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GENERAL COUNSEL OF THE
UNITED STATES DEPARTMENT OF COMMERCE
Washington, D.C. 20230

July 12, 1982

file behind product liability file

MEMORANDUM FOR: CHRIS DeMUTH
JOHN FOWLER
MICHAEL HOROWITZ
WILLIAM NISKANEN
JONATHAN ROSE
TIMOTHY RYAN
MICHAEL UHLMANN

FROM: SHERMAN E. UNGER SEU

SUBJECT: Meeting of the Working Group on Product Liability

A meeting of the Working Group on Product Liability will take place in my office, Room 5870, Department of Commerce, on Tuesday, July 13, 1982 at 2:00 P.M. Attached is a copy of the briefing materials prepared for the Cabinet on product liability.

Please call my Secretary, Brenda Lodge (377-4772) with the name of the person who will represent you, if you are unable to attend.

THE SECRETARY OF COMMERCE
Washington, D.C. 20230

MEMORANDUM FOR: MEMBERS OF THE CABINET COUNCIL ON COMMERCE AND TRADE

FROM : Malcolm Baldrige, Chairman Pro Tempore
Cabinet Council on Commerce and Trade

SUBJECT: : PRODUCT LIABILITY

ACTION FORCING EVENT: Senate Committee Hearings and Possible Mark-up of Legislation

The Cabinet Council last considered the product liability issue on April 7, 1982. At that meeting, members expressed two concerns about Federal involvement: (1) whether Federal product liability legislation is consistent with the Administration policy of "New Federalism"; and (2) whether there are economic policy arguments supporting a Federal approach. A Working Group was established by the Council to address these two specific concerns (Tab B).

Since our April 7 meeting, Senator Kasten has introduced S. 2631, the Product Liability Act, and has held two days of hearings on the bill. More importantly, Senator Kasten is planning to request full Senate Commerce Committee consideration of S. 2631 prior to the August recess. These events provide us an opportunity, if we can decide quickly the course of action we wish to pursue, to influence the legislation being considered.

In preparing to respond to the questions raised at the April 7 Cabinet Council meeting, staff of the Working Group reviewed:

- Hearings before twelve Congressional committees over the last six years, comprising more than 41 days of testimony (Tab C);

- The findings of the Interagency Task Force on Product Liability, published in seven volumes by the Department of Commerce in November, 1977; as well as the conclusions of the Task force in its final draft of the Uniform Product Liability Act, published by the Department in November 1977;

- More than 1500 pages of comments received by the Senate Commerce Committee on its draft product liability legislation;

- A paper on the economic consequences of a Federal product liability act prepared by a major business coalition, the Product Liability Alliance (Tab E);

- The product liability law of the fifty states and the District of Columbia (Tab I).

Based upon this review, the staff of the Working Group believes that confusing and diverse standards governing product liability produced by statutory and case law in the fifty states impose transaction and production costs on American industry. The staff believes these costs could be substantially reduced if a national standard were drafted.

Some members of the Working Group have suggested that additional studies should be undertaken, more comments solicited and prior data updated before we decide that Federal intervention in this area is desirable. The staff of the Working Group believes additional study and analysis would not help the Cabinet Council decide whether or not to participate in Congressional review of the product liability issue. Further study would, in their view, deny the Administration an opportunity to actively participate in the Congressional consideration of an issue which is already moving forward.

The conclusions of the staff of the Working Group as to the consistency of Federal intervention in the product liability area with the Administration's New Federalism, and the economic policy considerations underlying Federal product liability legislation follow:

A. FEDERALISM

Is Federal product liability legislation consistent with the Reagan Administration policy of "New Federalism"?

In the past, the Administration has defined the "New Federalism" in the context of returning health, safety, welfare, and environmental standard-setting and enforcement to the states. Food stamp administration, education policies affecting local school boards, neutrality on key state revenue issues, and broadcutting regulatory relief for state and local governments are all areas in which this Administration has sought to return operation and management -- subject in some cases to broad Federal oversight -- to the state level. The underlying bases for the policy are the desire to move decisions closer to those affected by them, and to permit state and local governmental bodies to deal with those issues which are best resolved in a local, rather than Federal, forum.

The goods which are the subject of the various state product liability standards (whether legislatively or judicially imposed) are sold in regional or national markets. Product liability standards adopted in any single jurisdiction which is part of that regional or national market affect the cost of goods produced for sale throughout that market. The additional costs imposed by the decision of a single jurisdiction in which the product is marketed to adopt a given product liability standard, therefore, must be borne by all the consumers in the regional or national market in which the goods are sold.

The effect of a decision as to product liability standards by the courts or legislature of a single jurisdiction, which is part of a regional or national market, is not, and cannot be, limited to the citizens of the jurisdiction whose courts or legislature made the decision. Because the effects of decisions involving them cross state lines, the formulation of product liability standards is not a matter which can effectively, or appropriately, be decided at state or local governmental levels, and Federal product liability legislation does not represent a Federal intrusion into matters which are more effectively or appropriately decided at state or local levels.

<u>Regulation of interstate commerce is a role traditionally and appropriately reserved to the Federal government.</u>

Since the publication of the Uniform Product Liability Act in 1977 by the Department of Commerce, only four states have enacted any portion of that model statute -- and these only in part (twenty-seven other states have enacted unrelated product liability measures, none of them alike). Despite efforts to achieve uniformity in standards governing product liability, the various state standards are more disparate now than they were a decade ago. Two state governors have vetoed state product liability legislation, on the basis that it would limit rights of consumers in that State but would not help the state's manufacturers, whose products are sold in other states and who, therefore, would remain subject to the more onerous product liability laws of other states.

Federal legislation, establishing uniform standards to reduce burdens on interstate commerce, is fully consistent with the role historically played by the Federal government. Such standards are uniformly upheld by the Supreme Court as an appropriate exercise of Federal power under the Commerce Clause. The states may not limit the length of trains operating within the State; they may not regulate the design and structure of ships; they may not require trucks to be equipped with mudguards which are different from those permitted in other States (Tab I).

Federal product liability legislation is consistent with this Administration's previous initiatives.

This Administration has previously employed a limited Federal approach to problems having interstate implications. The Administration strongly supported enactment of product liability risk retention legislation as a solution to the "insurance side" of the product liability problem. The Product Liability Risk Retention Act of 1981 provides for limited Federal preemption of state insurance laws to the extent necessary to permit the formation by manufacturers of risk retention groups.

The President's statement upon signing the Risk Retention Act into law bears repeating:

> "This Act is a marketplace solution designed to provide manufacturers, distributors and sellers with affordable product liability insurance. In keeping with this Administration's policies, this goal is accomplished without imposing any new Federal regulations or expenditures. The Act, respecting the rights of states to regulate the insurance industries within their borders,

utilizes existing mechanisms of state insurance departments, streamlined to express the single need for regulating this type of insurance... .

"In particular, the Act removes selected state regulatory barriers so that product sellers can form self-insurance cooperatives... .

"In short, the Act is a good example of how the Federal Government can resolve a nationwide problem without creating additional programs or agencies".

In addition, the Administration is supporting legislation currently pending before Congress which would preempt state usury laws. S. 1720, introduced by Senator Garn, would remove state-imposed interest rate ceilings on all loans. A principal concern of the Administration is that state usury laws distort national credit markets.

B. ECONOMIC POLICY CONSIDERATIONS

There is evidence that product liability rules have a significant impact on the price, quantity and quality of goods and services. As state courts and legislatures continually alter these rules, the uncertainties about possible liability increase. These uncertainties are translated into increased transaction (legal and investigative) and production costs, which in turn affect the quality, price and variety of products available.

Transaction Costs

Transaction costs are legal and associated costs generated by product liability lawsuits brought against manufacturers. The American Insurance Association estimates that for every sixty-six cents a victim receives, seventy-seven cents is spent in legal costs. A significant percentage of legal costs are generated by the need to determine "what the law is" in the state where the action is brought. These costs to the manufacturers are eventually passed on to the consumer.

It has been estimated that the cost to manufacturers for initial outside counsel fees related to typical out-of-state claims is approximately $2,000-to-$4,000 per claim. These initial expenses are for basic analyses of the law in any number of jurisdictions and this does not include litigation decisions required to be made by in-house counsel, pre-trial or court time or other costs. Since approximately 109,000 product liability suits were filed in state and Federal courts in 1981 alone, annual initial defense expenses may be as high as $200-400 million, before any case goes to trial and exclusive of settlement costs.

Production Costs

Because products are marketed nationwide they are held to not one but fifty-one possible standards. Manufacturers must design, label, ship, sell and market products which meet these varying standards. For example, New Jersey, Pennsylvania, California and Wisconsin each have different standards for design liability. As a result of these kinds of differences, one manufacturer of machine tools has recorded increases in product liability costs per machine from $200 in 1970 to $11,000 in 1982.

The incentive for marketing new products or improving current products is affected by some state laws which permit the introduction of post-manufacture improvements to establish that a product was defective. The losses involved in product lines or design improvements not made or introduced, are, of course, difficult if not impossible to quantify. Nevertheless, they must be taken into account.

It is estimated that the cost of product liability insurance represents between 10-15% of the price of some products. This cost includes either actual insurance premiums paid, or internal reserves held in anticipation of adverse judgements.

Effect on competitive position in international trade.

Present product liability standards are a disadvantage to American manufacturers when they must compete with foreign made products.

- Domestic product liability insurance rates are about twenty times what they are in Europe and vary between seven and forty times what they are in Britain.

- For many product lines, foreign manufacturers entering the American market for the first time have a price advantage over similar U.S. made products. They do not have to factor into the price of their product potential liability costs for products still in use in the United States after 20, 30 or 50 years. Also, they may introduce products with new safety or design features without worry about being held liable because their older products do not have such features.

The Hidden Costs

The costs discussed above represent only part of the picture. There is another significant area of costs which are not recorded:

- The costs incurred in the settlement of claims that are ultimately disposed of out of court without a determination of liability. Approximately 95 percent of liability claims are settled or dropped before they reach the jury. The overwhelming majority of those that proceed never reach a jury and are either settled privately or abandoned. Private settlements rarely become part of the public record, and parties frequently agree to keep the terms of the settlement confidential.

- Insurance costs. While it is known that U.S. businesses spent between $1.3 billion and $1.6 billion to commercially insure their product-liability exposure in 1981: (1) A significant number of businesses are self-insured or make no provision to cover their product liability exposure; and (2) These businesses do not report details of their product liability loss-and-expense experience. Since this group accounts for a significant part of the potential data base, their data represents a significant unmeasured cost inherent in the current product liability situation.

CONCLUSIONS

1. It it unlikely that the states will adopt uniform product liability standards in the foreseeable future.

2. The lack of uniformity among state standards has created burdens on interstate commerce which result in economic costs to the manufacturing and consuming public.

3. Federal legislation creating uniform product liability standards for the adjudication of product liability disputes by the states is both economically justified and consistent with Administration policy.

OPTIONS FOR ADDRESSING THE ISSUE

Option One: Take no action

Pro: (1) The Administration is not required to adopt a position at this time.

(2) This late in the current Session, it is unlikely that any legislation would be acted upon by the Congress prior to fall adjournment.

(3) This would allow more time for study of this issue.

Con: (1) U.S. Industry has been urging the Administration to simply recognize the need for Federal legislation. Failure to do so would risk alienating these groups.

(2) Failure to participate in the process early could hinder future Administration influence over the outcome of the issue.

(3) Three Administrations and four Congresses have already studied this issue. Further delays will limit the ability of the Administration to participate in this issue.

Option two: Recognize need for Federal approach and direct Working Group to develop Administration position on legislation and work with Congress to develop acceptable bill.

Pro: (1) The Administration could be on record as supporting the principle of a Federal approach, without favoring specific legislation.

(2) The Administration could have the opportunity to ensure the development of fair and balanced legislation.

(3) Demonstrates to business community Administration support.

Con: (1) Could imply Administration support for the Kasten bill (S. 2631).

(2) Consumer groups may criticize the Administration for supporting legislation they see as affecting the rights of injured persons.

(3) Could involve us in a process whereby the President may have to veto a bill even though the Administration had cooperated with the Congress.

CABINET COUNCIL ON COMMERCE AND TRADE

BRIEFING MATERIALS ON

PRODUCT LIABILITY

JULY 14, 1982

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A

THE SECRETARY OF COMMERCE
Washington, D.C. 20230

July 12, 1982

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FROM : Malcolm Baldrige, Chairman Pro Tempore
Cabinet Council on Commerce and Trade MB

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ACTION FORCING EVENT: Senate Committee Hearings and Possible Mark-up of Legislation

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(2) Consumer groups may criticize the Administration for supporting legislation they see as affecting the rights of injured persons.

(3) Could involve us in a process whereby the President may have to veto a bill even though the Administration had cooperated with the Congress.

B

MEMORANDUM

RECEIVED
OFFICE OF THE
COUNSEL

THE WHITE HOUSE

WASHINGTON

APR 9 10 18 AM '82

April 7, 1982

MEMORANDUM FOR: CHRIS DEMUTH
JOHN FOWLER
MICHAEL HOROWITZ
WILLIAM NISKANEN
JONATHAN ROSE
TIMOTHY RYAN
MICHAEL UHLMANN

FROM: DENNIS KASS
Special Assistant to the President
for Policy Development

SUBJECT: Working Group on Product Liability

The Cabinet Council on Commerce and Trade has designated you a member of the Product Liability Working Group. The Working Group has been directed to identify and analyze the economic and intergovernmental policy arguments for and against a new federal statute on product liability that would preempt jurisdiction of the states in this area. The Working Group is to report its findings and any recommendations to the Cabinet Council in 30 days.

Sherman Unger will serve as Chairman of the Working Group and will contact you directly concerning your participation.

cc: Secretary Baldrige
Edwin Harper
Sherman Unger

MEMBERS

General Counsel, Department of Commerce	Sherman Unger, Chairman
Assistant Attorney General for Legal Policy	Jonathan Rose
Counsel for Policy Analysis and Law, OMB	Mike Horowitz
Administrator, Office of Information and Regulatory Affairs, OMB	Chris DeMuth
Member, Council of Economic Advisors	William Niskanen
General Counsel, Department of Transportation	John Fowler
Solicitor, Department of Labor	Timothy Ryan
Special Assistant to the President, Office of Policy Development	Michael Uhlmann

DATE ESTABLISHED: April 7, 1982

CABINET COUNCIL ON COMMERCE AND TRADE

GENERAL COUNSEL OF THE
UNITED STATES DEPARTMENT OF COMMERCE
Washington, D.C. 20230

April 14, 1982

MEMORANDUM FOR: CHRIS DEMUTH
JOHN FOWLER
MICHAEL HOROWITZ
WILLIAM NISKANEN
JONATHAN ROSE
TIMOTHY RYAN
MICHAEL UHLMANN

FROM: SHERMAN E. UNGER SEU

SUBJECT: Meeting of the Working Group on Product Liability

The first meeting of the Working Group on Product Liability will take place in my office, Room 5870, Department of Commerce, on Monday, April 19 at 3:00 P.M. At that time, the agenda of the working group will be established and a timetable determined.

Please call my Secretary, Brenda Lodge (377-4772) if you are unable to attend.

SUMMARY OF MEETING OF WORKING GROUP

ON PRODUCT LIABILITY

OF THE CABINET COUNCIL ON COMMERCE AND TRADE

April 19, 1982

Office of the General Counsel

Department of Commerce

ATTENDANCE

Members of the Working Group: Sherman E. Unger, Chairman, William Niskanen, Timothy Ryan, Michael Horowitz, Chris DeMuth,

Designees: Timothy Finn for Jonathan Rose; and Jeff Miller for John Fowler.

Observers: Irving P. Margulies, H. Stephen Halloway, Department of Commerce; Allen Parkman, Council on Economic Advisors.

The first meeting of the Working Group on Product Liability was convened at 3:00 p.m., April 19, 1982.

DISCUSSION

The Chairman began the meeting by reviewing the charter from the Cabinet Council directing the Working Group to "identify and analyze the economic and intergovernmental policy arguments for and against a new Federal statute on product liability that would preempt jurisdiction of the states in this area."

Discussion of the charter followed. Members commenced by reviewing current legislative proposals and identifying the basis for Federal activities.

ECOMOMIC ISSUES

If there is a need for such legislation than the proponents should be able to quantify both the costs of the present tort liability system and the savings resulting from changes in this system. Precisely how this data might be gathered in a statistically reliable manner was discussed.

It was pointed out that the collection of certain types of proprietary data, such as product and insurance pricing, would not be feasible. Although a number of reports had been prepared by the Department of Commerce, most of the data available have been collected by the private sector. Concern was expressed about reliance on private sector data. Mr. Unger assured the Group that the Department of Commerce was able to evaluate these data. He also emphasized that much information has been collected over the past six years by Commerce and Congressional Committees.

The Group consensus was that the proponents of this legislation should be able to demonstrate the need in economic terms: what are the costs to producers and consumers resulting from the lack of uniformity in the tort liability system.

INTERGOVERNMENTAL ISSUE

The issue of Federalism was briefly discussed. The consensus among the Group was that resolution of this issue by the Federal government was not inappropriate. The lack of uniformity among the states - in an area of commercial law - mitigated in favor of a Federal response, although it was pointed out that a "broad brush" approach would risk a far greater incursion into state court procedures than may be necessary to resolve the problem.

This led to a general discussion of the parameters of proposed legislation. Many Group members expressed specific concerns with the Kasten Staff Working Draft, while acknowledging that the Working Group charter did not include addressing a particular piece of proposed or pending legislation or drafting its own bill.

Finally, in viewing what the role or purpose of Federal legislation should be, it was posited that Federal legislation should move to balance the interests of consumers and producers. For example, it is likely that at the state level consumers may have a slight edge in advancing their point of view over producers, whereas at the Federal level, the reverse is true. Since products are marketed on a nationwide basis it may be fairer to match the needs of the producer and the consumer at the Federal level. Therefore, if the goal is to correct certain imbalances among the states, it may well be that a Federal forum for resolution of this imbalance would be more neutral. Several members emphasized that the point to be considered in any Federal bill should not shift liability to or from a producer. Rather, the value of a Federal bill would be to reduce the part of the insurance premiums or transaction costs attributable to diverse state laws.

The Chairman summarized the meeting and stated the Department of Commerce would gather the necessary information with respect to the economic aspects of this issue and circulate the material to Working Group members as soon as possible.

The meeting was adjourned at 4:30 p.m.

C

CHRONOLOGY OF FEDERAL INVOLVEMENT IN PRODUCT LIABILITY LAW REFORM

<u>1976</u>

April 23	Executive Committee of the Executive Policy Board (EPB) directs Commerce Department to establish an interagency task force on product liability (Memorandum - L. William Seidman to James A. Baker, III). The report of the task force is to be completed by December 15, 1976.
December 15	Department of Commerce: 50-page Briefing Report on Product Liability problems and solutions for White House.
December 22	EPB recommends publication of reports prepared by contractors in conjunction with Briefing Report submitted. (Each of the underlying contract reports, focusing on industry, insurance and product liability law, were published between March, 1977 and May, 1977.)
September/ October/ December	Senate Select Committee on Small Business: 4 days of hearings on product liability problems affecting small business.

1977

January	S. 403, first Federal product liability bill, introduced by Senator Pearson (R-Kansas)
March/ November	Senate Select Committee on Small Business: Hearings on Impact of Product Liability Problem
April - December	House Subcommittee on Capital Investment and and Business Opportunities: Field Hearings on Product Liability insurance (15 Days).
April 27-29	Senate Commerce Committee: Hearings on Product Liability Insurance.
September 27	Department of Commerce: Interagency Task Force Final Report circulated for review.
November 24	Department of Commerce: Final Report of the Interagency Task Force on Product Liability published.

1978

April 6	Department of Commerce: Options Paper on Product Liability (prepared at request of OMB and Domestic Policy Staff) published. 43 FR 14612.
April 27	H.R. 12429 Introduced by Congressmen Steiger (R), Rostenkowski (D-Illinois), Gradison (R-Ohio), and Brodhead (D-Michigan); would allow tax deductions for contributions to product liability loss reserve accounts.
May 25	S. 1611 introduced by Senator Culver (D-Iowa); would allow income tax deductions for contributions to product liability loss reserve accounts.
June 9	H.R. 7711 introduced by Congressmen Whalen (R), Patterson (D-California), Pease (D-Ohio), Pritchard (R-Washington), Stanton (R-Ohio), Steers (D-Maryland) and LaFalce (D-New York); would allow deductions for contributions to product liability trusts and exempt such trusts from income taxation.
June 28	H.R. 8064 introduced by Congressman Mikva (D-Illinois); would allow deductions for contributions to product liability trusts and exempt such trusts from income taxation.
July 20	Administration announces program to address product liability problem.
August 28	Senate Subcommittee on Taxation and Debt Management: Hearings on S. 1611.
September 28, 29	House Subcommittee on Miscellaneous Revenue Measures: Hearings on H.R. 7711, H.R. 8064, H.R. 10272 and H.R. 12429 (Deduction for self-insurance for product liability).

<u>1979</u>

January 12	Department of Commerce: "Draft Uniform Product Liability Law" published. 44 FR 2996.
January 18	H.R. 1061 introduced by Congressman Latta (R-Ohio); would provide for improvement of product safety.
January 31	H.R. 1675 introduced by Congressman LaFalce (D-New York); would establish Federal product liability law standards.
January 31	H.R. 1676 introduced by Congressman LaFalce (D-New York); would establish uniform Federal product liability law.
February 27	House Subcommittee on General Oversight and Minority Enterprise: Hearings on the Uniform Product Liability Act.
March 14	H.R. 2891 introduced by Congresswoman Bouquard (D-Tennessee); would provide for the improvement of product safety.
March 14	H.R. 2964 introduced by Congresswoman Bouquard (D-Tennessee); would establish uniform standards, provide for the exemption of product liability trusts from income taxation, and provide for product safety.
May 23	H.R. 4204 introduced by Congressman Erlenborn (R-Illinois); would provide for the improvement of product safety.
June 26, September 27, October 16	House Subcommittee on Consumer Protection and Finance: Hearings on the nature and causes of the product liability problem.

<u>1979</u>,ctd.

September	Administration risk retention proposal forwarded to the Congress.
September 12	H.R. 5258 introduced by Congressman LaFalce (D-New York); would facilitate the formation by product sellers of risk retention groups.
October 12	H.R. 5571 introduced by Congressmen Preyer (D-North Carolina) and Scheuer (D-New York); would facilitate the formation by product sellers of risk retention groups.
October 25,26 November 14, 15,26,27	House Subcommittee on Consumer Protection and Finance: Hearings on H.R. 5571, and H.R. 5258 (identical bills); H.R. 1061, H.R. 2891, H.R. 4204 (identical bills); and H.R. 1675, H.R. 1676, H.R. 2964 and H.R. 5626 (identical bills).
October 31	Department of Commerce: "Model Uniform Product Liability Act" published. 44 FR 62714.

<u>1980</u>

April 1	H.R. 7000 introduced by Congressmen Preyer (D-North Carolina), and Broyhill (R-North Carolina); would provide for a uniform Federal product liability law.
April 23,29, 30	House Subcommittee on Consumer Protection and Finance: Hearings on H.R. 5626 and H.R. 7000.
March 10	H.R. 6152, Risk Retention Act of 1980, passes House of Representatives.
July 30	Senate Commerce Committee: Hearings on S. 1789 and H.R. 6152 (Risk Retention Act of 1980).
September 20	S. 1789 introduced by Senators Culver (D-Iowa), Nelson (D-Wisconsin) and Pressler (R-South Dakota); would facilitate the formation by product sellers of risk retention groups.
October 1	House Subcommittee on General Oversight and Minority Enterprise: Hearings on product liability insurance ratemaking, and to review the findings of the Federal Interagency Task Force.
October 17	H.R. 5626 introduced by Congressmen Sensenbrenner (R-Wisconsin), Broyhill (R-North Carolina), Roth (R-Wisconsin), Sawyer (R-Michigan), Corcoran (R-Illinois), Stockman (R-Michigan), Luken (D-Ohio), and Ireland (D-Florida); would establish standards for financial and legal responsibilities in product liability actions.
December 14	H.R. 6162 introduced by Congressmen Preyer (D-North Carolina), Scheuer (D-New York), Broyhill (R-North Carolina), Ottinger (D-New York), Luken (D-Ohio), Nowak (D-New York), Corcoran (R-Illinois), and LaFalce (D-New York); would facilitate the formation by product sellers of risk retention groups.

1981

January 5	H.R. 248, introduced by Congressman Guarini (D-New Jersey); would allow deductions for contributions to service liability trusts established for coverage of trust damages arising out of architectural or construction services.
January 20	H.R. 970 introduced by Congressman Guyer (R.-Ohio); would provide that trusts for payment of product liability be exempt from income tax, and that contributions to such trusts be deductible.
February 23	H.R. 1991 introduced by Congressmen Gradison (R-Ohio), Gephardt (D-Missouri), Brown (R-Ohio), Erlenborn (R-Ohio), Frenzel (R-Minnesota), Lagomarsino (R-California), Porter (R-Illinois), and Roe (D-New Jersey); would allow tax deductions of amounts paid for product liability loss reserve accounts.
February 25	H.R. 2120, the Product Liability Risk Retention Act of 1981, introduced by Congressmen Florio (D-New Jersey) and Broyhill (R-North Carolina); would facilitate establishment of product liability risk retention groups.
April 9	House Subcommittee on Commerce, Transportation and Tourism: Hearings on H.R. 2120.

1981, ctd.

May 4	S. 1096, the Product Liability Risk Retention Act of 1981, introduced by Senators Kasten (R-Wisconsin), Packwood (R-Oregon), East (R-North Carolina), Lugar (R-Indiana), Schmitt (R-New Mexico) and Cannon (D-Nevada); would facilitate the formation by product sellers by risk retention groups.
July 21	H.R. 2120 reported by the House Committee on Energy and Commerce
July 28	H.R. 2120 passes House, with amendment.
September 11	H.R. 2120 passes Senate, in lieu of S. 1096
September 25	H.R. 2120, the Product Liability Risk Retention Act of 1981, approved by the President (P.L. 97-45).
October 15	"Senate Staff Working Draft No. 1" of The Product Liability Act (Kasten, R.-Wisconsin) released for comment.
December 14	H.R. 5214 introduced by Congressman Shumway (R-California); sets uniform national standards for product liability cases.
December 16	H.R. 5261 introduced by Congressman LaFalce (D-New York); establishes the Standards for Product Liability Tort Law Review Panel, which would approve or disapprove State product liability legislation.

<u>1982</u>

March 1	"Senate Staff Working Draft No. 2" released by Senator Kasten.
March 9,12	Senate Consumer Subcommittee: Hearings on the need for product liability reform.
June 16	S. 2631 introduced by Senator Kasten.
June 30, July 1	Senate Consumer Subcommittee: Hearings on S. 2631.

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THE SECRETARY OF COMMERCE
Washington, D.C. 20230

July 6, 1982

MEMORANDUM FOR: EDWIN MEESE, III

FROM: Malcolm Baldrige MB

SUBJECT: Background and Summary of the Product Liability Issue

Wendell Gunn asked that we furnish you a memorandum summarizing the Product Liability issue. The following responds to that request.

BACKGROUND OF THE ISSUE

During the 1960's, state courts began to develop new and divergent theories on which to base the liability of product manufacturers for injuries caused by their products. Some of the larger states, notably California, New York and Pennsylvania, motivated by what they perceived as a trend toward more complex and dangerous products, with a commensurately greater need for consumer protection, moved away from theories based on negligence and developed theories intended to permit "compensation" to the consumer when injuries occurred. 1/ These theories were implicitly based on the perception that manufacturers and their insurers were better able to absorb and spread the cost of such injuries.

1/ The landmark court decision standing for such a result is Sindell v. Abbott Laboratories, Inc., 26 Cal.3d 588, 607 P.2d 924, cert. den., 499 U.S. 912 (1980). In that case, involving the use of the fertility drug DES, a group of manufacturers were held liable for the judgment in plaintiff's favor in proportion to their respective shares of the market, even though -- and because -- plaintiff was unable to demonstrate which defendant had manufactured the product. A similar legal result was reached in an unrelated case in New York, Bichler v. Eli Lilly & Co., 436 N.Y.2d 625, 2 Prod. L. Rptr. 8885 (1981).

These judicial trends in a few more populous states affected nationally the costs of obtaining product liability insurance. Substantial increases in the cost of such insurance -- even for those manufacturers located in states unaffected by such trends -- resulted from the fact that most products are marketed nationwide, and product liability insurance (unlike automobile, medical or worker compensation lines) is rated nationally. Product liability underwriters were therefore setting rates based upon increased exposure in a few states.

In response to this problem, President Ford established a Federal interagency task force in 1976 and appointed the Department of Commerce as its lead agency. The Interagency Task force on Product Liability conducted a major survey of the product liability situation generally. It found that both liability of manufacturers and product liability insurance rates had increased dramatically. Among the principal causes identified by the task force for these increases were (1) overly subjective rate-making practices by major insurance carriers, and (2) uncertainties and imbalances in product liability law among the states. 2/

In response to the problem of overly subjective ratemaking practices, the Department of Commerce supported, and President Reagan approved, the Product Liability Risk Retention Act of 1981. 3/ The Risk Retention Act ensures objective underwriting by permitting manufacturers to form risk retention groups and insure themselves. The Act provides for a limited preemption of inconsistent state laws in order to achieve this purpose. Although only one manufacturing group has so far explored seriously the possibility of forming a risk retention group, the Risk Retention Act is regarded as a positive force in the achievement of objective, competitive insurance rates.

The second problem identified by the product liability Task Force was that of uncertainties and imbalances in product liability tort law resulting from the growing differences

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2/ The Final Report of the Interagency Task Force on Product Liability was published by the Department of Commerce on November 24, 1977.

3/ Public L. No. 97-45, September 25, 1981.

among the states as to the standards of conduct to which manufacturers would be held. An outgrowth of the Task Force finding was the publication, by the Department of Commerce in 1979, of the Uniform Product Liability Act 4/, a model law for adoption by the states which, if fully adopted, would have established uniform standards of conduct (as well as certain procedural and evidentiary rules) nation-wide. Formulation of the Uniform Act was accomplished over a three-year period which the Department held extensive meetings with industry and consumer groups and received over 1,500 pages of comments.

The approach represented by the Uniform Act has not been successful. Only four states have adopted portions of the Uniform Act; twenty-seven other states have adopted various other statutes. Many of these constitute industry-weighted restrictions on the legal rights of consumers, and -- more importantly -- none of them is alike. For example, some states require that manufacturers warn consumers about dangerous characteristics of their products which are obvious, other states do not. Most states exclude evidence of improvements in safety in order to encourage safety innovation, but two states now admit such evidence. Many states have adopted similar legal theories, but case law suggests wide variations in their implementation. The result has been increased uncertainty among product sellers, insurers, and consumers. Meanwhile, state courts continue to explore new product liability theories.

MAJOR ISSUES IN PRODUCT LIABILITY TORT REFORM

Differences among the state laws are a source of major concern to industry groups advocating product liability tort law reform. They assert that their inability to predict in advance the standards by which their products will be evaluated results in excessive design costs and -- for the reasons set out at the outset of this memorandum -- unnecessarily high insurance rates. It is only fair to say, however, that these groups are also concerned by what they perceive as trends toward increased liability exposure and ever higher damage awards by courts and juries. In addition, they perceive certain legal practices and procedures as unnecessarily weighted in favor of product liability

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4/ Hereinafter "the Uniform Act".

plaintiffs. While uniformity is, of course, a major goal of Federal legislation, the major features of any bill will necessarily address those other issues which are of major concern to proponents of the legislation. Principal among these issues are the following, in summary form:

° Strict liability. Many states now hold manufacturers "strictly liable" for injuries caused by their products. While implementation of this standard varies widely from state to state, manufacturers now feel that many states are placing them in the position of "insurers" of their products. They believe Federal legislation should address this problem by providing that in cases involving product design, or warnings and instructions to the consumer, a traditional negligence theory should be substituted for strict liability.

° Manufacture by Defendant. Manufacturers are concerned that any bill must contain provisions which would override the result reached in the Sindell case (see Fn. 1). They feel it essential that Federal legislation require that a Plaintiff show by clear and convincing evidence that the Defendant did in fact manufacture the product that was the proximate cause of the injury.

° Government standards. The weight which should be afforded a manufacturer's compliance with applicable government standards is of major concern to manufacturers, who assert that full compliance should exempt them from further liability. The issue is complex, because there are major differences among Federal standards, and state and local standards vary widely in their quality and care in preparation.

° Workplace injuries. In the case of most workplace injuries which are subject to worker compensation programs, the employer and/or the employer's insurance carrier possess the right of subrogation of any employee claims against the manufacturer of the the product allegedly causing the injury. It is the view of manufacturers of heavy machinery that this practice causes unnecessary and frivolous litigation and unduly shields the employer from the responsibility to maintain a safe workplace. Industry groups therefore feel that Federal legislation should should eliminate the right of subrogation or, in the alternative, hold employers more accountable for their own negligence.

° Statute of repose. Among the most strident cries for relief are those of manufacturers held liable for injuries caused by a product which they had manufacturered 20, 30, even 50 years previously. In many product liability actions involving such actions, the conduct of the defendant is evaluated by contemporary standards rather than those in effect at the time of manufacture; and, in many cases, evidence of subsequent modification, alteration, or wear and tear is not allowed before the jury. Industry groups therefore support a "statute of repose" -- a provision limiting the number of years for which they may be held liable for their products.

° Punitive damages. Industry groups are of the view that the role of punitive damages in product liability actions has become grossly distorted. They see punitive damages as merely one other means available to juries to reach the "deep pocket" of the manufacturer and his insurer. In those cases where the product in question is mass-produced and is responsible for many different injuries (e.g., the Ford Pinto), manufacturers see multiple awards of punitive damages as being grossly excessive in light of a company's total fault or financial situation. These groups therefore support provisions which would, in various ways, place controls on the award of punitive damages. Such controls might take the form of limiting the amount of punitive damages which can be awarded in any single action, making punitive damages a function of the compensatory award, taking into account previous punitive awards involving similar products, or taking into account the defendant's financial status (e.g., net worth).

° Expert testimony and the Prima Facie Case. Although most states grant discretion to judges to dismiss cases not based on sufficient evidence, industry groups complain that this discretion is rarely used. They support legislation which would require courts to dismiss cases not based on substantial evidence, thereby preventing these cases from going before a jury. In a similar vein, manufacturers support provisions requiring that expert testimony be corroborated by substantial evidence, thereby limiting what they view as the excessive role played in product liability cases by expert witnesses.

Each of these issues is, of course, subject to widely varying approaches. Therefore, whether a Federal bill addresses these issues is perhaps less important than the manner in which each provision is drafted. In particular, provisions treating the liability of manufacturers for the design of their products, and the duty of manufacturers to warn product users of dangers in the use of such products, can be approached in a variety of ways, and present complexities which are beyond the scope of this memorandum.

RECENT CONGRESSIONAL ACTIVITY

Congressional interest in product liability legislation has been growing in recent years. A bipartisan effort began in the 96th Congress, where a number of bills were introduced and hearings were held. Some of these have been modeled after the Uniform Act developed by the Department of Commerce; others have suggested different approaches. In the 97th Congress, Senator Kasten, Chairman of the Senate Consumer Subcommittee, developed a draft bill, and after extensive public comment and several iterations, introduced a bill, S. 2631, on June 16, 1982. Kasten's Subcommittee held two days of hearings in March (at which I testified on behalf of the Administration) and two additional days of hearings on S. 2631 on June 30 and July 1, 1982. The Administration did not testify at the June/July hearings.

In the House of Representatives, Congressmen Shumway and LaFalce have each introduced legislation, and it is anticipated that Congressman Waxman will do so in the near future. The Shumway bill (H.R. 5214) is similar to the Kasten bill, but is drafted in a way that is thought by some observers to be more favorable to the interests of manufacturers. H.R. 5214 limits, for example, the amount of punitive damages that may be awarded in any action, and establishes strict time limitations on the liability of a manufacturer for his product. The LaFalce bill (H.R. 5261) would establish a system of Federal "review" of state laws, according to standards set forth in the bill, and provides for Federal preemption of state laws not meeting those standards. The Waxman bill, not yet introduced, is expected to be similar to Senator Kasten's working draft, but weighted more favorably toward consumers.

S. 2631 is conceded to be the current "vehicle" for Senate consideration of the product liability issue. A look at some of the principal features of the bill may be indicative of the direction in which Senator Kasten is moving.

- <u>Strict liability</u>. Section 5(a) of the bill provides for strict liability of manufacturers for defects in a product's construction. Strict liability is also provided for in connection with breaches of express warranties (section 7). In this respect, the draft follows the trend established by the Restatement 2d of Torts.

- <u>Negligence</u>. Liability for defective design and for failure to warn of dangers inherent in the use of the product (sections 5(b) and 6) are premised on common law negligence theories. This represents a concession to the difficulties experienced by courts in applying strict liability concepts to design and failure-to-warn cases.

- <u>Expert testimony</u>. Section 4(b) of the bill requires that expert testimony offered to establish a plaintiff's claim must be corroborated by substantial objective evidence. This responds to business groups who seek to limit the number of cases that go to juries on the strength of an expert opinion alone.

- <u>Workplace injuries</u>. Section 11 of the bill reduces an employee's damages by the amount recovered under any state or Federal worker compensation law. It prohibits subrogation actions against manufacturers by employers or insurers. This provision is expected to eliminate many of the transaction costs now experienced in litigation arising out of workplace injuries, while respecting the basic purposes of worker compensation schemes.

- <u>Statute of repose</u>. The bill contains two alternative sections (section 12) providing for time limitations on the liability of manufacturers for their products. The first alternative section provides for a 25-year limitation with respect to capital goods (as defined in the bill). The second alternative would create a presumption of non-liability for any product after the expiration of the warranty period (if any) or ten years, whichever is longer.

- <u>Punitive damages</u>. Section 13 of the Draft would provide a uniform standard by which punitive damages may be awarded: "reckless disregard" for the safety of the product user. The term is defined as "conduct manifesting a conscious, flagrant indifference to the safety" of those who might be affected by the product. Punitive damages could not be awarded in the absence of a compensatory award, and the actual dollar amount would be determined by the court. These provisions, while they would effect a significant change to the status quo, still do not go as far as many industry observers would like.

POLITICAL OVERVIEW

All sectors of the business community have indicated that recent developments in product liability law are intolerable and have recommended the adoption of Federal product liability standards. They assert that the extreme uncertainty in this area is having a dampening affect on productivity and product development. They wholeheartedly support legislation at the Federal level, and would of course prefer legislation which cures at least some of what they view as the major problems in product liability law today. Several industry groups are active in support of legislation achieving these and other goals. Principal among these are:

The Business Roundtable (which has formed a product liability working group);

The Product Liability Alliance, consisting of one hundred-plus firms, primarily manufacturers;

The National Product Liability Council;

The National Association of Manufacturers;

The United States Chamber of Commerce;

The National Association of Wholesaler-Distributors;

The National Machine Tool Builders Association; and

The Chemical Manufacturers Association.

These groups are well-organized and, at least for the moment, highly unified.

Opposition to Federal product liability legislation lies primarily in the American Trial Lawyers' Association, those consumer groups that have addressed the issue, and the American Bar Association. For the most part, however, these groups have not yet mounted a concerted effort in opposition. They will await developments. The insurance industry may be leaning in favor of legislation at this point (the majority of product liability underwriters favor a Federal approach).

<u>THE ADMINISTRATION POSITION</u>

On March 12, 1982, I testified before the Senate Consumer Subcommittee on the need for Federal product liability legislation. In view of my previous statements on the subject, it was widely anticipated that my statement would announce Administration support for the concept. However, at the eleventh hour concerns arose within the Administration that such support was premature. As a result, I limited my testimony to an endorsement of the congressional inquiry itself. This limited response came as a surprise for most followers of the issue.

The principal concerns within the Administration were:

(1) The economic need for a Federal product liability bill had not been adequately demonstrated; and

(2) Federal legislation might be inconsistent with the Administration's policy of "new Federalism".

As a result of the focus on these concerns brought about by the occasion of my appearance before Senator Kasten's Subcommittee, the entire product liability issue was referred to the Cabinet Council on Commerce and Trade. The Council met to discuss the issue on April 7, 1982. A second meeting of the Council is currently scheduled for July 14, 1982.

As a result of the April 7 meeting a Working Group was formed, chaired by my General Counsel, Sherman Unger. The assigned tasks of the Working Group are (1) to explore the economic basis for -- and anticipated results of -- Federal product liability legislation in its most likely form; and (2) to brief for the Cabinet Council the issue of whether Federal legislation is consistent with the Administration's concepts of Federalism and States' rights. The Working Group has recently completed both tasks, and I anticipate incorporating the results of the the Working Group's study in my report to the Council at the July 14 meeting. In brief, Working Group staff found sufficient basis for Administration support of a Federal approach, should the Council decide to pursue that option.

I or members of my staff would be pleased to discuss this issue further with you at your convenience.