

June 30, 1986

## THE AMERICAN CONSUMER PAYS DEARLY FOR THE LIABILITY INSURANCE CRISIS

### INTRODUCTION<sup>1</sup>

The liability insurance crisis is now pinching the U.S. consumer. Up to half the retail price of some manufactured goods now reflects the cost of insuring their manufacturers against product liability lawsuits. Insurance premiums are only part of the growing burden the consumer ultimately bears. On top of these are many indirect costs. Products are being withdrawn from the market, for example, because reasonably priced insurance coverage is disappearing, thus depriving consumers of goods and eliminating the jobs of those who make and sell the product. More American jobs are lost as U.S. firms relocate to other countries to avoid the prospect of defending themselves from very expensive American-style litigation.

Examples of how American consumers are feeling the insurance liability crisis impact:

- o Automobile owners in major cities along the east coast have been hit with increases in their liability coverage of up to 50 percent.
- o A "vanpool" program aimed at reducing rush hour congestion in Northern Virginia is threatened because participating van owners'

---

1. This is the fourth in a series of studies examining the liability insurance crisis. It was preceded by Background 498, "The Liability Insurance Crisis: What Washington Can Do To Help" (March 27, 1986); Background Update 10, "The Liability Insurance Crisis" (May 14, 1986); and Background 511, "A Sick Tort System Endangers U.S. Health Care" (May 21, 1986). Future studies will look at other aspects of the problem, including the extent to which the federal and state governments should be involved.

automobile insurance was abruptly cancelled and they cannot find replacement coverage.

- o Vaccination programs across the nation are threatened as one manufacturer after another either stops producing the drugs or finds it necessary to double or even triple the price per dose to recover skyrocketing insurance costs. In some cases no insurance is available. Among the hardest hit are the manufacturers of vaccines for diphtheria, tetanus, pertussis (DTP), measles, mumps, rubella (MMR), and polio.
- o An Ohio manufacturer of police equipment found his liability insurance cancelled even though he had never had a claim filed against his firm. As a result, he is planning to move his plant offshore, costing Ohio jobs for 300 skilled workers.
- o Bendectin, considered the safest and most effective drug for the treatment of morning sickness in pregnant women, has been withdrawn from the market because the cost of liability insurance threatened to exceed the \$13 million in annual sales revenue it generated for its manufacturer, Merrel Dow.

These and scores of other examples that seem to multiply monthly leave no doubt that the American consumer is becoming the main victim of the high jury awards that are pushing up the price of insurance liability premiums. Goods, services, and even jobs are disappearing. Resolving the insurance liability crisis thus is a major consumerist issue. It is puzzling then that some putative "consumer movement" activists, including Ralph Nader, deny that a liability crisis exists. Rather than address the cause of the injury, these so-called champions of American consumers are attacking the wounds. They balk at reforming tort laws and push for more regulation of the insurance industry. Going farther, Nader has characterized steps to reform liability laws, such as California's recently enacted Proposition 51, as "blackmail."<sup>2</sup>

The self-styled consumerists have ignored the interests of the consumers they claim to represent. Liability litigation has led to a bonanza for a few, and unreasonable settlements that are passed on as higher prices to most Americans. True consumerists would urge quick action to curb the runaway litigation explosion.

---

2. John Bilotta, United Press International, May 12, 1986.

## THE DEEPENING CRISIS

Until recently, the liability crisis seemed primarily a concern of "Big Business." It affected, it seemed, insurance companies, pharmaceutical manufacturers, and other economic giants. Now consumers are discovering that they are paying dearly for the crisis. New York City, for instance, temporarily closed a ferry recently, disrupting daily transportation for many commuters. The reason: the unavailability of insurance coverage. As a consequence, commuters going to New York City from parts of Long Island faced a two-hour drive around Long Island, instead of a 15-minute trip across New York harbor. Fully 40 percent of the nation's day care centers had their liability insurance cancelled last year; a significant proportion of these so far have been unable to obtain replacement coverage. Those that did often faced premium increases of as much as 400 percent.

Recreational facilities have been particularly hard hit. Ski slopes have closed, amusement parks have had to shut down rides--the famous rollercoaster at New York's Coney Island for a time was still--and the Boy Scouts have indicated that they will have to charge each member \$20 annually to cover liability insurance costs.

In short, the liability crisis is no longer the concern only of large firms that manufacture toxic or hazardous products. It now affects virtually everyone. Reforms proposed by lawmakers, however, have encountered a firestorm of opposition from an unholy alliance of attorneys who benefit from the present system and, ironically, self-styled consumer advocates who seem to alternate between arguing that there is no crisis or that the crisis is "manufactured." Meanwhile, the consumer suffers.

According to Ralph Nader, the liability crisis is really nothing more than an attempt by the insurance industry to "stampede legislators" and "create a climate" for an increase in rates.<sup>3</sup> The facts contradict him. They also belie the argument of other "consumerists" that increased insurance costs simply reflect citizens having their day in court.

## THE SCOPE OF THE PROBLEM

There has been an unprecedented explosion of liability lawsuits. Although Nader stated recently that such verdicts and lawsuit settlements "have barely kept up with inflation," the data show otherwise when specific areas are examined. According to the U.S.

---

3. ABC Nightline, December 26, 1985.

Department of Justice, between 1975 and 1985 there was a 758 percent increase in the number of product liability lawsuits filed. During roughly the same period, the cost of judgments granted in these cases skyrocketed 370 percent.

Medical malpractice judgments also jumped in size and frequency. Between 1979 and 1983, for example, the number of malpractice suits filed doubled for all physicians, and tripled for those practicing obstetrics and gynecology. Between 1975 and 1985, moreover, the size of malpractice judgments soared 363 percent. This naturally leads to steep increases in premium costs. And these are driving many physicians out of high-risk specialties and family medicine. As a result, many small communities may find themselves without medical care of the type most needed: family practitioners and specialists in obstetrics.<sup>4</sup>

Nader sees the rise in malpractice suits as a "good trend" because, he claims, it helps to control the actions of incompetent doctors. This ignores the fact that malpractice premiums have risen rapidly for doctors who have never been taken to court. It is the increased risk of costly lawsuits that is behind the trend, and not a surge of medical incompetence.

Everyday products are also much more expensive because of the insurance crisis. Approximately 25 percent of the price of a stepladder purchased in the U.S., for example, is accounted for by product liability costs borne by the manufacturers. Up to 15 percent of the cost of machine tools is attributed to the manufacturer's liability insurance. Toy manufacturers have suffered premium increases as high as 500 percent in recent years. And some 41 percent of America's automobile repair shops have had their policies cancelled, with 26 percent unable to obtain replacement coverage.<sup>5</sup> Where replacement coverage is available, it often is accompanied by a premium increase of as much as 80 percent.

#### THE CAUSES OF THE PROBLEM

Part of the problem of sharply increasing premiums stems from the fierce competition that characterized the insurance industry during the late 1970s and early 1980s. High interest rates allowed insurance firms to increase their investment earnings, thus enabling them to cut premium charges. The decline in interest rates has forced companies

---

4. Peter J. Ferrara, "A Sick Tort System Endangers U.S. Health Care," Heritage Foundation Backgrounder No. 511, May 21, 1986.

5. Source: U.S. Department of Justice Tort Reform Working Group.

to seek more of their revenues from premiums. But even this does not explain the dramatic increase in premiums or the denial of insurance to many groups with few previous claims. Rather, the root cause has been the explosion of liability litigation--and the uncertainty that accompanied it.

With the litigation urged by the consumerists in the 1960s and 1970s came a greater willingness for juries to grant large damage awards. In 1975, for instance, there were only three judgments exceeding one million dollars in medical malpractice cases, and only nine such judgments in product liability cases. By 1984, however, the number of such judgments jumped more than 130 fold, with 71 judgments of one million dollars or more for malpractice and 86 judgments of that magnitude for product liability. In addition, the number of suits filed had skyrocketed, causing a corresponding leap in litigation costs. In 1974 there were 1,579 product liability cases filed; in 1985 there were 13,554. As the burden of litigation increased, many companies predictably settled cases out-of-court, irrespective of their merit, simply to avoid the prospect of protracted and costly litigation. This, in turn, has pushed up costs to consumers.

Another factor contributing to the rise in settlement costs has been a series of court decisions establishing the principle that any party bearing any portion of the fault in a product liability case may become liable for all damages--no matter the degree to which they are at fault. This has led attorneys for plaintiffs to seek the so-called deep pockets in a case, that is, the individual or organization with the greatest financial resources. When hauled into court and faced with expensive and time-consuming litigation, such firms often reluctantly seek an out-of-court settlement to minimize their losses, regardless of the merit of the complaint. This has led some activist members of the judiciary to force settlements on companies where there are no real grounds for an action.

Typical of such settlements is the widely publicized Agent Orange case, in which a group of Vietnam veterans sued seven manufacturers of the chemical defoliant, alleging it had caused a variety of illnesses. Although the companies involved were convinced that their product had not caused the injuries alleged, the potential cost of litigation, even if they prevailed, was so high that they decided to accept a settlement of \$180 million. To their surprise, after the settlement was reached, the presiding judge stated that the case never should have been brought in the first place. Judges bear much of the responsibility for the litigation explosion by their interpretation of negligence and liability. Attorneys must also shoulder some portion of the blame. The contingency fee system may be the poor man's "key to the courthouse door," as the consumerists argue, but it is also a free ticket to a national lottery, where attorneys seek clients with the argument that they may win the jackpot.

The effect of questionable suits and large settlements is to raise costs to the consumer, thanks to high insurance and litigation costs. In addition, firms often institute defensive policies to minimize the potential for suits, often discontinuing the production of useful products that have become the target of frivolous litigation, such as in the case of Bendectin, the morning sickness drug. In medicine generally, states the American Medical Association, defensive practices are believed to account for one-third of the cost of the nation's health care. These practices include requiring extensive tests and X-rays, and in some instances, can include subjecting patients to such costly procedures as a CAT-Scan examination. This test uses sophisticated equipment and radioisotopes to obtain what amounts to a three-dimensional picture of a patient's body. Interestingly, although CAT-Scanners were not intended as standard hospital equipment, more and more hospitals are finding it necessary to acquire them because of a series of adverse decisions in lawsuits where patients alleged that the lack of a CAT-Scan was inherently malpractice.

#### WHERE IS THE CONSUMER INTEREST?

Professional "consumer" activists and their allies among trial lawyers contend that there is no liability crisis and that high settlements and the accelerating pace of litigation benefit the consumer. This is nonsense and is contradicted by the facts. The consumer is being harmed every day by the explosion of tort litigation. Some of the costs are readily apparent, such as the steep rise in the price of vaccines and the recent sharp increases in automobile insurance premiums. Other costs, such as the loss of jobs and the withdrawal of products from the market, are less apparent but just as real. These costs are not the result of some conspiratorial "manufactured" series of events. Rather they derive from an explosion of lawsuits that have been encouraged, directly and indirectly, by self-styled professional consumerists. Says Joan Claybrook, president of Public Citizen, a Naderite group: "Juries set the ethical standards for the rest of society."<sup>6</sup> She claims, therefore, that the place to settle all disputes is the courtroom. The only trouble is that this approach leads to costly litigation that is passed on to the consumer in the form of higher prices.

The consumer interest is not served by initiating even more suits. Nor is it served by stricter regulation of the insurance industry. This only would reduce further availability of insurance. What will best serve the consumer is a reduction in the costs related to the purchase of product liability insurance and in the costs of

---

6. Quoted by Steven P. Rosenfeld, Associated Press, February 9, 1986.

litigation companies face over frivolous claims. This can only be accomplished through a sweeping reform of tort law--precisely the approach that the putative consumer advocates oppose.

## CONCLUSION

The liability crisis reaches into every aspect of daily life. Almost every product, service, and transaction costs more than it should because the legal system is out of control.

Reform of the liability laws is long overdue. But there is considerable opposition to sensible change. This opposition is largely motivated by plaintiffs' attorneys, who benefit enormously from the current circumstances, and self-styled consumerists, who seem less interested in helping consumers than in spurring litigation to injure corporations and to force greater regulation on the economy. Neither group is truly concerned with the interests of the average citizen. True consumer advocates support those tort law reforms that will bring down the price of goods and services and will save jobs while still safeguarding the consumer from negligence.

Milton R. Copulos  
Senior Policy Analyst