OFFICE OF
REGULATION REVIEW
INDUSTRY COMMISSION

Amendments to the new Australian product liability law

A submission to the Senate Standing Committee
on Legal and Constitutional Affairs

SUBMISSION
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INTRODUCTION

The Senate Standing Committee on Legal and Constitutional Affairs has been asked to report on whether the *Trade Practices Act 1974* should be amended to:

- give Part VA of the Act the same extra-territorial impact as is currently given to Parts IV and V of the Act;
- delete or amend the provisions dealing with the statue of repose (subsection 75AP(2)); and
- assist plaintiffs in the discharge of the burden of proof.

In this submission, the Office of Regulation Review (ORR) — which is part of the Office of the Industry Commission — outlines some economic effects of product liability laws and then discusses each of the proposed amendments.

APPROACH TO ASSESSING THE PROPOSED AMENDMENTS

Product liability laws specify the circumstances in which people who suffer product-related loss or injury are entitled to receive financial payment from the producers (or sellers) of the goods.

The influence of product liability laws extends beyond the consumers who suffer loss and the producers who supply the goods concerned. The payment of compensation by producers will be reflected in higher product prices and hence will affect all consumers. Product liability laws also influence the incentives for producers to make safe goods and for consumers to take care when using goods.

In its report, the Industry Commission[1] assessed the effects of product liability laws under two main headings: economic efficiency and economic equity. *Economic efficiency* refers to the productiveness with which the community uses its scarce resources: it is about getting the highest 'net social benefit' from those resources. To use an analogy, it is about maximising the size of the national cake (not just in money terms) given society's limited quantity of ingredients. *Economic equity* refers to the fairness of the distribution of society's resources among its members. To continue with the cake analogy, it is about whether the relative size of the slices is fair.

Product liability laws affect economic efficiency mainly by changing incentives for producers to build safe goods and by affecting legal and business costs. Improvements in safety are beneficial in terms of economic efficiency whereas increases in costs reduce economic efficiency. How stringent a product liability law is — in the sense of how stringently it imposes liability *on producers* — will affect the balance between these benefits and costs. The more stringent is the law, the greater will be the incentive for producers to build safer goods (or take out more insurance against legal claims). This should improve product safety but it will also increase costs and prices.[2] At the same time, making the law more stringent towards producers will reduce the incentives for consumers to take care when using goods. Consequently, if economic efficiency is to be maximised, the law needs to assign liability in a way that properly balances these benefits and costs.

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1 Industry Commission, Product Liability, Report No. 4, AGPS, Canberra, 1990.

2 At the extreme, increasing the stringency of product liability laws can reduce product innovation and availability, and encourage consumers to continue using more hazardous second-hand goods rather than buy safer, but more expensive, new goods.

Product liability laws affect economic equity by providing access to compensation for people who suffer product-related loss and also by affecting prices for consumers generally. The more stringent the law, the easier it will be for consumers who suffer (or claim to have suffered) product-caused loss or injury to gain compensation. This will benefit them but at a cost to producers and, ultimately, to all other consumers who will be faced with higher prices. In other words, a product liability law that is insufficiently stringent will not be fair for consumers who suffer loss or injury from goods, but a law that is too stringent will not be fair to consumers who avoid product-related loss or injury. Again, a balance is needed.

In assessing the merits of proposed amendments, it is therefore necessary to consider how they will alter the stringency of the new product liability law and, thus, how they will alter the balance between the different benefits and costs. In this regard, it is important to recognise that changes made to the law to achieve one particular goal (such as to enhance equity for injured consumers by enhancing access to compensation) will have effects on other goals (such as providing incentives for consumers to take optimal care when using goods or for producers to incorporate an optimal level of safety into their goods).[3] The overall aim should be to ensure that any amendments promote a more efficient and/or equitable balance of benefits and costs.

In assessing the proposed amendments, it is also important to bear in mind the relationship between the new product liability law and other parts of the law. The new law itself (Part VA of the *Trade Practices Act 1974*) meets many of the criteria listed by the Industry Commission for an efficient and equitable product liability regime. For example, it overcomes the previous problem of non-owners of goods sometimes being unable to gain compensation in deserving cases, and it arguably also places an appropriate level of stringency on producers. However, contrary to the Industry Commission's findings, the new bill supplements rather than replaces existing laws. This means that many consumers continue to be afforded excessive rights under the law of contract.[4] Producers therefore face excessive liability in aggregate. Amendments made to the new law which increase its stringency can potentially exacerbate this problem.

EXTRA-TERRITORIAL APPLICATION

At present, foreign consumers who suffer loss or injury through using imported Australian-made goods can sue the producer (or importer) under their own country’s laws and some Australian laws, but not under the new Australian product liability law.

What would be the effect of allowing them to claim under the new Australian law? In these circumstances, foreign consumers would be able to engage in ‘forum shopping’: that is, they would be able to choose between their own and the new Australian law to seek compensation. Consumers would generally sue a producer (or importer) under the law they think will yield the biggest payout and/or the best chance or receiving a payout.

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3 For a discussion of optimal levels of safety and care, see Industry Commission, op. cit., pp. 72-74.

4 Actions for breach of contract in product liability cases make no general provision to reject or discount plaintiff's claims where improper use contributed to the loss suffered. This aspect of contract law means that producers will bear liability for some loss that should be borne by consumers, thereby providing incentives for producers to build excessive safety features into their products or to set prices that over-account for losses caused by the consumption of those products. Industry Commission, op. cit., p. 17.

In cases where the foreign law is more stringent or of equal stringency to the new Australian law (or where the level of damages awarded in the foreign country is generally higher than in Australia), extending the scope of our law would have no impact — foreign consumers' best bet would still be to sue under their own laws.

In cases where the foreign laws are less stringent than the new Australian product liability law (or where the level of damages awarded in the foreign country is generally lower than in Australia), extending the scope of the new Australian law to foreigners will adversely effect Australia's export competitiveness. In this case, the Australian producer could be sued under the more stringent Australian law, whilst foreign producers would not be exposed to this risk — they could only be sued under the more lax foreign laws. Of course, foreign consumers might in theory be willing to pay more for Australian goods because of the likely better compensation payments they could claim if injured by the goods, but in practice they will probably underestimate this value. Hence, Australian producers may suffer a disadvantage.

The extent of this loss in export competitiveness should be quite small. This is because most Australian exports are primary products or services. The former exports are generally not inherently hazardous and, thus, are unlikely to be subject to many claims. The latter simply are not covered by the new product liability law. The effect of extending the law could be greater for exports of more potentially hazardous manufactured goods, but even then it might be expected to be reasonably small, for three reasons. Firstly, the size of product liability premiums is generally small although, if other changes were made to the new law which increased its stringency on producers, the size of premiums could increase. Secondly, the new Australian law — based on the EC Directive — is similar to those in other advanced nations with which we compete. Finally, other actions under Australian laws remain generally available to foreign consumers injured by Australian goods, so the effect of extending the extra-territorial impact of the new law (as it currently stands) should not be overly marked.

Extending the extra-territorial impact of the new law would entail some benefits. The most obvious is that it would grant at least equal status to foreign consumers of Australian goods as it would to the Australian consumer and, under certain value judgments, this would improve international equity. It would also bring the new law into line with related Australian laws.

Overall, the ORR considers that the effects of extending the territorial impact of the new product liability law would be small and, while some minor reduction in economic efficiency may be entailed, the ORR sees little reason for not giving Part VA of the Act the same extra-territorial impact as Parts IV and V.

STATUTE OF REPOSE

A 'statute of repose' refers to the time limit (after the purchase of the goods) for which a producer can be held liable for loss caused by its goods. Under the new Australian product liability law, the statute of repose has been set at 10 years.

The length of a statute of repose has obvious effects on producers' liability and consumers' access to compensation. Shorter repose periods reduce a producers' total liability and consumers' access to compensation, while longer repose periods increase them. For the majority of products, most if not all faults in the product will probably

become evident reasonably early in the life of the product, so the length of the repose period might not have much practical effect. However, for some products such as therapeutic drugs, design faults might not show up until several years after production.

What length statute of repose is most economically efficient and equitable?

In considering this issue, it is important to bear in mind how product liability laws affect incentives for producers to build goods with an optimal level of safety. The aim of assigning liability to producers is that they should take into account all the likely costs resulting from the production and use (as distinct from misuse) of their product. These costs include not only the financial costs of production but also the costs of loss or injury resulting from product-caused accidents. Whether these costs are incurred today or well into the future is immaterial. They are still costs borne by members of society and, if economic efficiency is to be maximised, they should ideally be taken into account by producers when deciding how safely and sturdily to build their goods (and what level of insurance to take out for them).

Likewise, on equity grounds, if it is judged fair to compensate consumers for product-caused accidents which occur shortly after the production of a product, it would seem unfair not to compensate consumers for a product-caused accident which happened some time after the sale of the product, simply because a greater period of time had elapsed.

Consequently, provided that the essential elements of the product liability law promote efficiency and equity, it should apply irrespective of how long, after production, the goods cause loss or injury: that is, there should be no statute of repose.

Extending the repose period would have some minor adverse effects on economic efficiency. It would exacerbate slightly the problems of excessive producer liability in aggregate. A further problem is that, with a long repose period, some producers and importers may seek to avoid liability by going broke and transferring their business arrangements to another name. However, the commercial benefits of having an established brand image and reputation would largely outweigh these incentives. Of course, some problems of ‘fly-by-night’ operators will arise under any legal regime, but they will generally be short-term and should not be significantly affected by the length of the repose period.

Another consideration is that, if the loss or injury was caused by normal wear and tear rather than an actual production or design fault, producers should not be liable. This possibility appears to be covered by the definition of defect in the new law, particularly the clause which requires that the courts should take into account “the time when they were supplied by their manufacturer” in determining defect.

Overall, the ORR considers that the statute of repose should be repealed.

THE BURDEN OF PROOF

Should the new law be amended to reduce the burden of proof on consumers?

Amending the new product liability law in this way would increase its stringency; it would increase the effective liability borne by producers and would improve consumers’ access to compensation. Those consumers who suffered (or claimed to have suffered) product-caused loss would find it easier to gain compensation. As noted above, higher

compensation payments would be reflected in higher costs to producers and, ultimately, in higher prices paid by other consumers (or reduced product availability etc). Increasing the stringency of the new law would also alter the incentives for producers to build safe goods and for consumers to take care when using goods.

In discussing the onus of proof issue in relation to problems with current laws, the Industry Commission stated:

> As in the case of the assignment of liability, from an economic perspective, the onus of proof should generally reside with the party in the best position to gather information relevant to the question at issue.

This suggested to the Commission that the onus should lie with producers to prove that products were not faulty and with consumers to prove that negligent conduct did not contribute to the loss suffered. The Commission further noted that an inappropriate allocation of legal onuses may allow producers to avoid liability when the product is at fault and may allow consumers to receive compensation even when the loss resulted partly or wholly from their negligence.

However, the Commission also stated that whether it is practical to have a regime which requires producers and consumers to prove that they did not do something is a separate question. Further, in assessing the Australian Law Reform Commission's proposals[5], the Commission found that the effective presumption of producer liability entailed in the proposals would result in excessive shift of liability in practice. Another practical consideration is that the most important evidence in a product liability case is usually the individual product involved. The fact that the claimant, rather than the producer, generally has control of this evidence tends to undermine the assumption that the producer is in the best position to prove or disprove a defect in the goods. Overall, the Commission concluded that the issue of the onus of proof needed to be considered further.

Following the Government's announcement that it would adopt the European Community Directive as the basis of the new product liability law, Shaun Gath[6] argued that a fundamentally different judicial culture in Europe compared to Australia on the question of onuses of proof justifies modification of the EC Directive to suit the Australian legal environment. The more liberal interpretation of *res ipsa loquitur* in England was cited as evidence of this.[7]

The ORR[8] commented that, rather than fiddle with the EC Directive with rather uncertain results, the simple solution to this problem would be to legislatively adopt the English interpretation (and, if necessary, incorporate it into the Directive). Ewoud Hondious,

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5 The Industry Commission was asked by the Commonwealth Government to report on the economic effects of the product liability proposals advanced by the Australian Law Reform Commission and their effects on product innovation and insurance charges. The Industry Commission judged that the proposals would reduce economic efficiency and have small but indeterminate effects on economic equity. It considered that the major inefficiencies and inequities in existing laws could be overcome with less fundamental changes to the legal regime.

6 Shaun Gath, Adviser to the Minister for Justice and Consumer Affairs, *Product Liability: the Government's Proposals* , Address to the Australian Product Liability Association, 6 August 1991, p. 12.

7 The doctrine of *res ipsa loquitur* literally means 'the things speaks for itself'. It may be raised by a claimant who cannot explain a set of circumstances or events, which nonetheless suggest negligence on somebody's part, to draw an inference of negligence on the part of the defendant.

8 Ed Willett, Director of the Office of Regulation Review, *The Economics of Product Liability Law Reform in Australia*, Address to the Conference on Product Liability reform, Sydney, 11 November 1991, p. 11.

writing in the August 1990 edition of the Australian Product Liability Reporter, suggested that this would be the approach taken in England:

> Article 4 (of the Directive) provides that the injured person be required to prove the damage, the defect and the causal relationship between defect and damage...The doctrine of *res ipsa loquitur* will help him to prove the causal relationship.

While adopting the English interpretation of *res ipsa loquitur* would overcome the problem identified by Gath, it is not clear that the tortious concept of *res ipsa loquitur* has any particular relevance to a strict liability regime such as the EC Directive. This is partly because, as a strict liability regime, Part VA already covers identified cases (such as *Kilgannon versus Sharp Bros.* [1986] NSWLR 600) where the English interpretation of *res ipsa loquitur* may make a difference to Australian negligence actions. Certainly, attempting to incorporate such a concept into Part VA of the Trade Practices Act has proved a difficult exercise.

In addition to these evidenciary and legislative problems associated in modifying the burden of proof, making the new product liability law more stringent will tend to exacerbate the problems with the overall degree of liability faced by producers. As noted above, producers currently face excessive liability under the law of contract. In contract actions, there is no general mechanism for reducing the compensation paid by producers to account for the misuse of products by consumers. This leads to higher payouts and excessive costs, and distorts the incentives for producers to include an optimal level of safety in their goods. Increasing the stringency of the new product liability law would exacerbate this problem at the aggregate level.

Overall, unless the operation of the new law proves to be deficient in this area, the ORR would not favour special burden of proof provisions in Part VA of the Act.