The Heritage Foundation Backgrounder

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AN R_X FOR THE PRODUCT LIABILITY EPIDEMIC

INTRODUCTION

Item: A man sticks his two-year-old son's head between the running blades of a ceiling fan--and then sues the manufacturer for failing to warn him the child might be injured.

Item: A company that had manufactured textile machinery for 136 years goes out of business because of the costs of liability lawsuits over equipment it had manufactured decades earlier.

Item: After deciding that a drug a woman had taken during pregnancy was not responsible for her child's birth defects, a jury awarded her damages anyway--to help defray medical costs of the child's future care.

These cases and thousands like them typify the mounting epidemic of product liability litigation flooding U.S. courts. It is a crisis threatening the very existence of some industries, and it is costing the American public billions of dollars each year.

Although the insurance industry calculates that it paid out some $400 million in product liability claims in 1981, this is only the tip of the iceberg. In addition to climbing insurance premiums, manufacturers and their customers face billions of dollars in additional costs from inflated attorney's fees, nuisance suits, and unwarranted damage awards. Some estimates put the ultimate costs of product liability suits concerning asbestos alone at potentially $40 billion. A Rand Corporation study indicates, meanwhile, that 63 percent of the money resulting from claims tried under such suits does not even reach the claimants--it ends up in the pockets of attorneys.

The specter of product liability suits is leading more and more manufacturers to drop product lines they fear might generate

nuisance suits, not because the product would not normally be profitable or wanted by the public, but because of unacceptably high product liability insurance costs. Example: Connaught Laboratories discontinued production of its DPT (Diphtheria, Pertussis [Whooping Cough], Typhoid) vaccine to protect children from these diseases because it could not obtain liability insurance. The action resulted in a nationwide shortage of the vaccine. Many children under eighteen months of age went without protection until an insurer was found several months later.

When insurance is available, its cost represents an enormous hidden burden on the consumer. Twenty percent of the cost of a stepladder, for example, goes to pay for liability insurance, lawyers, and other related costs. Modern Iron Works, a Louisiana firm, estimates that 15 to 20 percent of the cost of the sawmill equipment it manufactures represents insurance and litigation costs arising from product liability suits. Merrel Dow, a subsidiary of Dow Chemical Corporation, discontinued production of the drug Bendectin, even though it was the only safe and effective treatment for women suffering from pernicious nausea during pregnancy. The reason: the cost of liability insurance for the drug reached $10 million annually, nearly equal to its $12 million to $13 million annual sales revenues.

Making the situation worse is the fact that the various states do not deal with product liability uniformly. Indeed 20 states do not even have product liability laws. In some jurisdictions, moreover, a person might be able to sue successfully, while in others, it might not be possible. In some cases, negligent action on a plaintiff's part might be taken into consideration, but it might not in others. In some states, improving the safety of a product might place the manufacturer in a Catch-22 situation, in which the improvement is used against him in court as evidence that the earlier version of the product was unsafe.

Product liability is a classic example of the type of situation the Commerce Clause of the Constitution was intended to resolve, namely the plethora of conflicting state laws and tariffs impeding interstate commerce. Product liability is a serious example of the explosion of tort litigation that threatens America's free enterprise system. To frame a rational policy that achieves the reasonable intent of liability laws while avoiding the unintended consequences and enormous cost, a number of basic concepts must be identified and understood. They are:

1) The standard of liability to be enforced must first be defined clearly.

2) The question must be resolved whether damage awards should bear some relationship to the actual economic injuries suffered by plaintiffs.

3) The matter of intangible injuries, such as "pain and suffering" or "mental distress," must be addressed, as must the

thorny issues of how awards for such injuries should be determined and whether there should be a cap for such awards.

4) The potential of other forms of compensation, and indeed the whole concept of providing "victim's compensation," must be considered.

5) The question of attorney's contingency fees, and their relationship to plaintiff's awards, must be examined.

Unless such issues are addressed and liability is defined much more precisely, the raging epidemic of questionable liability claims will cost the U.S. public ever more billions of dollars and will threaten the existence of entire industries.

DEFINING LIABILITY

At the heart of the current crisis in liability litigation is the question of just when a company or an individual can and should be held liable for damages in connection with an alleged injury. A reasonable approach to the question of liability would assume that a number of essential conditions must exist for liability to be shown and an award granted.

First, does the claimant provide some reasonable level of proof that the injury was actually caused by a product or by some action of the defendant?

Second, does the claimant demonstrate that the injury resulted from common-sense usage of the product, rather than from some gross misuse by the claimant?

Third, is the party being held liable actually responsible for the defect that resulted in the injury?

Finally, does the award of damages bear some relationship to the actual economic injury suffered by the plaintiff?

These tests would roughly define a "negligence-based" standard of liability. Such a standard would be based in some actual wrong-doing by a firm or individual, resulting in an injury. As such, there would have to be a finding of fault on the part of the firm or individual held responsible.

Strict Liability

Over the years the negligence-based standard of product liability has been eroded through a series of court decisions and a so-called strict liability standard has evolved in its place. Where strict liability is used as the standard, a defendant can be held liable for damages from an injury caused by its product or actions, irrespective of the amount of care it exercised in manufacture. This standard has been used most often in product

liability cases where there is a defect in design, or manufacturers have failed to warn customers adequately. Interpretations of this standard, however, have been so expanded that firms can and have been held liable for defects about which they did not know, nor could they have known, at the time of manufacture. For instance, where an improvement in technology made possible the removal of minute quantities of a harmful substance, which previously was not possible. In some cases, where a design defect was detected and corrected, that action in itself has been admitted in court as evidence against the defendant proving the original product was defective. Rather than enhancing the safety of products, therefore, a strict liability standard can actually undermine the willingness of industry to improve product safety.

Perpetual Liability

Further complicating the problem of the prevailing strict liability standard is the evolution of what amounts to "perpetual liability." A landmark decision in this area was Sindell v. Abbott Laboratories, handed down in 1980 by the California Supreme Court.

The case concerned DES, a generic drug widely administered for several decades to prevent miscarriages in pregnant women. The drug was alleged to be responsible for causing cancer in the daughters of women who had taken it. The problem in Sindell was that it was impossible to identify which of over 200 manufacturers had actually produced the batch of the drug taken by the plaintiff's mother a full generation earlier. The court dealt with this by holding that all manufacturers of the drug would be held liable and would be assessed damages in proportion to their share of the market.

As a consequence of the Sindell decision, the production of essentially generic commodities, such as petrochemical feedstocks, drugs, or other widely used substances, which are manufactured by many firms, is exposed to an extraordinary level of risk. Although there can be considerable differences in quality control and in other factors that in turn result in significant variances in the likelihood that the products might cause harm, Sindell fails to take such factors into account. More important, it also ignores the basic notion that liability should in some way be connected to some action by the defendant. Sindell also failed to take into account the relevant matter of the state of knowledge and the standards in effect at the time of manufacture of DES. Under current interpretations of liability, even if the manufacturer complies with all existing regulations and exercises the greatest possible care in producing a product, it still can be held liable at some future date for a defect impossible to be known at the time of manufacture and in a product manufactured by another firm. In short, as a consequence of the Sindell case, any manufacturer of a commodity is effectively liable for damage claims in perpetuity.

The application of strict liability standards has resulted in numerous damage awards by juries that would have been rejected under any reasonable interpretation of a liability standard. General Motors, for example, was successfully sued by the parents of a young woman injured in an accident while riding in a stolen car during a high-speed chase by police. The damage award was based on the claim that the automobile's anti-theft precautions were inadequate, even though they were in compliance with an existing federal anti-theft regulation. The argument seemed to be that, had General Motors prevented the car from being stolen, the reckless driving of the thieves--the proximate cause of the accident--could not have occurred. In another case, an equipment manufacturer was successfully sued by a worker injured while operating a machine from which his employer had removed the safety screen that would have prevented the injury. The manufacturers had to pay damages even though they had no knowledge that the screen had been removed and had not authorized its removal.

Absolute Liability

Further complicating the standard of strict liability is the evolving notion of "absolute liability." Under this, irrespective of the factual basis of the claim and even in the presence of contradictory evidence, the mere assertion that a product caused an injury is enough to obtain money from its manufacturer. As far-fetched as such a standard may seem, a number of recent lawsuits seem to be moving in this direction.

Among the most publicized examples of absolute liability was the case brought by a group of Vietnam veterans last year, claiming that their exposure to the chemical herbicide Agent Orange was responsible for causing a variety of illnesses in themselves and their offspring. Facing the prospect of hundreds of millons of dollars in legal expenses due to the veterans' class action suit and under considerable pressure from the court, seven firms who had manufactured Agent Orange agreed to a record $180 million out-of-court settlement, to be shared by some 200,000 claimants.

After the settlement was reached, Federal District Court judge, Jack B. Weinstein, who was instrumental in obtaining the settlement, admitted to the New York Times that "no factual evidence of any substance" had been produced to connect Agent Orange to the diseases the veterans claimed it caused. Weinstein went on to question whether the case should have been brought in the first place. Why then did the companies settle? Even if they could have won the day in such an emotionally charged case, their legal bills likely would have exceeded $200 million. Had they lost, the cost could have been billions.

The Agent Orange case is by no means unique. A similar settlement was almost reached in a class action suit concerning the morning sickness drug Bendectin, until lawyers for the estimated 1,100 plaintiffs objected. As a result, the case went to trial, and a Cincinnati federal court jury found no connection

between the drug and the birth defects it was alleged to cause. Although the March 12, 1985, decision was actually the third instance in which allegations concerning the drug's connections to birth defects had been rejected in court, it has been unavailable since 1983 because of the skyrocketing costs of product liability insurance. Despite a favorable outcome in court, the consumer is still unable to obtain a useful product.

DAMAGE AWARDS VS. ACTUAL INJURIES AND CONTRIBUTORY NEGLIGENCE

Since 1974, the number of product liability suits filed in federal courts each year has risen by more than 500 percent. Filing such suits is encouraged by the gargantuan size of damage awards granted in many cases. Predictably, the suits are particularly popular with attorneys. Since 1962, the first year in which a $1 million damage award was granted by a jury in a personal injury case, the number of $1 million plus has increased steadily, reaching 360 verdicts in 1983, the most recent year for which figures are available.

In many of these cases, the awards seem far out of line with the defendant's actual culpability. In one case, for example, a plaintiff was awarded $1.75 million after suffering a heart attack while starting a lawn mower manufactured by Sears Roebuck and Co. He claimed that the difficulty in pulling the starter rope on the machine was the cause of the attack, and that therefore the machine was defective. Yet, had the rope been easier to pull, the company might have liable for damages if a child were to start such a machine and subsequently be injured by it. The prospect of such awards provides a strong incentive for individuals to sue, and it also inflates the size of initial damage claims.

In many instances, the contributory negligence of a plaintiff is not taken into consideration. In one case, a 41-year-old body builder strapped a refrigerator to his back and ran a footrace. One of the straps slipped, resulting in an injury. He then sued the strap manufacturer successfully for $1 million, even though the strap had not been designed for or sold for running races with refrigerators on the racers' backs. In another case, two men who had placed a hot air balloon in a commercial dryer and were injured when the dryer exploded were awarded $885,000. Each such decision adds further to the incentive to sue, and effectively absolves plaintiffs of any responsibility for their actions, no matter how they might have contributed to the injury they suffered.

When a product causes an injury through some inherent defect, or as a consequence of normal use, clearly the injured party should be able to recover damages proportionate to the injury. Any award for such injuries, however, should be related to the actual economic loss suffered and should take into account actions by an individual that aggravated or contributed to the injury being sustained. This goal could be achieved by having the

judges determine actual damage awards rather than leaving this crucial decision to juries that might be swayed by emotional arguments put forward by plaintiff's attorneys. It could also be achieved by separating the determination of liability from the determination of the amount of a damage award.

Another means of keeping damage awards proportional to economic loss would be to place a cap on awards for "intangible injuries," such as "pain and suffering" or "mental distress." In California, such a cap has been applied to awards for noneconomic losses in medical malpractice cases. And a similar cap should be extended to other cases involving personal injuries. While it is appropriate to recognize that such intangible injuries exist, it is also necessary to recognize that the valuation of damages resulting from them is a subjective determination. Such subjective decisions are better left to a judge, or based on standards developed by an elected legislature answerable to the public, than turned over to juries easily swayed by emotional arguments of attorneys with an incentive to inflate damage awards to the greatest degree possible.

ATTORNEY'S FEES: HOW MUCH IS ENOUGH?

One of the most controversial areas in liability cases is the extent to which damage awards are absorbed by attorney's contingency fees. According to the Rand Corporation study of liability cases from asbestos-related injuries, attorney's fees consumed 63 percent of all damage awards. A typical court case, said the Rand study, resulted in a total cost of $380,000. Of this, $125,000 would be for legal fees paid by the defense, $114,000 in legal fees paid by the plaintiff, and $141,000 ultimately in net compensation to the plaintiff.

While the dollar figure for claims settled before coming to trial was a considerably lower $88,000, the distribution of the monies was essentially the same: 62 percent to lawyers, and the balance to the plaintiff. Should the cost of settling all asbestos-related claims ultimately reach the $40 billion expected by some experts, attorney's fees will account for $24.2 billion of the total. Nor is the situation with asbestos litigation unique--attorney's fees frequently amount to one-third to one-half of any award granted by a jury. Moreover, in large class action cases, attorneys enjoy the benefit of considerable economies of scale for their work.

The incentive to "shop" for clients, arising from contingency fees, was dramatically illustrated when hundreds of attorneys descended on Bhopal, India, to recruit the families of victims of the tragic accident. Still more attorneys descended on Institute, West Virginia, in an attempt to recruit additional clients for a lawsuit against the company which also operates a plant in that city--merely because the plant was producing the same chemical--and even though there had not been a similar accident. Since the

company, Union Carbide, will have to defend itself against such suits, irrespective of their merit, its customers and stockholders, and ultimately the American public, will have to bear a cost that could run into billions of dollars.

While the supporters of the contingency fee system argue that it enables those who otherwise would be unable to afford legal assistance to do so, the practice of assessing fees on the basis of a percentage of a damage award without regard to the actual work performed creates a perverse incentive for attorneys to attempt to inflate awards in hopes of reaping a windfall. A cap on fees based on actual work performed would still allow individuals access to legal services without unduly denying attorneys just compensation or allowing jury awards intended to compensate plaintiffs to be absorbed by litigation costs.

VICTIM'S COMPENSATION ALTERNATIVES

Some critics of current product liability laws suggest that an alternative could be found in a "no-fault" victim's compensation system, financed through the federal government, perhaps by a special tax on business. There are a number of problems with such proposals, however. First, they eliminate the notion of causality in product liability cases, effectively creating an open-ended entitlement program for anyone claiming an injury from a product. Since there also would have to be some limitation on total dollar claims for any such broadly drafted program, basing damage awards on actual economic losses would be very difficult. Most important, given the history of most entitlement programs, the creation of such a fund would lead to the creation of an interest group to lobby for expansion of its coverage and for its continuation whether or not it proved workable. Ultimately, compensation decisions would be based on political considerations rather than on their merits.

CONCLUSION: NEED FOR TORT REFORM

The problem of product liability has its roots in the broader question of tort law reform. As the costs of a litigous society become increasingly apparent, so too does the need to place some restraint on its continued growth. This can only be accomplished through the institution of a uniform standard of liability, along with a reasonable set of rules under which liability actions can be brought. Among the most basic requirements for such a standard would be:

1) A statute of repose or limitation on the time period during which manufacturers can be held liable for a defect that appears in their product;

2) A requirement that the degree of care exercised by manufacturers in producing their products must be taken into consider-

ation by a court, together with the standards for the products that were in force at the time of their manufacture;

3) A requirement that the misuse of a product by a party alleging an injury from that product be taken into consideration in determining fault;

4) A reasonable burden of proof on the part of the plaintiff that the product did indeed cause the injury;

5) A limitation on attorney's contingency fees to some reasonable approximation of the amount of work actually performed;

6) A requirement that damage awards be based predominantly on actual economic loss; and a limitation on the amount of any additional awards allowed for "intangible" injuries.

While such guidelines would not limit the ability of damaged parties to recover just compensation for injuries resulting from some negligent act or product, they would help curb the current abuses of liability law. These abuses are threatening the very foundations of the U.S. economic system. Their reform would inject a long overdue dose of common sense into a legal process that is currently out of control.

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