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Liability for Harm versus Regulation of Safety

A Text from S. SHAVELL

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Table of abbreviations

art.	article
ATF	Swiss federal court decision
CC / SWZ	Swiss civil code, RS 210
CJEU	Court of Justice of the European Union
cf.	see
CO / SWZ	Swiss obligation code, RS 220
Cst. / SWZ	Swiss Constitution, RS 101
e.g.	for example
et al.	and the others authors
EU	European Union
GNP	Gross National Product
Idem	same citation
Infra	below
LLCA	Law on the profession of lawyers, RS 935.61.
LRFP	Federal law on the responsibility for products, RS 221.112.944
n.b.	nota bene
OFAS	Federal office of the social insurance
op.cit.	see above citation
p.	page
pp.	pages
RS	classified compilation
sqq.	and following
supra	above
USA	United States of America
vol.	volume
vs.	versus

Introduction

"*Prevention is better than cure*" except you can't always prevent harms to be done neither can you let damages free of any responsibility. This is the whole problem about the debate of Liability vs. Regulation.

Since 1984, date at which Shavell wrote his theory, the two notions have evolved in a significant way, partly thanks to the numerous debates of the doctrine but also thanks to new important domains, like ecology. The complexity of the world *still* gives matters to discuss. Indeed, economy of mass or birth of "care states" motivated by public interest has affected the conceptions of our legislators.

At first, two word about the American *author* and his work. Shavell is at the same time a jurist and an economist. His work Liability for Harm Vs. Regulation of Safety tries to explain via four determinants why society, in 1984, has adopted a solution combining liability and regulation.

My *objective* in this work is to focus on some comparisons and criticize of Shavell's theory with others thinkers to see discrepancies. In a second time, I will show further developments and examples, especially Swiss ones.

The present paper is *organized* as follows: First, I will argue about the determinants factors (*infra* n°1). Then, I will explain the strengths and weaknesses of liability against regulation on particulars points (*infra* n°2). Finally, I will show some furthers developments (*infra* n°3), before ending with a general conclusion.

1 The choice of determinants factors

Preliminary point to be treated is the *reasons* we choose to prefer liability to regulation or vice and versa. Shavell's theory gives us four[1] but we will see that it is a subject of controversy.

First key to identify determinants is, according to Shavell, the level of a *social welfare*[2], which measurement diverged[3]. Social welfare is constantly evolving, as does the different determinants factors[4].

Recent authors have unveiled new kind of determinants in the *behavioural* factors. This approach looks how psychological notions as temptation[5] can motivates[6] or demotivates[7] subject from taking actions. In difference with Shavell's subject[8], it gives a perception of subject making irrational choices and not "high care" ones'[9].

Another determinant that should be added is a *geo-political* one. Indeed, Shavell's theory doesn't take in account that social welfare depends on where you come from[10]. At last, Shavell's operates a volunteer *simplification* of the subject by eluding several factors[11] resulting, in the end, in a lack of accuracy.

2 The use of Regulation and Liability

2.1 The use of Regulation

Regulation is an *ex ante* (before harm occurred) way, usually coming from public law entity, to prevent harm. It is often used when harm can be potentially very important, so that society recognize that there is a public interest for State to take care of it[12].

2.1.1 Weaknesses

First, Shavell points the ***knowledge of the risk***. Many assumptions are made in the doctrine but can be resumed as: "It depends one who has the better information of

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[1] Respectively: 1) knowledge of the risk of the activity 2) The insolvency of the injurers 3) The chance the suit doesn't take place 4) The administrative cost in comparison.
[2] SHAVELL, p. 358.
[3] cf. *World Rapport on human development of 1990*. Especially, the determinants they use (for instance, GNP can't be considered as an unique factor,…).
[4] For instance the Swiss federal court (ATF 131 II 656) has accepted that a lower quality of life, due to an accident, can be considered as damage, reinventing the usual notion of damages. Quality of life is then considered welfare and has an economic worth.
[5] SEGERSON / TSVETANOV, p.70.
[6] E.g. Consumer can be more likely to choose product that possess an ecological ground, for instance labels as Max Havelar. Cf. OKEYO ANYANGAH Joshua, p.64.
[7] GUL / PESENDORF, pp.1403 sqq.
[8] SEGERSON / TSVETANOV, p.70.
[9] E.g. consumers preferring a brand that has a code of conduct despite a higher cost (morality).
[10] An important factor can be the kind of law used (common law / continental). Cf. *infra* n°2.1. Under point: *probability people don't go to court.*
[11] Indeed, we can see (SHAVELL, p.358) a significant list of the things that Shavell doesn't take in account in order to simplify his theory.
[12] For a recent example of it, 7000 new buildings cannot be build because of the transport of chemical products on a nearby road. Cf. http://www.rts.ch/info/suisse/6200159-7000-nouveaux-logements-bloques-a-geneve-par-le-transport-de-chlore.html (consultation 9.10.2014).

the risk"[13]. Most of the time, the private party has this advantage, except when none has knowledge of the risk (e.g. facing new technology)[14]. A Swiss example of regulation concerning unknown risk can be seen in art. 119 Cst. / Swiss[15]. Such regulations presents standard too "stringent"[16] and has for consequences that private involvement are strongly reduced[17]. Moreover, regulators are not paid for performance and thus lack incentive finding information of the risk[18][19]. Furthermore, considering the cost of these information, especially in very specialized domain of technology, the cost would be too high for a State to be bearded[20]. In relation with insurers knowledge of the risk cf. *infra* n°3.

Another point against regulation is ***behavioural*** factors[21]. For instance, when consumers choose deliberately a product because of his price (so called "price consciousness"[22]) despite its low quality[23]. In this case, Regulation reveals to be unfair and discouraging for producers[24], because she shows not enough accuracy of the situation.

Next weakness I would like to develop is linked with a notion called ***inherent risk*** of activity[25], which is independent of any level of care used[26][27]. The negligence has then no reach, and makes regulations looks illusory[28]. The Swiss legislator has adopted a special law[29] named LRFP to prevent default in the production of goods. The system iss pretty unfair for producers[30] on several points, namely because the consumer doesn't need to prove producers' negligence[31], but furthermore producer

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[13] To see the importance of information, e.g. in product-related risk if the consumer *"correctly assess the risk of harm"* (which is unlikely) Regulation has the advantage over Liability. Cf. MICELI / RABON / SEGERSON, p. 55.
[14] KOLSTAD et al. p.894.
[15] The strict forbid modifying the human genome.
[16] SHAVELL, p. 359.
[17] N.b. In the art. 119 Cst. / SWZ examples', regulation is voluntarily too stringent because of political and ethical will in this domain. It doesn't make the social welfare decreases.
[18] BEN SHAHAR / LOGUE p.36.
[19] Private parties never take further cares as standards prescribe because it increases cost.
[20] It would be less costly for a State to use expert when harm occurred, like experts used during a trial.
[21] Cf. *supra* n°1.
[22] ESTEBAN et al. pp. 306 sqq.
[23] In relation with product-related risks: « *…inducing self-selection, consumers must expect to bear their own harm.* » MICELI / RABON / SEGERSON, p. 55.
[24] SEGERSON / TSVETANOV, p.70.
[25] GAROUPA / ULEN, pp. 35 sqq.
[26] In relation with it, Shavell has elaborated the *activity level theory*, which explain that the number of people use a product (e.g.), the more risky and so costly is the liability, therefore liability is attached to the number of consumer. Further on this GAROUPA / ULEN, op.cit.
[27] For a parallel in the Swiss driving responsibility, the system knows the same inherent risk basis but jurisprudence allows exceptions. One of them is when the fault of the other is so serious that it makes the error of the driver (the other) insignificant.
[28] Indeed, how, for instance, would a producer like Coca cola proves the good quality of each bottles when he produces millions a day? E.g spontaneous explosion of Coca cola's bottle: Escola vs. Coca-cola Bottling Co. References: 24 Cal.2d 453, 150 P.2d 436.
[29] N.B. this kind of protecting legislation is not isolated, e.g. art. 8 LCD. In the case of the LRFP, it's a quasi copy of an European directive, therefore applies also for EU law.
[30] In the hypothesis seller is insolvent, the LRFP allows the customer to sue the producer. With this extension, there is less probability to find insolvencies towards harmed customers (cf. supra n°2.2).
[31] Contradiction with art. 8 CC.

has no exculpatory proofs[32]. To develop this second point, the default of a product has to be seen as a normative (and not subjective) appreciation, which considers the absence of a reasonable security[33] from sight of a middle consumer (and so not the one who bought it) as a fault[34].

Last but not least, Regulation gives a solution in general; she is less ***flexible*** than liability. A court can always adapts liability[35], while it takes a long time to develop or change laws[36].

2.1.2 Strengths

Regulations are much more adapted than liability when we consider problem that could create a very ***large amount of harm.*** Most of the times, the common sense can tell if a domain should be regulate or let to liability; for instance the storage of nuclear products in a school seems unreasonable to anybody, because of the harm that would result, liability would be socially unbearable. In fact, it's the potential risk, which preliminary needs the knowledge of it that will give a preference for Regulation.

Another strength is that it's more ***adapted to moderns systems*** of mass production. For instance, it's not possible for a firm to have an individualized care contract with each of its consumers, as Shavell's liability forecast. It needs to have standards safety the way regulators can create[37]. Moreover, a consumer alone would have little power to negotiate his contract with an important firm; this is the whole problem of contracts' terms[38]. Then using regulations helps to protect the weak party of the contract and then improves social welfare.

2.2 The use of Liability

Liability is an *ex post* (after harm occurred) responsibility, she is used to rely on company in case of a damage. She's often used for situation where regulation is difficult[39].

2.2.1 Weaknesses

Shavell's big fear against liability is that ***injurers can't pay*** for the harm done. Shavell's theory is based on injurers having the same wealth, which was criticized notably by Schmitz[40]. The problem consists in the difference between a wealthy or not injurer. Indeed, the rich one can pay, he even has the advantage that if he has a

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[32] The producer has to prove that he took all the security possible to avoid damage. This proof is (almost) impossible to present. How can you proved you did everything wrong over a million bottle production a day (e.g. Coca-cola, note **Error! Bookmark not defined.**). Cf. ATF 110 II 456 (Schachtrahmen).

[33] Security is the key world. Absence or reasonable security coincides with the notion of default. Further on it see: Cf. WERRO, pp.171 sqq.

[34] N.B. in Swiss law, an author has proven there is no factual difference in the jurisprudence between fault and illicitly. Cf. WERRO, pp.171 sqq.; cf. also MICELI / RABON / SEGERSON, p. 55.

[35] E.g. through court decisions or decisional power of the judge (e.g. art. 4 CC / SWZ).

[36] Furthermore, law is never a complete tool, because of its temporality; it needs judges, doctrine and practisers in order to adapt to new situations. An historical example of it is the Prussian code of 1794.

[37] MICELI / RABON / SEGERSON, p. 55.

[38] E.g. nobody reads Apple's Terms when you buy a new Iphone. You can normally hope that your cell phone (e.g.) doesn't fold after two days; it's not an usual wear.

[39] Regulation can be impossible because of the diversity of harm that can be done. Cf. Shavell's example of someone crossing the street to catch a bus, in SHAVELL, p. 358.

[40] Schmitz makes the assumption that, for the liability and regulation to be socially welfare, it needs that wealth varies among injurers. SCHMITZ, pp. 375 sqq.

lot of consumers his risks to pay can stagnate at a peak[41]. In fact, Shavell's fears must be slightly nuanced. Nowadays, in Switzerland, when you cross the street to catch a bus and you get hit by a car[42] the obligatory[43] insurance will cover the whole damage and eventually[44] tries to recover its money if you have made a fault. Moreover, different sorts of systems like solidarity between producer and seller[45] insure solvency by including "deep pocket" into responsible. However, it's true that privates parties have, in general[46], not interest, to take further care as their solvency; in particular, they have no incentive to get insurance covering more that they should[47]. In the end, we can say that solvency is in slight disfavour of liability.

Probability victims don't go to court are pointed as an advantage for regulation in Shavell's theory. There is many reason why people don't go to court, e.g.: time elapsing, bothering of many years of process, no clear harm-maker, potential gain (less cost) of the trial[48]. However, the answer can strongly depends on which law is applying. For instance, USA is known for allocating big compensation[49] to those who goes to court. A famous case was Liebeck Vs. Mc Donald, where a woman had burned itself by spilling some coffee on herm, she won 2.7 millions $[5051]; with this kind of money you surely have an incentive to go to the court[52]. In other countries, like Switzerland, the potential gain represents no incentive, because it's usually very low compare to the cost and. Therefore, it depends on the jurisdiction. Here I placed it as a Weakness taking then a Swiss perspective (cf. *infra* n°3).

2.2.2 Strengths

A big strength is the ***extended liability***. As said for LRFP[53], a way to counter Shavell's argument of injurer being insolvent is to extend liability to "deep pockets". For example, in the ecological domain, there is a proposition to add to the responsible person the lender of the money[54]. This possibility could compensate the lack of regulators' information of the risk (cf. *supra* n°2.1.1) [55] and indirectly (via no borrowing possibility) to disadvantage risky companies. Another way to always link injurers to liability is, for instance to institute solidarity, as in principle polluters pays[56].

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[41] SHAVELL, *A model of the optimal use of liability*, p. 271.
[42] This example is initialy Shavell's.
[43] For instance, you need to contract insurance in order to practice the job of lawyer. Cf. art. 12 l f. LLCA. Most of the time, it's the risk an activity produce that justify the obligation.
[44] Only in a second time.
[45] Cf. *supra* n°2.2 and *infra* n°2.2.2 extended liability.
[46] Considering behavioral factors, the result can be however opposite.
[47] SHAVELL, p. 361.
[48] See *infra* n°3 for an example and developement.
[49] They look for so-called « deep pocket ».
[50] Liebeck Vs. Mc Donald's. References : 1994 Extra LEXIS 23 (Bernalillo County, N.M. Dist. Ct. 1994), 1995 WL 360309.
[51] This amount represents a punitive damage. The one person who win the trial get the money, there is no redistribution of the gain between victims. From this sight, the repartition is unfair regarding social welfare.
[52] Especially when lawyers doesn't charge you if you loose, which was a common praxis in the USA.
[53] Cf. *supra* 2.2.
[54] Cf. OKEYO ANYANGA, p. 62 sqq.
[55] *Idem*.
[56] With this principle, however the fault of the person in cause, he has to pay. A concrete example is the one of an owner of a polluted land ; even if the precedent owner had polluted the land, it's the actual who will pays. The owner still has a recourse action against the precedent owner.

2.3 Knowledge and liability for unknown risks: the concrete case of asbestos

A recent case[57] judged by the CJEU has given me the occasion to draw a parallel with our present subject[58]. The ***history of the case*** was the one of a worker who developed cancer 28 years after being in contact to asbestos. Back to these days, the use of it was common and the knowledge of the risk inexistent. His main problem was that the claim prescribed after 10 years from the occurring of the damage[59]. In this particular case, we can see that regulation was not possible and therefore needed liability as a complement like Shavell proposes it, which insures that medical cost where not support by the community[60].

What we can retain is that liability can protect social welfare in cases where regulation didn't forecast harms. This decision is an open door for further liability in the future and a confirmation of Shavell's opinion that the question of liability exists independently of the question of the Regulations' one[61]. However, even if potential damage[62] is humongous, the chance process took place was very low[63] and the final win of the plaintive is also pretty low. What changes this case is that potential enormous damage that corporation or regulator aren't able, to forecast clearly will rely on them. They will be hold responsible for it, as if it was an inherent risk[64]. This decision is very important because she is an open door for liability in relation with probably upcoming problems; for instance domains, which have few or no regulation at all (like cell phones diseases…). Then, corporations will be more likely to take suboptimal precaution[65], increasing by the way social welfare, in order to forecast those costs. Thus, it will maybe give them an incentive to protect themselves by contracting insurance[66].

3 Actual developments and propositions

3.1 Some sorts of Regulations

Some authors have noticed the effect of ***insurance,*** as substitute to the regulation[67]. Their argumentation is to say that insurers disposed of better information and better incentive to regulate the behaviour of people, "educating" them through raise or decrease of premium to act carefully[68]. In the Swiss case, we can say that Insurer

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[57] Howald moor and others Vs. Switzerland. Request n°52067/10 and 41072/11, 11mars 2014.
[58] The case applies also to Switzerland and will without doubt, inspired the new project of Swiss law of the prescription. Further on the subject: CHAPPUIS / WERRO.
[59] art. 127 CO / SWZ.
[60] In fact, the cost of those kinds of situations will always from on way or another fall on corporations. The first things that States can do when it needs money, in this example after an increase of his health care cost, is raising new taxes which will also be paid by corporations.
[61] SHAVELL, p.365.
[62] The potential damage is the medical fees of the people affected by cancer due to asbestos by their fault.
[63] Due e.g. to: the chance the sick person die before, the probability he knew what was responsible of this disease, the chance the company has changed, evolved, cost of the process and potential win, lack of responsible persons (About this last point see *supra* n°2.1.1, about the solidary responsibility in LRFP).
[64] Cf. *supra* n°2.1.1.
[65] Cf. KOLSTAD et al., p. 894.
[66] Cf. i*infra* n°3.
[67] BEN SHAHAR / LOGUE, p.37.
[68] *Idem*.

represent a huge financial power, and their intern directives (OFAS) [69] inspired most of the time the Swiss Federal court, which considers them as reflecting the law[70].

Another developments that can be pointed is the creation of private markets systems, which favours the firms' incentive to pursue good behaviour. For instance, the ***Bourse of the carbon***, which permit to fabricants creating low carbon emissions to sell back their "right to pollute" to others firms that create (too) high carbon emissions[71].

3.2 A sort of Liability

An interesting proposition, as future model of liability, was proposed in relation with the development of the asbestos' problem. It consists in a tax that would be collect and paid by producer of risky enterprise or consumer (e.g. on the selling price of a product). The tax would feed a ***special fund*** that would be transfer to the State in order to protect against unknown risk on the long term.[72].

Conclusion

In conclusion, we can say that the debate on liability and regulation, first brought by Shavell, is still of actuality. In the near future, *growing problems will probably rise*, for instance, those linked with cell phones waves, or the food industry[73] renewing the debate. However, if you want to have a correct vision over the problematic and solutions some others thinkers mentioned earlier have to be taken into account; especially concerning the determinants factors to be used.

Concerning our analysis of strengths and weaknesses, the use of *liability combined with regulation* is the best way to keep social welfare interests'[74]. Also, we have seen that new propositions, including private regulation by itself are developed, notably thanks to behavioural comportment of the people, which affects the level of care taking by corporations. Shavell's method, in nowadays sight, should then be optimised and his analyse be mitigated; however his conclusions still applies.

[69] Which are elaborated by them and should have any effect on third party.
[70] With this system, bad risks are sanctioned at the benefit of social welfare.
[71] GASTAUT, pp. 5 sqq.
[72] CHAPPUIS / WERRO, III.D.1.
[73] Cf. an interessant article about firms creating addictive product to retain customer http://www.letemps.ch/Page/Uuid/c264e808-4e45-11e4-a701-a0e5a8a72efd/Ce_qui_les_a_rendus_obèses (consultation 9.10.2014).
[74] Kolstad however, thinks that suboptimal regulation makes liability looks useless. KOLSTAD et al., p. 894.

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