

Background Paper 79-5

PRODUCT LIABILITY



## PRODUCT LIABILITY

Product liability refers to the legal responsibility by the manufacturer or marketer of a product for any bodily injury or property damage caused by that product. Product liability insurance coverage is purchased to protect against claims arising from law suits filed by users who suffer injury or damage.

### I

#### The Problem

Costs of product liability insurance premiums have risen sharply in recent years. Particularly vulnerable are smaller firms and companies in certain high risk fields. In some instances, insurance protection may be either unaffordable or unavailable. The most seriously affected producers are in such fields as machine tools and other industrial equipment, medical and electronic devices, sporting goods, chemicals, pharmaceuticals, paints and coatings, and automotive parts.

While producers of durable or capital goods and high risk products have always been vulnerable to product liability actions, there appears to be a growing number of case filings by ordinary consumers who are injured by home appliances and other more common goods. Injuries in the workplace have also resulted in a growing number of product liability actions. In addition to actions against manufacturers, lawsuits against suppliers of component parts, wholesalers, and retailers also fall within the scope of product liability.

Although there is a crisis atmosphere surrounding product liability insurance, interim legislative studies in Missouri and Oregon have not been able to substantiate a true "crisis." A major study undertaken by the U.S. Interagency Task Force on Product Liability concluded that there is no widespread problem ("crisis") of product liability insurance being unavailable, even though costs of insurance have increased substantially since 1974. However, the national study did declare the need for carefully considered action to address authentic problems of insurance cost and availability.

All studies to date emphasize an almost total lack of information in the product liability field. Numbers of cases and outcomes are difficult to document. Statistics related to premiums and losses are also lacking. Basic information to substantiate insurance rate hikes is unavailable, and insurance companies have been accused of "panic pricing." Much of the data needed to regulate insurance rates at the state level is unavailable due to the interstate nature of the marketing/selling of most products and the indication that insurance companies establish their rates on a national basis. Thus, each state's companies generally pay rates that reflect the highest level of liability to which a product could be subjected nationally with no relationship to the state's individual situation. Almost all of these factors and the ones to follow were evident in the medical malpractice insurance crisis of 1974-75.

#### The Causes

The lack of documented information makes it difficult to analyze the causes of the product liability problem. However, research has concluded that no single cause is solely responsible for the situation. Several factors have combined to produce the problem, and each factor must be addressed if a viable solution is to be achieved.

Three principal causes of the product liability problem have been identified as follows:

1. Insurer ratemaking practices - Ideally, insurance premiums should reflect actual risk factors. Product liability ratemaking appears to fall far short of this ideal. In effect, premiums are considered "best estimates" based upon subjective estimates of risk. The lack of statistical data and changing judicial interpretation in an uncertain tort-litigation system have caused insurance companies to rely upon these personal "best estimates" of what they believe the future might contain. The national basis for ratemaking also tends to neglect the situation in the individual states.
2. The manufacture of unsafe products - Some products suffer from defects in construction or design. Surveys indicate that a number of manufacturers, especially

small businesses, do not have planned product liability loss prevention programs in the basic areas of design research and quality control. Some manufacturers maintain that they do not realize a benefit in insurance rates when they institute product liability prevention programs.

3. Uncertainties in the tort-litigation system - The tort-litigation system provides the vehicle for people to go into court in a civil action to recover damages for certain wrongs committed against them. The tort-litigation system with its changing judicial interpretations has brought an "atmosphere of uncertainty" into the product liability field. Among the primary areas of uncertainty in the laws are the rules relating to the responsibility of the manufacturer in product design and warning about potential hazards. Also, the manufacturer does not know "in advance" the bounds of his liability. Rules are also unclear relating to the responsibility that the product user should bear for his own lack of judgment or misconduct. Various state courts have provided individual interpretations in such aspects as contract responsibilities (expressed or implied), strict liability, negligence, warranty (expressed or implied), and the definitions of such terms as "liability," "defect," "unreasonably dangerous," and "duty to warn." It should be pointed out that manufacturers, wholesalers, retailers, and the insurance industry perceive this "atmosphere of uncertainty," while proponents of the current tort-litigation system (primarily trial lawyers and consumer protection groups) maintain that the system is functioning properly and serving the best interests of the public.

Additional causes of the product liability problem have also been suggested as follows:

1. The growing number and complexity of products.
2. An increased awareness and assertiveness on the part of consumers.
3. The general litigation increase in the United States.

4. Attorneys as a part of the problem, particularly the contingency fee system (collecting a percentage if the case is won and nothing if the case is lost).
5. Publicity from large settlements or judgments that raises unrealistic expectations.
6. The time element of long-term liability in risk exposure.
7. A growing involvement of workplace accidents and the worker's compensation system. (Employees have the opportunity to augment worker's compensation benefits with damages recovered through a product liability suit, usually at little cost because of the lawyer contingency fee approach. Similarly, the worker's compensation insurance carrier of an employer attempts to recoup its costs through legal action against the original product manufacturer.)

#### Possible Solutions

Although it would be virtually impossible to present all of the suggested remedies that have been offered to "improve" or "reform" the system, those most frequently mentioned are listed in the following section. Some of the proposals are designed as stop-gap measures to provide prompt relief, particularly in the area of insurance availability and cost to smaller firms. Others are more comprehensive and involve fundamental changes with less immediate impact. Many of the proposals are closely related and are thought to work more effectively when combined with others in an integrated approach. No attempt is made here to evaluate any of these proposals.

1. Modification of ratemaking practices.
  - a. Expand reporting requirements of insurance companies and brokers providing product liability insurance to include statistics concerning the amount of product liability premiums; number of policies written; number of policies canceled, nonrenewed, or refused to be written; number of closed claims by category; and amount paid in the settlement or discharge of all closed claims.

- b. Relate rates/premiums to statistical assessments of product risk.
  - c. Monitor rates and premiums to insure that they are fair, nondiscriminatory, and reasonably related to product risk.
  - d. Promote generally greater financial disclosure and accountability in the insurance industry.
2. Reduction in manufacturing of unsafe products.
- a. Require manufacturers to adopt product safety programs.
  - b. Require insurers to build differentials into product liability rates.
  - c. Require insurers to assist in loss prevention activities of manufacturers.
  - d. Initiate governmental collection and dissemination of data.
  - e. Require more stringent warnings on products.
3. Adoption of statute of limitations (limit liability based upon the length of time since a product was manufactured or first entered the stream of commerce).
4. Adoption of useful life limitation (limit liability based upon the "useful life" of the product).
5. Strengthening of legal defenses.
- a. Allow "state-of-the-art" as a legal defense.
  - b. Allow introduction of evidence that a product complied with established standards when it was produced.
  - c. Establish subsequent alteration or misuse of the product as a legal defense.

6. Placing of restrictions on financial recovery.
  - a. General damages ("pain and suffering").
  - b. Punitive damages.
  - c. Collateral sources.
  - d. Comparative responsibility or fault.
  - e. Elimination of ad damnum clause (plaintiff's statement of dollar amounts sought in case). This is already the case in Nevada.
7. Initiation of periodic payment of settlements versus lump sum payment.
8. Modification of attorney's fees (elimination of contingency fee system).
9. Regulation of expert testimony.
10. Initiation of split trials (liability determination versus damage awards).
11. Implementation of an arbitration system.
12. Modifications to worker's compensation system.
  - a. Contribution and indemnity (contribution to fault and damage payments by manufacturer and negligent employer).
  - b. Subrogation (worker's compensation carrier sues original producer to recoup losses).
  - c. Hold harmless clauses (employer agrees to reimburse manufacturer for liability).
  - d. Making worker's compensation an exclusive remedy.
13. Modifications affecting insurance mechanism.
  - a. Mandatory insurance.

- b. Unsatisfied judgment funds - public fund available to injured plaintiffs who cannot collect on an otherwise enforceable judgment.
- c. Assigned risk plans - if rejected by the voluntary market, person seeking insurance is placed in a pool and assigned to a carrier who must assume the risks assigned to it.
- d. Joint underwriting associations (JUA's) - all providers of a type of insurance pool premiums and spread the losses evenly.
- e. State-operated funds - state creates an insurance market for those risks that have been rejected by at least two insurers.
- f. Federal insurance or reinsurance - federal government provides high risk insurance or bears some losses in certain high risk areas through reinsurance.
- g. Federally chartered insurance - rather than state chartered insurance that now exists.
- h. Captive insurance companies - insurance companies established by a single manufacturer or group to insure risks of that concern or group.

14. Adoption of no-fault insurance.

## II

### Other States

Every state has laws that secondarily relate to product liability. However, in most cases these laws address only general liability in the overall tort system. In the past couple of years, bills specifically oriented to product liability have been introduced into virtually every state legislature. Currently, 17 states have enacted laws directly related to product liability, and over 200 bills have been considered. Utah, Colorado and Oregon have enacted the most comprehensive product liability laws. The states of Minnesota,

Massachusetts and Kansas have passed information reporting laws to address the problems of inadequate data and nationally based ratemaking procedures. Maine, Wisconsin, Missouri, Illinois, Georgia, and Oregon have compiled interim studies of the subject.

In 1977, a state-by-state nationwide drive for new legislation was undertaken by affected interest groups. Thus, many of the bills that have been introduced and enacted exhibit similar content. Seven characteristics are included in most of these proposals:

1. Statute of repose or limitation.
2. "State-of-the-art" defense.
3. Product compliance with standards.
4. Misuse or alteration defense.
5. Limitation on evidence, such as technological advancements.
6. Elimination of ad damnum clause (Plaintiff's statement of dollar amounts sought in cases).
7. Basic standard of responsibility - attempts to define and clarify product liability by defining terms such as "defective products" and "unreasonably dangerous," and sometimes attempts to alter responsibility in other ways.

Wisconsin has initiated a nonlegislative response to the problem of product liability insurance cost and availability by establishing a voluntary placement procedure known as the Market Assistance Program (MAP). For a small processing fee, MAP attempts to find a willing insurer to offer affordable coverage to a firm through normal channels. The four basic features of Wisconsin's MAP are:

1. It is a voluntary industry committee.
2. It acts only on referral from a local insurance agent.
3. It is not a guaranteed placement facility.

4. It is intended to be a temporary organization to provide some relief while the legislature seeks more permanent solutions.

It should be noted that representatives in most states indicate that it is too early to assess the effect of their product liability laws.

#### Federal Actions

Product liability legislation was introduced in both houses of the 95th Congress. Proposed actions included reinsurance programs, tax relief deductions, tort reforms, worker's compensation measures, product testing and certification, and federal chartering of captive insurance companies. Only the tax relief deduction proposal was enacted. This effort is expected to have minimal effect on the overall problems of insurance costs and availability.

Following completion of the Federal Interagency Task Force study of product liability, the Secretary of the U.S. Department of Commerce directed her staff to prepare a model uniform product liability law which could be enacted by the states. They are also drafting suggested insurance regulation standards to address product liability insurance ratemaking. In addition, an interagency council is being established to serve as an information clearinghouse and forum for discussion of product liability issues.

#### Model Legislation

There is no lack of model legislation in the product liability field. Manufacturing and insurance industry organizations are one source. The Council of State Governments' "1978 Suggested State Legislation" also contains two model laws pertaining to product liability. The suggested Product Liability Tort Reform Act provides for a statute of limitations, elimination of punitive damages and attorney contingency fees, limits on general damages, and introduction of evidence concerning collateral payments. The suggested Product Liability Insurance Placement Facility Act would establish a compulsory joint underwriting association (JUA) to guarantee the availability of product liability insurance by requiring insurance companies to participate in the association as a condition of doing business in the state.

Through its interim study, a select committee of the Missouri Senate has drafted what might be referred to as model acts on product liability actions and information reporting.

The most extensive effort relative to model legislation is being undertaken by the U.S. Department of Commerce. A comprehensive model uniform product liability law is in its eighth draft and should be ready for distribution by February of 1979. This model is being drafted in a format that will allow state legislatures efficiently to eliminate unwanted elements while retaining desired sections.

### III

#### Nevada Actions

In 1977, a product liability measure (Senate Bill 426) was introduced into the 59th session of the Nevada legislature. As introduced, the bill included provisions for a 6-year statute of limitations, defense based upon compliance with established standards at the time of manufacture, defense based on product alteration or misuse, elimination of punitive or exemplary damages, elimination of evidence relative to advancements in technology or subsequent changes, permitting evidence relative to collateral payments, and allowing contribution and indemnification (contribution to fault and damage payments by manufacturer and negligent employer). Relatively extensive testimony was heard before the senate committee on judiciary, and the bill did not get out of committee.

This background paper is not designed to present recommendations. However, an attempt has been made to outline the complexity of the product liability situation and to discuss alternative courses of action. For further information, the research library has a concise but relatively complete set of documents concerning product liability.

## SUGGESTED READINGS

(Available in the Research Library)

Interagency Task Force on Product Liability, "Final Report Executive Summary," PB-273-220 (24 p.); "Final Report," PB-273-220 (700 p.); "Selected Paper," PB-273-625; (584 p.).

Product Liability, Wisconsin State Legislative Reference Bureau, Research Bulletin 78-RB-2, September 1978; 19 p.

Product Liability: An Overview, Wisconsin State Legislative Council Staff, Research Bulletin 78-3, May 5, 1978; 52 p.

Report of the Senate Products Liability Study Committee, Georgia State General Assembly, January 1978; 29 p.

Report of the Senate Select Committee on Product Liability, Missouri State Senate, December 30, 1977; 80 p.

"Product Liability," State Legislative Report, National Conference on State Legislatures, Denver, Colorado; 5 p.

News Release and Background Paper, U.S. Department of Commerce "News," July 20, 1978; 7 p.

"Product Liability Score Card" (Chart of state legislative action). Business Insurance, September 4, 1978.

"1978 Suggested State Legislation," Volume 37, The Council of State Governments, Lexington, Kentucky, August 1977; pp. 103-113.

Product liability statutes from Utah, Colorado and Oregon.

"Product Liability," Legislative History of Senate Bill 426 of the 59th Session of the Nevada Legislature, 1977; 30 p.