society by asking at trial one simple question: Is it possible to identify any specific cost-effective action that either the injurer or victim

75. For a fuller discussion of this argument, see Priest, *Compensation for Personal Injury in the United States*, in INTERNATIONAL COLLOQUIUM ON COMPENSATION FOR PERSONAL INJURY (J. Hellner ed. 1987).

76. See Priest, *Insurance Crisis*, *supra* note 11.

could have taken which would have prevented the accident? If so, then liability should be placed on the party that could have prevented the accident most effectively in order to create incentives to take such actions in the future.⁷⁷ If no specific action can be identified, then the issue in the case becomes totally one of insurance for the loss.

This standard may sound suspiciously simple, but I believe strongly that it is the only relevant accident reduction concern. The only question relevant at trial should be, "Could this accident have been practicably prevented prior to its occurrence?" Again, for the objective of accident reduction, everything else is irrelevant. Losses that cannot be prevented can only be insured against.

Some might object that this simple standard sounds very much like the negligence or fault standard, which virtually every court has repudiated in at least some contexts. ~~I deny this assertion. Judge Posner and Professor Landes have trumpeted the similarity between the negligence standard of the 19th and early 20th Centuries and modern cost-benefit analysis of economics⁷⁸ and have also argued recently that the strict liability standard of modern products liability law is efficient.⁷⁹ But I believe the Posner-Landes propositions to be incorrect.⁸⁰ The negligence standard as it was implemented in the 1950s and early 1960s, and of course before, was crude and unexacting. It placed minimal requirements on manufacturers, and it enforced rigorously defenses that are irrelevant to cost-effective accident reduction. The strict liability standard and other doctrines of modern tort law which complement it, indeed, were improvements over the vague standards of the negligence regime, if only in the more clear definition of the goals the law sought to achieve. As elaborated, however, the modern doctrine of strict liability represents an overreaction which has led to the unraveling of insurance markets. The trumpeting both of negligence and strict liability by the efficiency-of-the-law theory has led modern analysts astray. It has deflected what should have been and should be unanimous disapproval of modern tort law and the tort law that preceded it by those concerned with the economic effects of law on consumers.~~

The simple way to reduce the accident rate in all product- and service-related contexts is to ask "Was there a specific act that could practicably have been taken that would have prevented the accident?" If such an action cannot be shown, then attaching liability in the case will not affect the acci-

77. G. CALABRESI, *THE COSTS OF ACCIDENTS* (1970), R. POSNER, *ECONOMIC ANALYSIS OF LAW* (1972).

78. W. LANDES & R. POSNER, *THE ECONOMIC THEORY OF TORT LAW* (1987).

79. Landes & Posner, *A Positive Economic Analysis of Products Liability*, 14 J. LEGAL STUD. 535 (1985).

80. See Priest, *Modern Products Liability Law and Its Effect on the Accident Rate*, in BROOKINGS INSTITUTION CIVIL LIABILITY PROJECT (R. Litan & C. Winston eds. 1987).

A. Mitchel Polinsky & Steven Shavell, “The Uneasy Case for Product Liability,” 123 Harvard Law Review 1437 (2010)

The liability of manufacturers of products for harms caused to their customers--product liability--has great prominence in the United States. Tens of thousands of product liability cases are filed annually in state and federal courts, including some as class or other mass tort actions that can involve thousands or even millions of individuals as plaintiffs. The legal bases for product liability suits are expansive, comprising liability for manufacturing defect, design defect, and failure to warn. Product liability cases receive significant attention from the media, especially when they concern widely sold products that harm many consumers. Moreover, product liability is of growing importance outside of the United States, particularly in the European Union and in Asia.

Perhaps surprisingly, no one to our knowledge has attempted to examine the question whether, or in what circumstances, product liability is socially desirable, considering its major benefits and costs. We undertake this task here and come to the judgment that the case for product liability is problematic for a wide range of products. The essence of our argument is that the ... beneficial effects of product liability--inducing firms to improve product safety... and providing compensation to injured consumers--are, for many products, likely to be outweighed by the litigation and related costs of product liability.

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II. The Safety Benefit of Product Liability

In this Part we first discuss how market forces and regulation might reduce product risks. We then investigate the safety benefit of product liability, that is, the extent to which it adds to the level of safety already generated by market forces and regulation.

A. Incentives To Reduce Product Risk Generated by Market Forces

Market forces can provide firms with an incentive to improve product safety, for if consumers believe that the risk of a product is high, they will either avoid buying the product or will not pay as much for it as they otherwise would. For example, Tylenol’s market share fell from 35% to 5% following the deaths in 1982 of seven individuals who had ingested contaminated Tylenol capsules. Odwalla’s sales of natural juices declined by 90% in 1996 after one person died and sixty others were made ill by consuming some of its products containing E. coli bacteria. And Audi’s automobile sales dropped by 69% after reports in the mid-1980s of problems of sudden acceleration of its vehicles. There are many other examples in which sales declined significantly after consumers learned that a product was especially risky.

When, however, the harms at issue are not as salient as the ones just mentioned, market responses will tend to be weaker. If the losses are low, occur infrequently, are difficult to trace to

a product, eventuate many years after a product is used, or are concealed, then the harms will be noticed less often by consumers. Hence, in many circumstances firms might experience only a modest, or possibly no, decline in sales as a result of selling products that injure consumers.

While the demand for a firm's product might decline in response to detrimental information about product risks, it is also possible that demand would rise in response to favorable safety information. Volvo, for example, has been able to charge a premium for its automobiles, apparently because they have performed especially well in crash tests and have included safety features unavailable from other manufacturers. Cirrus Design became the bestselling manufacturer of four-seat, single engine aircraft, in significant part because of its innovative provision of ballistic parachutes to lower its planes to safety in the event of loss of control. Sellers of bottled water are able to charge much more than the price of tap water because consumers perceive bottled water to be more pure.

The degree to which consumers will punish manufacturers for unsafe products or reward them for safe products clearly depends on the information that consumers have about product safety, and they have many sources of such information available to them. In 2009, for example, the top ten newspapers in the United States, with a total paid circulation of more than eight million people, published an estimated 2,800 articles related to product safety. General news magazines, such as Newsweek and U.S. News & World Report, frequently include articles about product safety, as do numerous specialized magazines, such as Motor Trend and Guns & Ammo. Moreover, Consumer Reports tests a broad range of products and evaluates their risks. The subscriber base of these magazines is approximately 45 million individuals. Daily television news programs report on major product defects and accidents, and feature news programs, such as 60 Minutes and 20/20, often include segments on product problems. The combined viewership of the three network evening news programs, Fox News, and CNN exceeds 25 million people, and that of 60 Minutes and 20/20 is about 18 million. The internet also allows consumers to easily locate evaluations of the safety of most widely sold products, and many government agencies provide evaluations of product risks.

Obviously, consumers will only be exposed to a small fraction of this information due to constraints on their time. Furthermore, individuals might not properly evaluate the information that they do have about product risks because they are subject to various cognitive biases. Hence, the availability of extensive information about product risks does not necessarily imply that consumers will be well-informed about these risks.

Consumers should have a relatively good assessment, however, of the risks of many widely sold products. A primary reason is that the media and regulators have naturally strong incentives to identify and publicize the risks of such products. If there is a safety problem with a popular drug or an automobile, tens of thousands of individuals or more could be affected, which the media would be eager to report--as our examples of Tylenol and Audi automobiles illustrate--and which would probably attract the attention of regulators.

The influence of market forces on product safety therefore is likely to be particularly important for widely sold products. Moreover, firms that sell products in large volume have more to lose if consumers think that their products are dangerous and more to gain if consumers believe that their products are safe, giving them a greater incentive to invest in product safety. Additionally, large firms tend to be especially concerned about their reputation for safety because they often offer multiple product lines and have long time horizons.

Conversely, consumer knowledge about product risks should be less good for products that are not widely sold because media and regulatory interest in these products will be lower. For instance, a problem with space heaters made by a local manufacturer and sold in limited volume would be unlikely to receive more than brief mention by the media or to be noticed by regulators. Hence, market forces usually will be less effective for products that are not widely sold and the companies that sell these products will tend to have weaker incentives to increase their safety.

The preceding observations about products that are, and are not, widely sold only describe central tendencies. It could be that consumers do not have good information about the risks of a widely sold product, especially if, as we noted above, the harm the product causes is small or infrequent, is difficult to attribute to its source, or occurs many years after the product's use. Thus, market forces might not induce the manufacturer of a widely sold product to improve its safety. It could also be the case that consumers do have good information about a product that is not widely sold. The customers of a neighborhood restaurant, for instance, might be expected to learn about a frequent problem of food poisoning there by word of mouth. Thus, market forces could lead a seller of a product that is sold to a limited number of individuals to take care to reduce the risk of harm.

B. Regulation of Product Risk

In addition to market forces, government regulation affects the safety of a broad range of products, and we now briefly describe several areas of regulation.

Automobiles. Automobile safety regulations are extensive in nature and include, for example, requirements regarding seatbelts, crashworthiness, fuel tank construction, and windshield and tire strength. These requirements are primarily enforced by the National Highway Traffic Safety Administration (NHTSA), whose annual budget exceeds \$856 million. Firms are subject to sanctions for violating automobile safety regulations and their executives are potentially subject to criminal liability.

Pharmaceuticals. Pharmaceutical products must satisfy rigorous testing and labeling requirements that are overseen by the U.S. Food and Drug Administration (FDA). The FDA's Center for Drug Evaluation and Research has a staff of approximately 3000 employees and an annual budget of about \$760 million. New pharmaceuticals generally are subject to four phases of clinical trials to ensure that they are safe and effective. Prescription drugs must satisfy FDA

labeling requirements and include information about their proper use. Significant violations of FDA drug regulations are subject to fines and imprisonment.

Aircraft. Stringent aircraft safety standards, set by the Federal Aviation Administration (FAA), govern the manufacture, maintenance, and airworthiness of all aircraft. Every accident involving a civil aircraft is investigated at the initiative of the National Transportation Safety Board (NTSB). Violations of aircraft regulations may result in seizure of noncompliant aircraft, civil penalties, and criminal sanctions.

Consumer products. Safety standards apply to numerous consumer products, such as toys, cigarette lighters, baby cribs, and household chemicals. These standards are developed and enforced by the Consumer Product Safety Commission (CPSC), which was created “to protect the public against unreasonable risks of injuries associated with consumer products.” In addition to imposing civil fines for violations, the CPSC has the authority to order the recall of unsafe products.

Regulations of the type just noted have beneficially affected the safety of many products. For example, automobile safety standards have been determined to have significantly reduced the number of deaths due to collisions. Similarly, FAA safety requirements have been found to have played an important role in lowering general aviation aircraft accidents. There is evidence that regulation has reduced risk in other areas as well.

Safety regulation is likely to be more effective for widely sold products, such as automobiles, pharmaceuticals, and aircraft, than for products whose distribution is limited. One reason is that regulators will be more concerned about the risks of products sold in high volume, as mentioned in the previous section, and thus will tend to invest substantial effort in regulating them. A second reason is that regulators will obtain more information about a product’s hazards if many members of the public are using the product and then reporting problems after suffering from its defects.

Of course, regulation will be far from perfect due to the limited knowledge of regulators, their budgetary constraints, and the possibility that they may be captured by the firms that they are responsible for overseeing. Consistent with these observations, some studies have found regulation to be ineffective or of limited value in certain contexts. Our point is not that regulation will serve as a general cure for product safety problems, but rather that it contributes in a significant way to reducing many product risks.

C. Risk Reduction Accomplished by Product Liability

Product liability is applied through three primary doctrines. Under the design defect doctrine, a firm can be held liable for accidents caused by its product if the design of the product was defective, meaning, essentially, that a different design could have been employed that was safer and not excessively costly. Under the manufacturing defect doctrine, a firm can be held liable for

an accident if the particular unit that caused the accident was not manufactured according to the intended design. Under the failure to warn doctrine, a firm can be held liable if it failed to provide a reasonable warning about the riskiness of the product.

Even though product liability might lower a product risk in the absence of market forces and regulation, it will turn out to be superfluous if a desirable safety precaution has already been taken because of these two factors. Consider, for example, electronic stability control in automobiles, a feature that can reduce the risk of skidding and rollovers. Market pressures could lead to adoption of this feature if consumers appreciate its value, or a regulator might require it. Hence, product liability might not be necessary to induce automobile manufacturers to adopt electronic stability control--and, apparently, market forces have played a role in stimulating this improvement.

It may happen, of course, that neither market forces nor regulation results in a beneficial reduction of risk for the reasons that we discussed in sections A and B. Then, product liability may be efficacious. Consider a shield on a lawnmower that could prevent stones from being ejected by its cutting blades. Market forces would not induce manufacturers to employ the shield if consumers do not understand its benefits, and regulators might not require the shield for similar reasons. But the prospect of being found liable for a defectively designed lawnmower might induce manufacturers to include the shield.

Another reason that product liability could be effective is indirect-- that product liability litigation may result in publicity about product problems and thereby enhance market forces and spur regulation. If adverse reactions to a drug would not come to the attention of the media or regulators unless product liability suits were brought, then product liability could be responsible for lower sales of the drug and regulatory action to remedy its dangers.

The degree to which product liability reduces product risk is therefore an empirical question, which we now address. In an early and widely cited study, Professor George Priest examined accident statistics during the 1970s and 1980s, a period when the scope of product liability law grew substantially and the volume of product liability litigation increased greatly. However, he found no discernible effect of the enhanced product liability activity on accident rates. A significant qualification concerning the interpretation of his finding, however, stems from the fact that the accident rates he considered were for general categories of accidents, and that the accidents were not necessarily product-related. Hence, a small decline in product-related accident rates might not have been revealed by his data. But a large decline would have had a measurable effect unless product-related accidents were a small fraction of all accidents; we therefore find the Priest study suggestive.

Several studies of the effect of product liability in particular industries, which we summarize below, also examine whether product liability affected accident rates during the period when the volume of product liability litigation increased in a marked way. These studies conclude that

product liability has had no noticeable impact on accident rates and thus tend to confirm Priest's findings.

General aviation aircraft.⁶⁸ In separate investigations, Andrew Craig and Robert Martin assessed the influence of product liability on the safety of general aviation aircraft. They observed that the liability and defense expenditures of manufacturers of these aircraft rose sharply from the 1970s to the 1980s, growing approximately nine-fold. However, the rate of fatal accidents did not display a decline that could be linked to the sharp increase in liability. The accident rate had been falling for many years, and in the years during and following the increase in liability the accident rate did not decline more steeply; it actually fell less steeply. Craig and Martin both concluded that heightened liability apparently did not reduce general aviation aircraft fatalities.

One reason that product liability might not be expected to affect the safety of general aviation aircraft very much is obvious--purchasers of aircraft have a pronounced incentive to obtain information about the safety records of the planes they will be flying. Hence, market forces are likely to play a significant role in inducing aircraft manufacturers to provide safe airplanes. A second reason that product liability might result in little improvement to the safety of aircraft is that FAA regulation is extensive, as mentioned above.

Motor vehicles. Professor John Graham employed regression analysis to determine whether product liability reduced motor vehicle fatalities during the period 1950-1988.⁷³ He found essentially no effect and concluded that if there is a beneficial influence of product liability on motor vehicle accidents, it is too small to be detected using aggregate data.

Graham also undertook five case studies of specific safety problems in motor vehicles. The studies concerned defects related to the fuel tank of the Ford Pinto, transmissions in Ford vehicles, the roll bar of the Jeep CJ, airbags and seat belts, and all-terrain vehicles. Graham found that when safety problems arose, manufacturers responded primarily because of a concern about their reputations with consumers and because of pressure from regulators. For example, after fuel tank explosions in the Ford Pinto were widely publicized, Ford voluntarily altered its fuel tank design and also made changes in response to increased regulatory requirements of the NHTSA. Significantly, Graham found that in all of the case studies product liability was not necessary for the stimulation of the specific safety improvements that were adopted. He noted, however, that product liability might have been sufficient to induce certain safety improvements or at least to have hastened them, especially because the adverse publicity accompanying litigation can spur market forces.

Childhood vaccines. Richard Manning studied the effect of product liability on the diphtheria, pertussis, and tetanus (DPT) vaccine. He found that the liability risk borne by manufacturers of DPT increased dramatically from the late 1970s to the late 1980s. Notably, the number of suits filed against such manufacturers in the first three years of the data, 1978-1980, averaged two per year, whereas in the last three years of this data, 1985-1987, the average number of suits was 217.⁸⁶ The safety of the DPT vaccine did not, however, change during this period.

The preceding synopsis of empirical evidence concerning the effect of product liability on accident rates covers the main statistical studies of which we are aware. No others are mentioned in three reviews of empirical research on the safety benefit of product liability.

Although the empirical evidence that we have summarized is comprised of a limited literature and is subject to criticism, we believe that one may reasonably conclude the following from it. First, the influence of product liability on product safety is likely to have been at most small for the three industries studied, general aviation aircraft, automobiles, and childhood vaccines. Otherwise the investigators presumably would have found a measurable effect of product liability on product safety during the period when product liability litigation increased dramatically. Second, the findings of these industry studies support the prediction that the safety benefit of product liability for many other widely sold products--those for which market forces and regulation have similar importance--will be small. However, market forces and regulation may be more significant for general aviation aircraft, automobiles, and childhood vaccines than for the average widely sold product, implying that the safety benefit of product liability may be lower for these industries than more generally. In any case, when we combine the foregoing conclusions with the points made in sections A and B about the contribution of market forces and regulation to product safety, we come to the opinion that a skeptical attitude about the effect of product liability on product safety for widely sold products is warranted.

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V. The Costs of Product Liability

In this Part we discuss the costs attributable to the product liability system: the legal expenses associated with product liability lawsuits, as well as the loss of consumer welfare due to the increase in product prices resulting from product liability litigation.

A. Legal Expenses

A common measure of the legal expenses associated with tort liability is the percentage of the total payments made by defendants that is retained by plaintiffs--the lower this percentage, the higher the legal expenses. Tillinghast-Towers Perrin reports in a nationwide survey of the tort system that victims receive only \$0.46 of every dollar paid by defendants. Other authors come to similar conclusions. James Kakalik and Nicholas Pace estimate that in tort litigation generally, victims obtain \$0.46 to \$0.47 per dollar of tort system expenditures. Also, Kakalik and his coauthors ascertain that in asbestos cases victims obtain \$0.37 of every dollar paid by defendants, and Stephen Carroll and his coauthors find that in such cases victims obtain \$0.42.¹³⁰ Professor Patricia Danzon concludes that for medical malpractice claims victims receive \$0.40 for every dollar of defendants' liability insurance payments, and Peter Huber also reports that victims receive \$0.40 for such claims. Huber states as well that in product liability litigation, victims obtain \$0.40 for every dollar paid by defendants for liability insurance.

Professors Joni Hersch and Kip Viscusi observe that in tort litigation in Texas, plaintiffs receive \$0.57 for every dollar paid by defendants. Some of these studies do not take into account the administrative costs of insurers, the value of the time spent by litigants, or the operating costs of the judicial system, and therefore overestimate the amount obtained by victims per dollar of total litigation-related expenditures.

The preceding review of findings about the costs of the tort system implies that, for each dollar that an accident victim receives in a settlement or judgment, it is reasonable to assume that a dollar of legal and administrative expenses is incurred. In other words, for society to use the tort system to transfer money to victims is analogous to a person using an ATM at which a withdrawal of \$100 results in a service fee of \$100.

* * *

B. Product Liability for Products That Are Not Widely Sold

As we have explained, market forces and regulation are likely to be less effective in promoting safety for products that are not widely sold than for products that are widely sold. Hence, the safety benefit of product liability will generally be greater for such products. This observation strengthens the case for product liability for products that are not widely sold, though our analysis of the other benefits of product liability, and of its costs, applies more or less unchanged.

Questions

1. The Restatement expresses no opinion on the question of liability when there is “harm to persons other than users or consumers”? Do you think there should be liability in such cases? An example of harm to persons other than users or consumers would be a car that, because of a defect, spins out of control and injures a pedestrian.
2. Which argument in the articles in this packet did you find most persuasive?
3. Which argument in the articles in this packet did you find least persuasive?
4. Do you agree with Priest that product liability should be restricted to situations where there was a “specific cost-effective action that the injurer ... could have taken which would have prevented the accident”?
5. Do you agree with Polinsky & Shavell that product liability should be restricted to products that “are not widely sold.”