Proposed Remedies for the American Problem: U.S. Governmental Activity*

By Professor Victor E. Schwartz**

After you have heard all the speakers at this conference, the old metaphor of the blind man and the elephant should come to mind. We have heard from persons with a defense orientation or an insurance orientation. They might describe product liability as massive like an elephant's head. On the other hand, the plaintiff's bar may find it rather flexible like the elephant's tail. The Federal Interagency Task Force on Product Liability has had six months to describe the whole elephant. At this point we have been able to describe its outlines. While the animal is not fully fleshed, we believe that our study will be a contribution toward developing a better understanding of this complex subject.

Section D of your materials is a reprint of the Task Force's *Briefing Report*.[1]† This afternoon I will highlight some of the nuances in that re-

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1. *See*, First World Congress on Product Liability, London, January 19-21, Program Materials, D: i-40.

† [The *Final Report* is now available under access No. PB 273-220, U.S. DEP'T OF COMMERCE, INTERAGENCY TASK FORCE ON PRODUCT LIABILITY, FINAL REPORT (National Technical Information Service, Springfield, Va., Nov. 1977) (A check in the amount of $20.00 paid to the order of Nat'l Technical Information Service should be included).

The information contained in the *Briefing Report* was developed and clarified in the 700-page *Final Report*. The *Final Report* expands its coverage in several areas. First, there is expanded information concerning product liability laws, see Ch. II of the *Final Report*. Secondly, the *Final Report* in Ch. III, V, & VI expands in depth on the role that product liability insurance underwriting policies have played in the overall product liability "crises." Finally, in Ch. VIII the *Final Report* extensively discusses product liability remedial devices and possible alternatives.

The Interagency Task Force on Product Liability has now been officially dissolved as a working Task Force. However, the Carter Administration has asked the Dep't of Commerce to prepare a list of specific recommendations, based on the findings of the Final Report as to what the proper role of the federal government is or should be in the overall product liability field.]

port—some of the shadings that cannot be developed in cold type. After I am finished with this presentation, I will welcome questions that you have concerning the report and its findings. Let me make five points about the report that should help it out in perspective.

First, it is important to understand that the report is preliminary in nature. It represents a still picture of what the Task Force learned as of December 1, 1976. There is a good deal of other data and information that is currently being acquired in the United States. An example is a closed claim survey—a survey of judgments and settlements—that is being conducted by the Insurance Services Office, an organization that assists the insurance industry in its rate-making practices. We did not have the material from that closed claim survey available to us at the time we made the study. One can learn a great deal from closed claim surveys; for example, that preliminary results of that survey show that for every dollar insurance companies pay out, $.42, is expended on defense costs and of that $.42, 85% is used for attorney's fees. Throughout the course of our study we heard a great deal about the contingent fee-that of every dollar the plaintiff receives, his or her attorney may take approximately 35% of that dollar. But no one really stressed defense costs; that is part of the problem, too.

Second, aside from being preliminary in nature, the *Briefing Report* is a highly condensed picture. We have developed thousands of pages of material on products liability, and it will be presented to the public in an organized form through our contractor reports in the insurance and legal areas. The legal work was done by The Research Group,[2] the insurance work was done by McKinsey Incorporated, which is also an international research organization.[3] Gordon Associates, Inc., a third contractor, developed our industry report.[4] This report was more complex than the others in the sense that the contractor had to conduct an independent survey and collect responses from 337 corporations. These corporations were large, medium, and small in size and distributed over a variety of types of industries in the workplace area and in the consumer area. Finally, we will have a large *Final Report* that will be issued under the auspices of the Task Force itself. It will attempt to synthesize all of the contractor reports and other information we obtained. Thus, you can appreciate how highly condensed the *Briefing Report* is.

A third point about the *Briefing Report* is that it was not based on any preordained, philosophic or interest group point of view. It is true that the

2. [U.S. DEP'T OF COMMERCE,] INTERAGENCY TASK FORCE ON PRODUCT LIABILITY: LEGAL STUDY (National Technical Information Service., Springfield, Va., April 4, 1977). For a summary of the findings contained in the LEGAL STUDY, *see* page A-1 herein [of The Research Group International conference publication].

3. *Id.*, [U.S. DEP'T OF COMMERCE,] INTERAGENCY TASK FORCE ON PRODUCT LIABILITY: INSURANCE STUDY [McKinsey Incorporated, 1977].

4. [U.S. DEP'T OF COMMERCE, INTERAGENCY TASK FORCE REPORT ON PRODUCT LIABILITY: INDUSTRY STUDY (Gordon Associates, Inc., 1977)].

study was generated in part by the fact that some manufacturers, particularly small manufacturers, brought the problem of product liability insurance, its cost and availability to the attention of the White House. But I was instructed by the Under Secretary of Commerce to look at product liability from all perspectives, including that of the injured consumer and the worker, and present the report in that fashion. We received very persuasive and well-written materials from a variety of groups, but I was told to look through the glitter and find facts and data that would help present an accurate picture for the Administration. Moreover, if the report reflected merely one point of view or another, it seems certain that it would be ignored in the transition to a new Administration. Product liability is not a problem of one party or another in the United States, it is a problem that may affect consumers, insurers, and industry.

A fourth point to appreciate about the *Briefing Report* is that, aside from balancing the interests of consumers, insurers, and manufacturers, we also had to balance different views within our government. This was an interagency study.†† The Consumer Product Safety Commission, which we heard about this morning, participated in the study although it was not a member of the Task Force. The President's Council of Economic Advisors participated. The Department of Health, Education, and Welfare and the Federal Insurance Administration (which is part of the Department of Housing and Urban Development) also participated. Each agency had a slightly different point of view. Thus, the *Briefing Report* is a composite of many, many views within the government itself.

A fifth point about the *Briefing Report* that should be noted, especially in light of some of the descriptions of it that have appeared in the press, is that it is important to read the 40 pages that develop, expand, and discuss matters that are condensed in the Executive Summary. It is perhaps understandable that the press would select a sentence or two from the Executive Summary, but this can, in turn, be a bit misleading. For example, some of the trade press said that the Task Force found that "there was no product liability crisis." Some interest groups were shocked by these stories. These groups said, "There's no crisis at all? Look at all the trouble we're having! How can the Task Force make such a generalization?" Well, it never made that generalization. What we said was that our study suggested that "the so-called product liability 'crisis' is not a crisis in the sense that a large sector of industry cannot obtain product liability insurance or that the increased cost of such insurance has made a substantial impact on the price of many products."[5] And then we

†† Participating agencies in the Interagency Study include the Departments of Commerce, Health, Education and Welfare, Housing and Urban Development, Justice, Labor, Transportation and Treasury. The Office of Management and Budget and the Small Business Administration also participated.

5. First World Congress, *supra* n.1, D:x.

said, "On the other hand—it does seem clear that a number of small businesses [Mr. Baldwin stated some examples this morning[6]] are facing a difficult choice of whether to go without product liability insurance at all [with the consequences that could flow from that decision] or to purchase it at a sharply increased premium."[7] We then said (recognizing the product liability situation is a moving tide) that, "The situation could become more severe in the future."[8] And we also said something that is important for legislators all over the world to realize: "Government action need not always spring from crisis."[9] Sometimes it is good to anticipate a crisis before it is upon us, but often legislators are only moved by mass voter reaction and mail they receive. Therefore, we may not see immediate substantial legislative action on the topic of product liability in the United States.

Let me very briefly discuss our findings—some of the most important ones. We found that, in the years 1974 to 1976, product liability premiums appeared to have risen substantially in most of the specific targeted industries that are discussed in the report. The Task Force selected those industries on the basis of preliminary anecdotal information that came to the attention of the Department of Commerce. Thus, the Task Force did not look at the claims experience of manufacturers of canned foods or other industries that did not appear to be having a severe problem. But it did look at the machine tool industry. It did look at manufacturers of medical devices. Those groups experienced a substantial rise in their product liability premiums in the past two years, 150% to 200% (on the average), according to our telephone survey. We also received anecdotal information which indicated that the writers' premiums rose more than 1000%. In some instances letters informed us that an individual's premium had increased by 500% or more although no claims had been filed against the letter writer's company. Again, it is important to note that we did not have the means to authenticate the assertions set forth in these letters.

We found that the industries that were most severely affected were industrial chemicals and high-risk consumer goods such as pharmaceuticals, automotive parts, and medical devices. Although we did not study sporting goods and ladder manufacturers, we received a good deal of anecdotal information from them that suggested that they were having serious problems, too. We found that the problem of increased product liability insurance costs had been more severe for smaller firms in all industries. If a manufacturer produces more goods in greater quantities, he may be able or better able to pass off the cost of product liability insurance in the price of his product.

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6. *See* pp. 27-40 herein [of The Research Group International conference publication].
7. First World Congress, *supra* n.1, D:x.
8. *Id.*
9. *Id.*

In spite of substantial efforts to find out whether companies could not obtain product liability insurance, we were only able to identify about 75 by name. And our finding in that regard has recently been confirmed by a group that specifically looked at small businesses that were having the most trouble—they found less than 1% could not obtain insurance at all. Nevertheless, product liability premium costs had risen substantially; thus, the problem was much more one of affordability of product liability insurance than availability. We might contrast the situation to that of flood insurance. A number of years ago, in the United States, persons who were in flood-affected areas were totally unable to obtain protection against floods—that is not the product liability situation.

The Task Force found (and this was one of its more controversial findings) that in most industries, even those affected by sharp increases in product liability premiums, that costs had accounted for less than 1% of sales. There had been a rise toward that 1% figure. Also, in certain segments of the capital goods industry, the cost was higher. The persons whose costs were affected by 5% might suggest that the 1% figure is misleading, and that the Task Force should not have averaged things out. Moreover, as goods go through the chain of distribution from manufacturer to distributor to retailer, each purchasing product liability insurance, there can be some augmentation of that 1% figure. Thus, product liability insurance may represent more than 1% of the cost of a product.

As I mentioned earlier, the Task Force found that a number of companies are going without product liability insurance at all. Now, this was always true, but more are doing it now. This could affect injured consumers. They may have a claim that they will be unable to enforce.

We found that the rate of product liability claims appeared to have been rising in excess of the rate of increase in actual product injuries. We did that by the number of accidents reported to the Neiss System—accident information collected by the Consumer Product Safety Commission. That finding is somewhat speculative, but we felt that it was firm enough to present it in our *Interim* or *Briefing Report*.

The Task Force found that the concern about product liability insurance caused some manufacturers, for example, manufacturers of pharmaceuticals, to forego or delay the introduction of new products. But it was unable to make an important determination in connection with that finding. Were the manufacturers holding off the market valuable pharmaceuticals that could alleviate disease or were they holding off the market pharmaceuticals that might be more dangerous than they were worth? In the time period allowed, the Task Force could not make that determination.

The Task Force found that product liability problems have caused some industries and some insurers to devote more time and resources to product liability prevention techniques. To consumer groups, this was a very positive finding. There are writings in the United States—legal writings—that suggest that the tort system has very little effect on the actual conduct of

potential defendants. Many persons who have advocated a no-fault system or a no-fault position have said that the tort system really does not have very much of a deterrent effect. Well, the Task Force found that the current product liability system, with some of the "horrors" that have been mentioned today, has had that effect. Persons with major responsibility within the context of a corporation's hierarchy are now concerning themselves with product liability prevention techniques. Insurers who normally did little or merely provided brochures to their insureds in regard to product liability prevention techniques are now, in some instances, providing personnel to assist companies with regard to that area.

The Task Force found, and its finding in this regard is based on less data than the others, that some persons who are injured by products receive full compensation from the present tort-litigation system, but we also found that many persons do not. They never enter into the system at all. This group represents the overwhelming majority of persons injured by products.

The Task Force also found that some workers by lawsuit (and this was explained by a number of speakers this morning) can shift the cost of a work-related accident from their employers onto the manufacturer of industrial products. Because they can do that, the legal system has reduced costs (ever so slightly) for workers' compensation systems. The effect is very small.

Finally, the Task Force found that the total amount of pending claims in our target industries appeared to have increased substantially in the years 1970-1975.

The Task Force could make no "call" as to whether the size of the average judgment is rising at a rate higher than inflation. Different data sources were in conflict as to this point.

What caused these impacts in the areas of product liability? Well, there are some causes that the Task Force cannot do too much about. Those causes are set forth in item four on page iii of our *Briefing Report*.[10]

For example, inflation is a factor that has caused a rise in product liability costs. Inflation has increased medical costs, wages, and attorney defense costs. Our Task Force was not in a position to suggest a cure for inflation.

Also, consumer awareness has caused a rise in the number of product liability claims, but we found no way to make a consumer's mind go blank so that he or she no longer realizes that he or she has the right to sue. That would not seem a very sound way to tackle the product liability problem!

We also noted that the increases in the number and complexity of products have been part of the problem.

Finally, we observed that product misuse has contributed to the rise in

10. *Id.* at D: iii.

the number of injuries. Perhaps better consumer education would help address this problem.

There were three principal causes that we thought we might be able to address. I will mention them very briefly—the report develops them. These "causes" are not listed in the order of their importance.

The first problem area is insurance company product liability rate-making procedures. Now, the Task Force did not find that the insurance companies were engaged in a criminal conspiracy with regard to their rate-making, but it concluded that the process could be improved and that the result might be lower product liability insurance costs for some manufacturers. Our *Insurance Study* will present a relatively clear picture of how product liability insurance rates are set. The report indicates that many insurers did not anticipate the burgeoning of claims that occurred in the 1970's. They did not anticipate that product liability would become so important. Thus, product liability insurance was merged with other types of liability insurance protection, and a particular rate was set on the whole package. Therefore, the contractor could not obtain clear profit and loss statements in regard to product liability insurance.

Also, insurance companies did not collect data in regard to risks of particular products to the extent that might be feasible. On the basis of this and other information, our *Briefing Report* suggested that the Administration give serious consideration to having the Federal Insurance Administration (FIA) study what improvements might be made in the rate-making process. The FIA would work on this matter with the National Association of Insurance Commissioners. In the United States state insurance commissioners have the primary responsibility for developing rules in regard to insurance rate-making.

A second cause of the problem is manufacturing practices. To some extent these practices contribute to the fact that people were injured by products. Many of the cases surveyed by our legal contractor involved products that had defects in construction. For example, a bottle had a defect or impairment that was in it at the time it left the factory. The bottle was not in accord with the manufacturer's own picture of what its bottle should look like. I am not suggesting that there were many bottle cases; I am just using that as an example. Defect in construction problems can be alleviated by improved quality control.

While manufacturers themselves seem aware of the problem—very much aware—we thought that the government might provide some assistance to some, especially small businesses, by supplying those businesses with information it obtains about defective products. The United States government obtains such information through its administration of the Occupational Safety and Health Act and the Consumer Product Safety Commission. The government would not be using its regulatory arm, but simply providing some assistance to some businesses that desired it.

The third cause of the problem, and to most insurers and trade associations it seemed the major cause, is the tort litigation system itself. We

found a basic tension in that system in the area of product liability law. Thus, some judges see tort law as essentially a means of apportioning responsibility based on fault. These courts attempt to balance the rights of a plaintiff who misused a product and a manufacturer who was at fault in producing a product. A comparative fault system would be an ideal answer to persons with that philosophy or point of view. Other judges appear to believe that the tort system today, in 1977, is basically a method of compensating persons who are injured by products. They search for some way to hold a manufacturer responsible when its product causes an injury. A few courts almost go to the borderline of treating the tort system as if it were a social security system. You can look at thousands of cases and attempt to learn hundreds of rules, but if you always keep in mind this basic tension, you will have a better overall understanding of product liability law in the United States.

However, understanding the dynamics of this tension does not tell you what to do to change it. When it came to that issue we could only offer some of the best possibilities to consider. Some remedies are short-ranged in nature. They basically are mechanisms to lubricate our insurance system. One remedy is to create a national voluntary product liability pooling system. Under that system different insurers could place similar risks in one pool. Legislation would authorize the formation of the pool and deal with any antitrust problems it might raise. The topic of insurance pooling can be quite complicated and will be discussed in the Task Force's *Final Report*. The Task Force's *Briefing Report* also presented considerations in regard to having a federal stand-by product liability reinsurance mechanism and showed how it might work. We noted that the current product liability problem was not as severe in terms of unavailability of insurance as in situations where federal reinsurance or federal back-up insurance had been used in the past. We also discussed the use of captive insurance companies. It might be helpful if federal law was clear as to [when premium payments to captives would be deductible for the purposes of federal income tax]. It should be noted that captive insurance companies may not be a viable option for smaller companies unless they could utilize the device through their trade associations. Again, captives are a complex subject and their tax status is somewhat uncertain. This area could be clarified or improved by joint work by the Internal Revenue Service and the Federal Insurance Administration.

I have only mentioned some of the residual insurance market mechanisms that might help the product liability situation. Please appreciate that these are short-range remedies. Modifications of the tort system itself provide the main area for long-range solutions. We found that the most immediate problem area in the tort system focuses on injuries that arise in the workplace. Now, a lot of figures have been mentioned as to how many injuries arise in the workplace. The latest figures that I have seen come from the preliminary report of the Insurance Offices Service Closed

Claim Survey. That Survey suggests that 20% of product liability claims stem from workplace injuries, whereas 80% are consumer injuries. But when it comes to high level claims, claims above $100,000, one could even say claims above $50,000, a disproportional amount of those claims come from workplace injuries. These suits are filed after an individual has collected workers' compensation. It may be, we cannot say for sure, that the workplace injury is a high pressure point with regard to the upward thrust in product liability insurance rates.

We received many suggestions regarding modifications in the tort system that focus on injuries that occur in the workplace. Two were singled out in the *Briefing Report* for special attention and further consideration. One remedy would allow a product manufacturer who is sued by an employee who was injured in the workplace to pass part of the cost of that suit on to a negligent employer. Thus, if an employer removed a guard or failed to keep a machine in good repair, the manufacturer (who was sued by an employee) could place a cost of that injury on the [employer]. People have asked why that remedy was not endorsed by the Task Force. Well, there are considerations on the other side. The employers say that when they purchased workers' compensation insurance, they wanted to be totally free from the cost of lawsuits by their employees based on injuries that occur in the course of employment. Also, that remedy might increase, not reduce, litigation and other transaction costs. The Task Force is giving further consideration to this remedy and may have a recommendation about it in the *Final Report.*

A broader and more far-reaching remedy would make workers' compensation a sole source of recovery for persons injured in the workplace. If they were injured by a product, they would receive compensation from the Workers' Compensation Board. They would not have the right to bring a subsequent tort suit against the manufacturer of a product that injured them. That would be helpful to many constituencies who are sitting in this audience right now. Nevertheless, simply eliminating the workers' right to sue a manufacturer would probably (according to our *Legal Study* and our own look at case law) be unconstitutional. Even if it were constitutional, it is unlikely to develop sufficient political support for passage. For the remedy to be seriously considered, the rate of workers' compensation benefits would have to be raised substantially in some states. Also, a mechanism would have to be developed whereby the manufacturer of a defective product contributed to worker compensation awards. These issues will be carefully explored in our *Final Report.*

Our *Briefing Report* did suggest that, if product liability law as a whole is modified, reform would be more effective if it came at the federal, as compared to the state, level. In that connection, we noted that product liability rates are set on a nationwide experience basis. Thus, individual state law changes (which probably would not be uniform) would have little effect. On the other hand, tort law has been the province of the states.

[Even when a law was passed allowing citizens to sue the federal government for torts committed by its employees, the nub of that law relied on state tort law for its basic substantive rules.] Nevertheless, a federal uniform product liability law may help relieve the uncertainty that has caused rates to rise. On the other hand, some believe that drafting such a law at this time would be like putting an extension on an outmoded railway station. These persons believe that the tort system itself is so filled with problems that it cannot be salvaged. They suggest that true reform will only occur if the tort-litigation system is abandoned and we turn to a no-fault compensation system.

The Task Force studies about the no-fault compensation systems appear in our legal and insurance contractor reports. As was the case with every other remedy that came to the attention of the Task Force, there were new problems in the potential cure. For example, how does one define coverage in a no-fault product liability system? One may have to include every product-related injury in the scope of coverage or transaction costs may eat up the savings that the system is supposed to bring about.

A six-month study cannot resolve all product liability problems. Nevertheless, we have set some sound building blocks that will help provide reasonable solutions to those problems. I thank you for your attention and hope you utilize the work products of the Task Force.