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Transcript of Hearing on Products Liability

Joint Committee on Tort Liability

JOINT COMMITTEE ON TORT LIABILITY

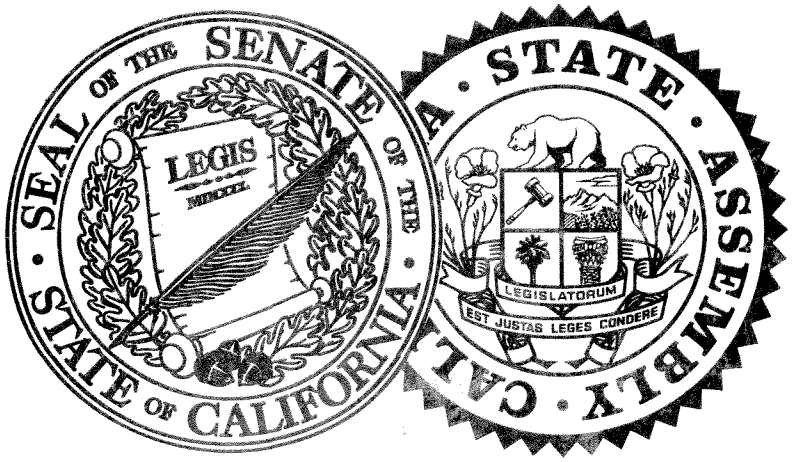
Transcript of Hearing

on

PRODUCTS LIABILITY

San Diego, California

July 18, 1977



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No. 647

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California Legislature

Joint Committee on Tort Liability

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A G E N D A

Products Liability
State Building Auditorium, Room B-109
1350 Front, San Diego, CA
July 18, 1977

1. D.K. Holliday, Vice President, Sentry Insurance
   Thomas Conneely, Regional Vice President & Counsel, Alliance of American Insurers
2. Creighton White, Fireman's Fund
3. Richard Epstein, Professor, University of Chicago Law School - American Insurance Association.
4. Wiley Aitken, California Trial Lawyers Association
5. Gerald Cashion, Vice Chairman, California Product Liability Task Force
   Dick Romney, Board Member
6. Gerald Phillips, Professor, University of Tennessee Law School
7. Berry Griffin, Risk Insurance Management Society
8. Bob Steinberg, California Applicants Attorney Association

JOINT COMMITTEE ON TORT LIABILITY
San Diego State Building
July 18, 1977
(Products Liability Public Hearing)

CHAIRMAN JOHN KNOX: (See Appendix I) If the meeting will come to order, please. I think we'll start the hearing promptly. We have a number of witnesses to hear today, and we want to give everyone a chance to explain their point of view and respond to questions from the Committee. This is a regularly called hearing by the Joint Committee on Tort Liability of the California Legislature. Today's hearing is on the subject of products liability and is the second in a series of three hearings we're having during this month of July on various aspects of tort problems in California.

In Los Angeles on July 11 we heard testimony on professional liability and on July 22 we'll be in San Francisco, and that's this Friday, to hear testimony on insurance company underwriting practices.

The particular problem we're considering today is this: California manufacturers and consumers have in recent years been confronted by a crisis of potentially disastrous dimensions. In 1974, which is the latest year for which we have statistics, products liability losses and loss related expenses totaled almost $200 million nationwide, and if current actuarial studies are correct, this figure may now be approaching a billion dollars. While the breakdown is not precisely known for California, it is clear that as in medical malpractice and other liability areas, that California's share accounts for the largest portion. It is

also clear that most insured manufacturers in California have had premium increases ranging from 100% to 5,000%.

We are told that the cost of products liability insurance in many instances may exceed 20% of the manufacturer's sales receipts for essential products like medical supplies and packaged food items. For simple household products such as chairs and ladders, this cost may be as much as 40% of the receipts. These charges are eventually reflected in higher retail prices, and as a result an added burden is placed on the consumer's pocketbook in an era of chronically high inflation.

Small and medium sized manufacturers lacking the bargaining and economic power of the corporate giants in many cases have been forced to go without coverage or funded self-insurance programs. Still more serious are the reports our Committee has received that several manufacturers have ceased production altogether. Quite obviously, if this denotes a trend, we're on the verge of a calamitous situation for California business.

We are presented with a dilemma. On the one hand, if we do nothing, the result could well be economically catastrophic, but on the other hand, presently proposed legislation may only immunize manufacturers from suits, leaving large classes of injured parties without remedies and without manufacturers receiving a meaningful reduction in premiums.

Accordingly, the purpose of today's hearing is to consider the causes of and possible solutions to the problem facing manufacturers while also assuring victims of faulty products that they will be fully compensated for the injuries they suffer.

Our witnesses today include distinguished scholars and representatives of manufacturers, insurance underwriters, and the legal profession. Testimony will form a basis for interim recommendations we intend to make for legislation before the next session of the California Legislature. We are aware that the blame for the present situation has been laid on all sides. Responsibility has been fixed upon a myopic judiciary -- I didn't write that, may the record show -- avaricious insurers and lawyers, and careless manufacturers. The problem is indeed complex, and we only ask that the witness give primary consideration to the recommendations to the public's interest, even though this may not always coincide with their immediate economic interests. We are primarily interested in suggested solutions to the problem. I think the Committee, as I indicated at the hearing we had earlier in the month, is pretty well convinced there is a problem, and while we'll be glad to listen to your horror story -- we've heard an awful lot of them -- what we're interested in now is in proposals for legislation that may be of assistance in solving the problem.

Our first witnesses this morning are from the American Mutual Insurance Alliance, Mr. D. K. Holliday, Vice President of Sentry Insurance, and Thomas Conneely, Regional Vice President and Counsel of the Insurance Alliance. Gentlemen.

While you're coming up I should introduce my colleagues. On my far right is Senator Newton Russell of Los Angeles County; next to him is Mr. Fred Hiestand, one of the Counsels to the Committee; on my immediate right is Martha Gorman, also Counsel to the Committee; on my left Joyce Faber, Committee Secretary,

and to her left, Assemblyman Alister McAlister, Santa Clara County, and to his left Assemblyman Floyd Mori of Alameda County. As other members come in during the day, we'll introduce them.

Gentlemen, if you want to proceed.

MR. TOM CONNEELY: Mr. Chairman and members of the committee, I'm Tom Conneely. The association I represent has recently changed its name and we're now known as the Alliance of American Insurers, but the process of the change is a little slow, so I'm basically the same organization.

My sole function here this morning is to make a couple of brief comments and describe the Alliance and then turn the microphone over to Mr. Holliday, who represents Sentry Insurance Company, which is one of our member companies.

The Alliance is a trade association of over one hundred property and casualty insurance companies. Most of our companies are mutual companies. Among the services we provide to those companies is to appear at hearings such as this and endeavor to make available to the committees, such as yours, as much information as we can gather. My only intention is to, at the conclusion of all these hearings, submit something in writing and some material that will fill whatever gaps that seem to be there from our point of view. I prefer not to inundate you with a lot of stuff which will simply duplicate other things which you will receive. I want to make it clear that I'm available to any members of the Committee or staff at any time to attempt to respond to questions. With that I will simply turn it over to Mr. Holliday.

CHAIRMAN KNOX: Mr. Holliday.

MR. KEN HOLLIDAY: (See Appendix II) Thank you, Mr. Chairman and members of the Committee. My name is Ken Holliday. I am Vice President, responsible for commercial lines, underwriting and loss control for Sentry Insurance, a mutual company. Sentry is a medium-sized company and we'll handle about $150 million in commercial business this year.

My background has been primarily in underwriting for almost 19 years. I have a BBA degree, a major in insurance; I have an LLB degree, and am a member of the Georgia Bar. I am also a CPCU. I have been active for the past year and a half in several industry committees dealing with the products liability problem. At the ISO, which is the Insurance Services Office, a rate-making and statistical organization for the industry, I am currently serving as the Vice Chairman of the Products Liability Committee, which is looking into several aspects of the situation, the major effort being a closed-claim survey which involves something over 20,000 products claims closed by some 23 companies during the last part of 1976 and the first quarter of 1977. The final report of that survey will be available sometime toward the end of the summer.

I also serve as Vice Chairman of a subcommittee of that committee which has done a complete review of the standard coverage, insurance coverage that is being granted for products liability. Some recommendation for amendments of coverage have been made and are still in committee and they are not finalized at this point.

The National Association of Insurance Commissioners last year also appointed a task force to study the products liability situation. They held several hearings and were to submit a final

report to the NAIC Executive Committee in December in Phoenix. I was appointed as a member of an advisory committee and some 15 representatives from industry, trade associations, and so forth and advised that committee on its final report. We were charged in December with developing a voluntary mechanism for the insurance industry to deal with complaints on availability of insurance. And that was finalized by the target date of February 15 and submitted to the task force and has ultimately been adopted by the NAIC.

One of the recommendations was that each State Commissioner appoint an Advisory Committee locally to deal with products complaints on availability and work to solve them, to find markets that were willing to write the coverage for those insureds. Subsequent to that, we did form such a committee in Wisconsin, and I am currently serving as Chairman of that committee.

I have given Ms. Gorman copies of three or four documents I think would be informative to this group. The first is a pamphlet or paper prepared by Insurance Services Office on rating procedures and statistical procedures for products liability (See Appendix III). A lot of good information is there on the rating difficulties. Also a pamphlet prepared by the American Mutual Insurance Alliance outlining some of the problems with the proposed mandatory residual market mechanisms which some people have thought would be a solution (See Appendix IV). And also Sections 3 and 5 of the NAIC Advisory Committee report to the Task Force (See Appendix V).

I understand, essentially, you would like to know something about how the process of underwriting goes on. As the paper

from ISO points out, the rate-making methodology employed in the past by ISO produces manual rates for a minority of the business, that is from the standpoint of premium volume for products liability. The majority of the premium comes from what we call A rated classes. An A rate is simply that there has been insufficient data....

CHAIRMAN KNOX: Can you speak more directly into the mike please, Mr. Holliday?

MR. HOLLIDAY: Better? Okay? The A rated classes, again, simply means that there is not a manual rate that is statistically justified. There are some broad parameters that are arrived at through judgment largely by analogy with other classes of business. Some of the classifications, particularly in manufacturing, are simply those of a wide variety of products and the quality of products within a given classification.

CHAIRMAN KNOX: What's an example of an A rated product in the last few years? Can you think of one?

MR. HOLLIDAY: You mean as a classification of business?

CHAIRMAN KNOX: Well, you said a product is A rated -- I guess it's a new product that there is no experience on. Right?

MR. HOLLIDAY: Well, or that there's such a wide variety of exposure within the product that there is no credible rate base to break it down to the fine classification. One good example would be farm equipment machinery manufacturers.

CHAIRMAN KNOX: I see.

MR. HOLLIDAY: That classification includes anything from a simple plat point all the way up to combines or very sophisticated machinery. So when you look at that and try to establish an average rate, it obviously would be unfair to the plat point

manufacturer and would probably be inadequate for the more hazardous machinery.

CHAIRMAN KNOX: Thank you.

MR. HOLLIDAY: So those are the classifications that are largely -- the price is largely determined by the judgment of the underwriter involved. I might just mention a few of the things that he takes into consideration in determining a price. First, there is probably a departure point in the schedule of published A rates, or a range somewhere, an average for the class. So you must consider characteristics of the product, which would either make it more hazardous or less hazardous than the average. He gets his information from the producer, the agent or broker, or salesman who gathers information from the insured about his past losses, how many losses that he suffered, what has been the outcome of those losses. Products brochures, loss control engineers' reports that he orders, he looks at management experience in that line, considers what happens if the product does malfunction. Would it take an arm off or would it just simply bruise a knee? This is the extent of the hazard.

The question of hard goods versus soft goods and the life of the product. In other words, if you're talking about some of the capital goods which have experienced quite a problem, punch presses, the life of those products sometimes runs 40 or 50 years, so there is a great accumulation of exposure on the market as opposed to a cooking manufacturer where most of their products are consumed within a short period of manufacture.

Discontinued products, and we find that is quite common where an insured may have tried a product in the past, maybe started

to make a snowmobile, started for a couple of years, then discontinued it. And we have to know how long it was out, what was the loss history on those products, and determine a price for that exposure which still may be out in the market. The markets where he distributes, for example. We were looking at a case recently where about 75% of his product, and it was a farm equipment manufacturer, was in Canada, and the products climate is altogether different there, so a substantial credit was given in his rate, due to the fact that this product was primarily used in a country where we don't have the growing strict liability doctrines and so forth that we have in this country.

Labels, warnings, proper instructions, design -- whether he handles or distributes foreign products or incorporates foreign components in his product. We have a problem of getting to the manufacturer of the foreign products with our court system. Any whole harness agreements that he might have signed or have signed in his favor could be a plus or minus in his rating as it affects the exposure. There is what we call a vendor's endorsement, where a distributor may be covered under the manufacturer's policy. Of course that cuts down the exposure for the insured distributor so there's a credit usually given for that. The quality control programs and record keeping are important. The testing that is done and the records kept. Whether he has enough records in terms of serial numbers, warranty registrations and so forth to undertake a recall program in the event he determines that he has a very unsafe product that's out. We find quite a few of the smaller manufacturers, particularly, that don't have that kind of record

available, and it would be impossible, virtually, to recall faulty products.

In the design you look at the quality of the product itself. That is, if it's an economy model versus a quality model with good safeguards on it. Changes in design in the past. Perhaps we find in our loss control survey that they are making a good safe product now but that only began two years ago. There are still a lot of products out without the safeguards, and that has to be of concern.

Defense costs are a big item and we find that particularly a lot of the manufacturers of machinery for the work place are sued frequently and have defense costs even though they may escape paying a judgment. So the defense cost has to be priced into the coverage because it's a real factor in products liability.

Another thing is reinsurance availability in the cost of reinsurance for the primary insurer. A variety of other considerations go into looking at that individual's product. For example, I was discussing with Tom a case we had recently with manufacturers of a posthole digger, an auger type with a power takeoff from a tractor. It is almost impossible to guard that working part entirely, so we were asked to insure or look at the manufacturer. It so happened that we were aware of the particular auger since we had incurred a claim lodged against the distributor in another state on that particular auger. So in going to our claims person who had been handling that case, he had done an exhaustive investigation and we found out that this was one of the few that they had put out without a safety device, and as a result, an exposure that normally an underwriter would shy away

from, through the knowledge that we have gained through handling the investigation of another insured for that product, we were able to give him a quotation, at least.

CHAIRMAN KNOX: Now you're surveying 20,000 products claims?

MR. HOLLIDAY: A little in excess of 20,000, yes, sir.

CHAIRMAN KNOX: And what are you looking for when you're surveying? What information in categories are you going to have?

MR. HOLLIDAY: This is a rather exhaustive questionnaire that each claims person as he closes that claim completes. And it is designed to gather information on a variety of questions that have been raised about products liability.

CHAIRMAN KNOX: Who is filling out these claims, the claims people for the insurance company?

MR. HOLLIDAY: Yes.

CHAIRMAN KNOX: I see.

MR. HOLLIDAY: The claims person who closes the claim finally for the compnay. So he is familiar with the file.

CHAIRMAN KNOX: It would show the nature of the claim, the nature of the injury, how much was paid, what the cost of defense was, etc.

MR. HOLLIDAY: The theory of settlement, whether punitive damages were alleged, and whether he felt that impacted on the final judgment. Some of the proposals for schedule of benefits, questions were constructed so that those could be evaluated and priced out or at least get some evaluation of a no-fault....

CHAIRMAN KNOX: And you're going to summarize all this and publish it?

MR. HOLLIDAY: I assume we'll have that summary toward the end of the year. It will be published and widely distributed.

CHAIRMAN KNOX: We'll look forward to having a chance to look at that. Do you know if the Insurance Commissioner has appointed a Products Advisory Committee in California?

MR. HOLLIDAY: I'm not sure. The last update I had, we had about 13 states that were either appointed or in the process of appointing. We have Massachusetts, New Hampshire, Connecticut, some of the eastern states, Illinois, Michigan, Wisconsin and Minnesota that are in the midwest, and Kansas. California, I think, had expressed an interest, but the status of that advisory committee, I'm uncertain.

CHAIRMAN KNOX: Now from the standpoint of an underwriter, if you were going to see if the law could be adjusted in some fashion that would cause you to set a substantially lower rate in general for manufactured products, what changes in the law would you suggest? Generally speaking, that is.

MR. HOLLIDAY: Yes. As a member of the Alliance without getting into this in detail, we have served on several committees there and the Alliance has published a pamphlet which does include, and I believe Tom will leave a copy of this with you, some of the modifications in the tort law that we favor. In terms of whether those modifications, were they to go into a given state this year, would that impact on the premiums being paid by those insureds in that state, that would be very doubtful. Because of the way products claims arise and in the state perhaps, and the union, maybe even overseas, the modifications in a given state would have very little impact on the rates. If those were enacted

uniformly, country-wide, they certainly would impact on the escalation of cost, depending on when claims that were affected by those statutes arose.

CHAIRMAN KNOX: In other words, it would take a while, regardless of what we did, before it would have an impact on the industry and thus on prices and what not. Any questions from members of the committee? Senator Russell.

SENATOR NEWTON RUSSELL: Yes, I was wondering, if there are no changes toward liability, if things go on the same as they are, what is your prognostication as to the ability of the insurance industry to continue to provide product liability insurance coverage?

MR. HOLLIDAY: I think, by and large, we will continue to provide a market. The big question that we're facing now is the cost of providing that coverage. The affordability to the buyer. Given enough time, working with a system and given some stability in that system, I think the pricing for the coverage can be handled by the insurance industry.

SENATOR RUSSELL: Assuming that we do not have those stabilizing factors, do you see a continuing escalation absent some type of legislation?

MR.HOLLIDAY: Yes, I was working toward that. What we have seen in the last two or three years really is a catching up of rate level. We were inadequately pricing it in the past years, with the emergence of strict liability doctrine and the theory of entitlement that it brought the claim activity up to a level. I'm not certain that that will continue to escalate, that is in the pricing, as much in the next five years as it has in the past five

years. But it will continue to escalate as long as claims and signs of claims escalate.

SENATOR RUSSELL: Can you tell me approximately, not maybe your company, because let's assume that you do everything 100% right, but generally in the insurance industry in terms of product liability analysis and premium prices, how much of it is really speculation and estimate, because of the factors that have come upon us, the escalation in costs, so many other unknown factors, how much of it is really speculation? You just don't know.

MR. HOLLIDAY: Well, a good part of it is judgment. I would prefer to use the term informed judgment rather than estimation because there are some facts from which we're basing these, particularly when you look at the small manufacturers. If you have dealt with a larger one of the same type, you've got some idea of the loss. You've got more credibility, let's say, and you've got some idea of the cost of carrying the losses and expenses. But certainly it is judgment, largely judgment at this point.

SENATOR RUSSELL: Basically it seems to me that informed judgment was somewhat lacking in the past because you, the industry, has for many justifiable reasons, I guess, lagged quite far behind what they should have been charging.

MR. HOLLIDAY: That's true.

SENATOR RUSSELL: So you cannot say, you can say it's an informed judgment, which in the past was not very well informed at all. So that's why I ask you now, based upon recent history

and projection, how adequate is that informed judgment? Of course, I guess I can't expect you to say not very adequate, but can you give us some kind of an idea? Are we still working in a maze, or do you really think you have a handle on this now, assuming no legislative changes?

MR. HOLLIDAY: I think the attention given to products liability ten years ago, six years ago, was slight, simply because in terms of the overall commerical lines book of business, it accounted for a slight fraction of it. With the emergence of what has occurred in the last few years, this is fast becoming a major line of insurance. For our own company, for example, we have increased partly through rates, and partly through taking on additional exposures, is about ten times over what we were writing in 1969 and 1970. So now it has become enough of a major part of our book of business, it's getting more education of underwriters, loss control people.

SENATOR RUSSELL: Well that being the case, why are we told in California that a lot of -- it's harder and harder to get insurance and product liability, not just the cost but a lot of companies are going out of that line entirely or in California. You say the contrary, that your company is increasing its business.

MR. HOLLIDAY: But there are still types of business that we are not equipped to write. We don't have the expertise to write aircraft products, for example, not the capacity, because you're looking at great catastrophe type losses, and most of that is handled through pooling arrangements.

SENATOR RUSSELL: So as far as your company is concerned then, you have a handle on it, you know where you're going. It's

increasingly a larger part of your total business which musn't mean it's going to be a profitable part, and aside from the fact that it may be too costly and so forth, as of now you're in control of the situation?

MR. HOLLIDAY: In those markets where we feel we have the expertise, but we are certainly not able to provide every product with a quotation. And that's really the function of the State Advisory Committees that I alluded to earlier. It is to take these accounts that cannot get insurance quotes, and put them in the hands of some experienced and sophisticated producer-type people and underwriting people from larger companies in the area. They simply go to work trying to match up perhaps that agent who doesn't have access to all the markets with the market willing to write it.

SENATOR RUSSELL: Well in the areas in which you are expert, have there been products that you have dropped and you will not insure even though you're expert, because of....

MR. HOLLIDAY: Because of individual loss history? Certainly.

SENATOR RUSSELL: For example?

MR. HOLLIDAY: There's a period -- well, thinking of an automobile jack manufacturer which was to consumers, and he had a very lax testing program. We had a lot of failures to these jacks. If that customer won't take the necessary steps to build in quality controls, positive locking devices, and so forth, then you will find generally the companies are unwilling to insure that product in its present form.

SENATOR RUSSELL: In a specific company, is there a general category of a product that you don't touch anymore, even though you're an expert, because of various problems?

MR. HOLLIDAY: Not any product line that we, Sentry, have gotten out of, no. But individual cases within there, because of the variations in quality control, variations in management expertise, of design, this sort of thing, we would not write. Or we might write one just like it from another firm.

SENATOR RUSSELL: Thank you, Mr. Chairman.

CHAIRMAN KNOX: Any questions? Mr. Hiestand.

MR. FRED HIESTAND: Yes, Mr. Holliday, do you break down or do you know if there are any statistics that show of all the different rating classifications, what percentage falls into the large A rating and what percentage is in the composite rating, either in terms of like gross sales of the companies, the total premium dollars that are written by insurance companies? What criteria that you divide this up so that one would just have some notion as to....

MR. HOLLIDAY: Yes, the yellow pamphlet from ISO shows that for the latest year, which is the policy year ending in 1974 -- if you have that, it's shown on page 13 -- it shows that broken down by the monoline manual rating classes. The monoline A rated classes and the composite rated, loss rated and large A rated classes, which is by far the majority of the premium of the total.

MR. HIESTAND: The large A rated class?

MR. HOLLIDAY: Yes.

MR. HIESTAND: And this is broken down in terms of the premiums that are charged?

MR. HOLLIDAY: Premiums and the incurred loss by those categories by year.

MR. HIESTAND: If an individual manufacturer is in a line, you would normally put, say, in a large A class rating, but he says, look, I've got a different procedure for doing it. Like we've been told, there was a manufacturer of punch presses that used remote control but yet he found his insurance premiums for the operation of these punch presses was just as high as it was for people with manual control punch presses; they just wouldn't consider it. It was just a punch press. Is there any way someone who wants to get insurance can have the company come in and actually evaluate that particular product and say, you know, look we're a punch press, but we do it in a different way?

MR. HOLLIDAY: Yes, certainly. The loss control engineers of a given company could well go in and look at the problem. In that particular case it comes from the modification that might be made by a purchaser in bypassing the remote control. There have been instances where the manufacturer, regardless of modifications made, has been involved in suits, involved in a lot of expensive defense, whether he's held liable or not.

MR. HIESTAND: Well, in determining -- I mean, if someone makes what is a safe product, do you then anticipate that the user may not use the product as it is supposed to be used. Therefore it could be hazardous, therefore it goes into a different rating than it would be if it was used as intended?

MR. HOLLIDAY: Well, I'm simply saying that may have been the case in the remote control punch press because we find a lot of those are modified. They are on the market for fifteen, twenty

years and it really isn't a guarantee that claims won't arise.

MR. HIESTAND: Well, I know, but it seems that with any product, no matter how safely made, you can anticipate that someone may not use it as it was intended or may take off the safety equipment. In determining how to rate it and what premiums ought to be paid, do the insurance companies anticipate that the most dangerous use which this product can be put will likely be put by the least reasonable person in determining what insurance ought to be?

MR. HOLLIDAY: Well, that may certainly be the consideration of some people. The loss history of that manufacturer is a governing consideration as well as the industry in total. If he has been manufacturing remote control or guarded punch presses throughout the life of his firm, then I would think certainly he would be paying a lower rate than one who did not. It may be that he started this three years ago when the majority of the outstanding exposure did not have that safety device, too. So the rate credit being given currently would have to be a very minor one, if at all.

ASSEMBLYMAN S. FLOYD MORI: You mentioned the problem of having goods or products that are manufactured with foreign parts or from foreign manufacturers. What is the problem when you have different state laws and goods are manufactured in a different state and sold and used in another state? What kind of problems arise there?

MR. HOLLIDAY: Normally, you can still bring in the manufacturer into our court system here, if he's in the United States. We find many cases a manufacturer might be incorporating

a subassembly or distributing parts that are manufactured overseas where there is no way to get to them, so he stands in the shoes of the manufacturer as far as that suit goes. The difficulty of determining what quality controls, we just don't have the wherewithal to make a trip to Germany to see just how they manufacture that product.

ASSEMBLYMAN MORI: Even at that -- let's say the cotton-picking machines that are used in California, but manufactured in Kansas, which has a different quality control state-administered type of standard than we would here in California. Are there any problems associated with that? You have different standards in different states. Manufacturing, we are told, for example, that California has higher standards than any place else. But yet, if products are used here and manufactured in Alabama, what kind of problems do we have, or do we?

MR. HOLLIDAY: Well, the rating that is established for product liability assumes countrywide distribution. We are not establishing rates by state's own product liability. So it assumes that whether it's manufactured in California or in Alabama that the suit could arise anywhere in the country.

CHAIRMAN KNOX: Do you use the largest common denominator, then? Judgements are higher in California. In Iowa they've got to pay based on California judgements.

MS. MARTHA GORMAN: One of the things we've been hearing is that some insurers of products say they won't insure products manufactured in California. This is a statement made saying that our current law in California is chasing manufacturers out of the state. That doesn't fit with what you just said, does it?

MR. HOLLIDAY: That has not been my experience. No, we make no such distinction in our company.

CHAIRMAN KNOX: Right, anything further? Thank you very much, gentlemen. We appreciate your attendance very much. I know that you've come from a long distance and it's very kind of you to be with us. Mr. Creighton White of the Fireman's Fund. While Mr. White is coming up, I would like to introduce Senator Robert Beverly, Vice-Chairman of the Committee from Los Angeles County and recent visitor to Alaska. Mr. White.

MR. CREIGHTON WHITE: (See Appendix VI) Chairman Knox, members of the Committee. My name is Creighton White. I am Vice-President of Fireman's Fund Insurance Company. I have nationwide responsibility for commercial auto and liability underwriting. The remarks I make here today are directed at underwriting practices in the product liability area. Of course, Mr. Holliday touched on many of the same sort of issues that I intended to touch upon and are contained in my statement. Therefore, I will skip over those things that he's already addressed. Fireman's Fund is the seventh largest property-liability insurance group in the country and a major market in California for all types of personal and commercial property and liability coverages. It has substantial interest in the findings of this Committee. Last year Fireman's Fund wrote an excess of $10 million of identifiable premiums for product liability coverage. About 15% of this amount was in California, that is, involved California sellers of goods. The policy of Fireman's Fund regarding product liability coverage is the same as with other lines of insurance. We want the business, but only when it is adequately priced. The adequate price for

products liability insurance has, however, become very difficult to ascertain because of new doctrines and procedures in the tort liability system that inflated the legal scope of liability and spawned enormous increases in litigation and jury verdicts. The Chairman of the U.S. Consumer Product Safety Commission recently stated that in California product liability awards have increased 800% since 1965. He also affirmed that there is now an average of ten $100,000 product-related awards every week in the state. This activity has transformed the product liability line from a miscellaneous, rather minor exposure, to a most volatile, difficult one and in a very short period of time. Naturally enough then, product liability underwriters are taking a close look at applications for the coverage and are charging premiums sufficient to cover the loss potential and expenses. Following, I listed some of the things that a product liability underwriter will look at. I think Mr. Holliday did an excellent job describing most of these and perhaps I could skip over that in order not to bore you too much.

CHAIRMAN KNOX: It's one of the last things that is interesting. What is the financial standing of the manufacturing concerns? It's been our experience that when businesses are compelled to making cuts, safety programs are among the first to feel the cutback.

MR. WHITE: That is our experience. And not only related to products liability situations, workers compensation situations, what have you, when there is expense cutting to be done, we often find it is in the safety area. Of course, often applicants for products liability coverage are deficient in one or more of these

areas. But when they are willing to adhere to our loss control recommendations the problems can be corrected. Consumers are protected, underwriters can assume the risk profitably, in most instances, and thus develop a capacity to accommodate the always growing insurance needs of our society. I might mention that in the State of California we have 62 loss control engineers on the job in the field, including two industrial hygienist engineer types. As I perceive the product liability market today, the situation is more one of affordability of the coverage than of availability. There are ready sources of product liability insurance in California and across the country. As we have determined in these marketing assistance programs, which are blooming and have already been described, we find, for example, that most people, most manufacturers, most sellers of goods with products liability problems may not have received the type of marketing assistance that they require. In these marketing assistance programs, we have found to date that we can take care in the regular market of most of the product liability problems that come to the fore.

SENATOR RUSSELL: In the small business, say a new business or a new order of business, can those types of individuals meet these standards and remain solvent economically today, or does it really take a going establishment of a larger size to be able to meet the criteria? I recognize that it would depend on the type of product, but let's say one of the tougher ones. Are we in a sense sort of precluding the small entrepreneur from getting into that type of business?

MR. WHITE: This is a possibility. It, of course, presents considerable financial strain to meet these kinds of criteria, and I would have to say that I can foresee that perhaps certain entrepreneurs would be precluded from entering a new product because of the liability cost and the funding for safety reasons, quality control, what have you.

ASSEMBLYMAN MORI: It is my understanding that the cost of liability insurance is somewhere 1% or less than sales. In relationship to size, what normally happens to cost? Does cost rise inversely to size?

MR. WHITE: No. As we talk about size, I suppose you're talking about the jumbo type manufacturers, for example, as opposed to the smaller guy it may be $1 or $2 million sales.

ASSEMBLYMAN MORI: Well, we're talking about sales as a cost of percent of sales. As sales go up, does liability cost go down or vice-versa?

MR.WHITE: No. This could happen because when you get into the underwriting of the super account, the large fellow, you most often use his own claim experience against his own... he's self-rated in effect. I'm thinking of a DOW Chemical as an example. It has tremendous exposures. I couldn't say how much of DOW Chemical sales goes into product liability exposures, translated that way. I know it's considerable. I don't have the actual relationship.

SENATOR RUSSELL: I'm not sure I got that answer. As the company is bigger, exposure is greater. Does the percentage of the amount that he pays for insurance as it relates to the product, does that increase in a steady progression, or what?

MR. WHITE: It could be higher depending on the product. What I was saying was that it's difficult to answer because when you get that big they are often on a large deductible basis. They assume more of the risk themselves or are on what we call a retrospective rating plan. That is, after the fact, the losses below a certain level are looked at and then charged back to him through a rating formula agreed upon between the two parties.

SENATOR RUSSELL: Well, let's take one that is modest size and growing. Can he expect his insurance cost, as a percentage, to keep pace or increase faster?

MR. WHITE: It would keep pace because the rates are based on total sales without regard to size.

CHAIRMAN KNOX: Did you want to finish the statement? I had a question about Exhibit 1. It says that for each dollar of loss, I assume that is dollar paid to a claimant, there was an additional 42¢ of expenses incurred by the insurance company in defending the claim. 42%, your guys are getting more than the plaintiffs' lawyers.

MR. WHITE: That may be true. Not all that is attorney fees, incidentally. The close claim study indicated, though, that about 80-85% was.

CHAIRMAN KNOX: But this doesn't include brokerage fees for selling the insurance or general overhead of the company. This is the actual defense for that particular claim, 42¢ per dollar paid to a claimant.

MR. WHITE: Out of these 7,791 close claims studied, this was the fact.

CHAIRMAN KNOX: Excuse me. Does this include those claims where you don't pay anything? In other words, you successfully defend or deny the claim and you just don't pay anything.

MR. WHITE: The study did, but this particular dollar ratio -- gosh, I have to get back to the statistics.

CHAIRMAN KNOX: I mean, what I'm trying to get at is that for a dollar of loss, it's 42% of expense on that claim alone. It has nothing to do with other claims where you successfully defend or for some reason or another you didn't pay.

MR. WHITE: To answer that I would have to get back to basic statistics.

CHAIRMAN KNOX: Okay, well let's not.

MR. WHITE: I would like to mention that this is a preliminary report of the close claim study that has already been mentioned by Mr. Holliday and only 7,700 records were analyzed, and we'll have in excess of 20,000 soon.

CHAIRMAN KNOX: Well, they predict the election of the President with a smaller sample than that. The other question I wanted to ask. You point out that 30¢, based on the study so far -- the preliminary report -- 30¢ of each dollar of loss that the employer was negligent to some degree. So that the so-called strict liability under the warranty standard, or whatever it is, is not responsible for at least 30¢ of the dollar of loss.

MR. WHITE: Well, remember the employer is not required to pay for these kinds of liabilities. He's excluded from this because the Worker's Compensation Act, etc.

CHAIRMAN KNOX: We're talking about product liability loss.

MR. WHITE: That's right. Where the employer himself in the estimation of the claim man....

CHAIRMAN KNOX: We're talking on Workers' Compensation now, as opposed to a consumer....

MR. WHITE: This is all products liability stuff. What we're trying to say here is that the employer of this injured employee, this injured employee brought suit against our manufacturer. The employer, in the estimation of the claim man, the man filling out the form, was also negligent. He might have been negligent by failure to maintain the machinery if the machinery was involved or overcoming safety devices or whatever.

CHAIRMAN KNOX: Okay, anything further. Yes. Mr. Hiestand.

MR. HIESTAND: I just have a couple of questions. One is on "C", the next item which Mr. Knox is referring to. This would mean, I gather, just from simple logic that based on your experience a statute of limitations for products liability that barred claims beyond six years would eliminate 45% of the total products liability claims for the companies that you have insured.

MR. WHITE: This is not just us, but that is the early indication. The preliminary indications from this close claim study, yes.

MR. HIESTAND: You mention in your prepared testimony that you feel that insurance acts as a check and balance on shoddy products, but part of that is just because of the cost in the marketplace. And that cost that is becoming high is also in response to the tort liability system which you then comment you feel has become more of a check than a balance. So my question

is what do you feel ought to be done to change the tort liability system so that it becomes more of a balance than a check?

MR. WHITE: Balance as between the two parties, right, the plaintiff and the defendant? There are two major alliances. You have heard from Mutual Alliance. There is also the American Insurance Association to which we belong, and we have a list of proposals for your consideration which we feel will return the rights as between the parties to a more balanced basis and I think I will defer to Professor Epstein, who is coming up next.

CHAIRMAN KNOX: Okay.

MR. WHITE: May I just make a couple of comments. On Exhibit 2, I believe one of you gentlemen previously commented about lack of judgment in the judgment areas on the part of the insurance industry and that is true. As you can see on that second row of figures, the "A" rated classifications in the loss ratios relating even up to policy year of 1974 where 125.9% loss ratio was noted. I think the rest of the exhibits are pretty much self-explanatory.

CHAIRMAN KNOX: Thank you very much. I appreciate your attendance in taking time to prepare this information for us. Mr. Richard Epstein, Professor of Law, University of Chicago, and representing the American Insurance Association. Professor, do you have a prepared statement this morning?

PROFESSOR RICHARD EPSTEIN: (See Appendix VII) Well, I have a prepared statement which is now being typed up which will be available to you later. It turns out that I would rather not discuss most of the material in the prepared statement. It seems to me that the gist of the questions that have been raised by the

Committee have turned on specific proposals for recommendation. Much of what that statement was designed to do was to recount the chronicles. Much of the shifts in products liability law above and beyond the commonplace one of negligence in strict liability, it seems to be that it is reasonably self-sufficient, and I would rather devote myself to some of the issues that came up here and to direct attention in particular to some of the problems of a substantive nature that have been raised. I think one of the best ways perhaps that one could begin this is to begin with the statement which was read before and which it was noted that there is always going to be a trade-off; that is, there seems to be very little way in which somebody can find the situation or scheme which will on the one hand relieve manufacturers of some of the burdens which seem to be imposed upon them by the current situation in products liability without cutting down by some degree of measure of plaintiff's recovery. The dilemma is not perhaps as difficult as it sounds because it may well be possible to reshape some of the substantive rules in a manner which will reduce the very high administrative costs which are now associated with the operation of the system. I think, for the most part, if one could find a way, as it were, to eliminate the friction which takes place in many of these products liability transactions without reducing recovery, things would be best. Unfortunately, it seems to me that that is going to be fairly difficult to do unless you are prepared in the course of this Committee to take a comprehensive reevaluation of the entire system of civil procedure and related instances which are current in this state and indeed in many others. So what I thought I

might want to do is, as it were, make the case for our statute of limitations in a way which is somewhat different perhaps than that which is presented in our booklet, although I think, in effect, it supplements what's done. Maybe in order to make the thing a bit more concrete, what I'll do is I will go to my strength, which is talking about cases rather than to the strength of the previous witnesses, which is to talk about general underwriting practices and the like. As I was reading the advance sheet, I came across a case that was decided recently in California which I think is a very instructive vehicle by which you could talk about some of the problems which plague products liability cases and which indicate some of the problems and prices which you have when you deal with this kind of coverage. The case Price vs. Niagara Machine and Tool Company, and I have it here. It is 136 Cal Reporter 535. In one sense it is a perfectly routine products liability case. A fellow gets his fingers cut off by a machine in the course of its operation when there is some unexplained malfunction. The question is, what do you do? Twenty years ago it was quite clear what one did with a case like this. It clearly rose out of and in the course of employment and it was a Workmen's Compensation case and the only thing you had to decide was the extent of medicals and work disability that was caused by the particular accident. But the growth of third party actions, of course, to get the Workmen's Compensation benefits (and I think that's quite proper) and then you start to bring an action against some third party manufacturer, supplier, or distributor of the line. In this case what you did, you had a tool press which was manufactured in New York in 1940, which was sold to some other person

before it was sold to the employer of the injured worker. It turns out also that the press was originally equipped with certain kinds of guards which had been removed when the machine had been sold from one carrier to another. So in order to deal with this kind of case, what you had to do was to go through a whole variety of questions all of which were shrouded in uncertainty in order to get some kind of resolution of the questions, simple questions, as to whether or not the defective machine which was put on the market by this defendant was the cause of the injury of this particular plaintiff. The statement looks very simple when you state it like that. It doesn't look to be too much different from the question of whether or not Jones ran down Smith in an intersection, but the moment you start to look at the way in which these cases unpack themselves in trial, you begin to wonder how it was that you could even solve them at 42% of the total claims dollars because it seems to me that the cost should in reality be a great deal higher. The first thing one has to note about this case is that machine tools are generally made as multi-purpose items which are going to be customized by any individual employer or manufacturer after they are purchased by the product liability defendant. One of the problems that you have in the product liability area is that recent documents -- I guess the major California cases -- Balito v. The Improved Machinery Corporation -- something like that, decided in 1973. Before this case, the general rule was that you made a machine and the question of customization was strictly an employer's responsibility, not that of the original manufacturer. That being the case, in effect, if you made it in accordance with your own specifications, the fact that certain safeguards were not put on

the machine at the time it originally started which persisted until the time of defect. Now what happens? You have to decide whether or not the customization should be taken on by the original manufacturer or by somebody else, and that's a question upon which you could have endless kinds of debate because it turns out some customization may be possible at the general level. Some types of customization may not be. It may be possible to put on an all-purpose guard but the all-purpose guard may not be particularly good for any one purpose and it may well be that better substitutions will take place later on in the chain of distribution.

CHAIRMAN KNOX: Is the issue of foreseeability relevant, as far as the manufacturer is concerned?

DR. EPSTEIN: I think foreseeability is one of the great inheritants of the modern tort law. It seems to me that it dominates a great many of the discussions in ordinary negligence but it seems to me that it is an essentially unmanageable test. You can foresee that anything will be done with the product. Nothing is more foreseeable than that a safeguard would be removed by some employers who wish to increase the machinery's output and efficiency. What you really have to ask is not the question of whether or not the guard is forseeable. The issue before these cases is whether or not some party other than the original manufacturer has full control over the machinery and could make the decision one way or another in order to keep that guard on or to take it off. It seems to me if you start to look to full control as the tests in these kinds of cases, what you will be able to do is to insert the more sensible traditional common law view of causation back into the case and to say that it is possible even if there is an original defect to cure, or if there was an

original machine which was safely made, to convert into one that was defective by subsequent use. If you start to use the question of foreseeability, all you are going to do is to make each and every one of these cases jury determination and then you are just going to have no principle judgment because whereas the jury may come up with an answer, doesn't have to defend it, which is very convenient in a case like this for the very simple reason that there is no principle way that you could start to defend these judgments one way or another. It seems to me that if you want to get major institutional reforms, one of the important things you have to bear in mind is that rules have their place and anything which just constantly opens up a very broad range of factual inquiries to a jury without what it encompasses, to what to do or where to go, is going to increase uncertainty, if going to increase the difficulty of making estimations about underwriting, it is going to make it very unclear to people who not only manufacture machines but those who service them and use them as to what their responsibilities are. At this point, virtually, under the California law of products liability anything goes to the jury and it may do with it what it wants. There is nothing which has a kind hard edge, tough-minded quality about it. It seems to me that if you had a good rule which talked about cures and curing causes in products liability and machine tool cases, you would be a lot better off than with the current situation that we have today. For example, in the Price case which I just mentioned, the plantiff's attorney, having lost the case at trial and now trying to get either a retrial or directed verdict in his favor, argued that really you can't cure an original defect because what happens is

somebody else might install a guard on there but it may not be connected with screws which are quite as strong as those which the original manufacturer would have put on there, so therefore, it is a little bit easier to disconnect it, as though somehow or other it should make a difference whether it is going to take a screwdriver or a rachet wrench in order to get that guard off. It seems to me that kind of point, once you reach that level, you are really talking about the kinds of speculation which do not lend credit to the judical system and yet that's exactly where we are in the current situation in California.

CHAIRMAN KNOX: What was the holding in the case?

DR. EPSTEIN: The holding in the case -- it was nice -- there was no holding in the case. There were a series of objections raised by a plaintiff's attorney after the fees which were rejected by the Appellate Courts and one of the reasons why the case is so important is this is the kind of case which one can lament even though it turned out in the defendant's judgment which was affirmed on appeal because the important question was not to my mind institutional, it was not the outcome of the case. The important question was the proceedings that were used to reach that kind of decision. If you had a strong rule which said the state of the art governs the time in which this thing is put on the market, there is a directed verdict for the defendant, a summary judgment which would take you maybe a nickel per trial, literally, because no one would bring it. If you start to have these kinds of open-ended cases, open-ended indefinite rules, what you are talking about is 100 grand on either side, if the injury is large enough to warrant that kind....

CHAIRMAN KNOX: Well, obviously in this case, the defendant's motion for a non-suit failed at the trial and it went to the jury.

DR. EPSTEIN: It went to the jury. And the jury decided for the defendent. What they did, Mr. Knox, in a sense they reinvented the wheel. Every single major issue of substantive law came up in the course of that decision to be passed upon by the jury. I think you ought to examine the opinion because it's....

CHAIRMAN KNOX: I will.

DR. EPSTEIN: ...it's instructive of the way in which you had, in effect, not an accident case anymore but some sort of a litigated form of World War III in which people bring you truth and force from every conceivable point in order to interpret safety ordinances by the New York Department of Safety in 1931. And, in fact, what is so remarkable about this case is that they manage to talk about eight or nine issues of causation without ever telling you how the accident happened. Because as it turns out the products liability law has gotten itself so convoluted and so bizarred to death that you don't really care about the immediate elements. You only care about those things that are remote and distant in time, and never about those things that are immediate and proximate. It is a complete conversion of the general rules of causation that say you start from the accident and look for the nearest things first and the remotest things last, to exactly the opposite situation. We ignore plaintiff's conduct, we ignore employer's maintenance, we ignore rehabilitation/modifidation and repair, and we go after that poor guy, who 40 years ago shipped out a machine which was not only in accordance with specifications but

in accordance with the customs, standards, and practices of doing business at that time. There is no way that one can develop a system of incentive effects, you know, based upon your incentive effects that they create to undo acts that have long been done, and yet that is exactly what you get in this kind of a case.

CHAIRMAN KNOX: Now what do you suggest as a remedy?

DR. EPSTEIN: What do I suggest as a remedy? We do have our package, and, I think, that obviously I don't think that it is necessary to go down the 16 or 17 other factual issues that were raised by this case. Suffice it to say that each of them were shrouded in uncertainty, dripped in confusion, but what one needs, I think, are rules which will give you some sense of what counts as a safe harbor. It seems to me that it is absolutely important to have the type of situation that says that if you do it right at the time that you let that thing out on the market, come hell or high water, you are going to be safe from liability, even if somebody else is not; and it seems to me that that is what you want with the future, and also the past.

Now, in the discussions of underwriting, I think it is important to have to distinguish two issues, and I would like to make a point perhaps a bit more forcefully than was made before. When you price a machine tool, say your punch press, Mr. Hiestand, you don't only price the punch press that comes off the presses today, as it were, because then you do have to worry about modifications upon which they can hold you to account, but there is no rule that says it is just a safety. You also have to price the backlog of machinery that is already on the market. It turns out

that that is just a terrible problem because you don't know who owns the machine, you don't know the extent to which they have been maintained, you don't know, as it were the value of the laborer who happens to be using the machine, whether it happens to be low level labor or high level labor, or whatever. And you have to really do this on an individualized basis, and you can't do it, so when they look at this guy with a recent development of innovative machinery, they are going to charge him with all the sins past, present, and future with respect to things already out on the marketplace. And it seems to me that in order to handle that problem, both in the grading problem and in terms of the sheer equity in favor of the defendant, who did everything that was expected of him at the time that he did it, that you have to have some kind of statute of limitations based upon, and which guarantees you some sort of protection, based upon the use of the product out in the market. Now, the question then is, what is the size form that you could use, and here I think it is important to mention the alternatives, which I would reject, and which were endorsed by the Interagency Task Force in its report. They had two types of things: one said that we could start the use of useful life type of limitations, and say that for each particular product, you are going to start to assign some form of useful life and the moment the product is out on the marketplace before that useful life, it seems they say that liability or the defendant should be insulated from liability. There are several problems with that. One, you never know how to calculate the useful life for any machine that is constantly undergoing provisions

prepared for maintenance and improvement. If you take a building, for example, its useful life is perhaps 20 years without maintenance and 50 years with, and so when you start to try and figure out what it is, you are not going to be able to do it product line by product line. You're going to have to do it product by product. At that point, it seems to me that the entire system just collapses of its own weight as a generalized kind of defense, because there are too many individual discriminations that have to be made in order for it to be working. All you will do, in effect, if you make that into a statute, is to give another layer of common law, of statutory confusion above and beyond the common law confusion that we have.

Now, I don't wish to say that the useful lives are unimportant, but it seems to me that as a matter of case law, you can introduce that into cases and arguments, you know, in this great battle of negligence and strict liability and whatever, and do it with a fair bit of force and effect. I certainly would not want to introduce a statute which would foreclose the defense which in principle makes good sense. What I want to say is that it seems to me it is a singularly unpromising line for legislative reform. It seems to me that rather than to have to bite the bullet of how these cases ought to go, and try to do it in a manner which knocks out most of the bad cases on principle, which costs a great deal to bring and defend, which clutter up the courts, which take a great deal of resources away from all persons concerned, whether it be social resources, plaintiff's resources or defendant's resources; and the only way you could do that, I think, is by

straight time limitation, and then you build into that time limitation certain kinds of exceptions I will get to in a moment in order to try to preserve those rich loads of decent cases which ought to be brought or try to keep out the dross which ought to be kept out.

The second kind of proposal that one might consider, which I also think ought to be rejected, is one which is based upon contractual types of situations. It has been suggested in the Interagency Task Force study that we engage in a system that deals with an elaborate set of disclaimers, and what you do is that you start to make your products and put disclaimers on the product thing and use that thing for 10 years at your peril. Well, what is wrong with that? I don't think there is anything wrong with it in principle, so long as you could be sure that the network of communication is going to take place between worker who uses the machinery and the defendant who does not. The problem that you get with contractual solutions is two-fold. On the one hand, with respect to the products that are going to go into the marketplace in future years, it is clear that you are not sure that the communication is going to make itself known; the warnings may get rubbed off, they may get effaced, they may get removed, the product goes from hand-to-hand, the parties that use them may not read them, so it's a real question as to whether you get anything that even looks like the contract. And oddly enough, here the statutes of limitations is better, because by making it a public declared statement, this is what we want to do, everybody will be given notice of it, not because the manufacturer in the individual case will have to give notice, but because the law, as suitably publicized, will be put

into work places with notices of the effect, will make the communications take place much more easily because it will be done by better and independent sources.

The other problem that you get with the disclaimer type situation, or the second one, who is going to set the statute of limitations. If you have the manufacturer set it, there is always the question of whether or not there will be an advantage taken by third parties, not subject to the original agreements. I have less fear about that than most people because I basically believe that markets work even when it comes to safety if you know what the rules of the game are going to be. But if you don't share my kind of confidence, and I must say that most people don't, you are going to have to find somebody else who is going to set those warnings and the last thing I would want to do is have a committee of 500 sitting down on each of 10,000 products that come on the marketplace each day, saying you are eight years, you are ten years, you are nine and a half, or whatever. It seems to me that you get yourself in the worst kind of political morass imaginable if you try to make those individuated judgments.

The second problem that you have with the statute is it doesn't deal with the backlog of products that are already on the market. That is, I would guess the several millions of machines of one kind and description which are out there already, and to the extent that you start to talk about disclaimers, it seems to me that it would not work with products that are already in the marketplace. To take the contractual metaphor one step further, unilateral variations of previous contractual arrangements by one party are not binding on the other, and it seems to me that the

disclaiming causes that are instituted for products that are already on the market would amount to a unilateral disclaimer. So it seems to me, therefore, that you are driven back to the kind of standard statute of limitations that we have had, and the trick that you have to do with a statute of this sort is to say what you think the dominant principle ought to be and what you think ought to be the exceptions to it, and we have struggled at great lengths with the AIA to see if we could try and figure out those areas in which defenses are appropriate by way of statute and those areas in which they are not. And my own guess about the situation is that you wish to have pretty much a blanket statute with a single time period across the board. I am in favor of a fairly generous time period, the statute itself as granted says eight, I gather the Committee revision says ten and that is fine as far as I am concerned. Then what you have to do is figure out what it covers. I would like it to cover all liabilities regardless of the theory in which the case is brought. That is, it seems to me that if you were to say, for example, that only strict liability actions were barred, there would be a resurgence of negligence cases, because the truth of it is that the distinction between strict liability in negligence, which may have been perfectly clear in 14th Century road accident cases, is not at all clear when it comes to modern product liability cases. If you stop and look at the kinds of things that you are supposed to take into account in design defect cases under a strict liability theory, you find that it was the exact same list of things that you take into account under a negligence suit. The way in which you can combine them may be somewhat different, but, in fact, the difference is so

marginal that you will not have the kind of major systematic institutional effect that legislation ought to aspire to, ought to achieve, it seems to me. So it seems to me you ought to go across the line and then what you ought to do is to create a set of exceptions. Now, what are these exceptions to be based upon? Well, one of the exceptions that I think you are doing to want in a statute of this sort are exceptions based upon duties imposed upon a manufacturer after he has parted with possession and control of his product.

Now, it is quite clear under the modern institutional framework, many of these obligations today are imposed by statutes, and as far as the total loss is concerned, whatever you think about the merits of the statutes that impose them; these don't present any kind of a particular problem. But, for example, if you have a product that is going to be recalled because it was discovered to be dangerous 11 years after it was first put on the marketplace, and the manufacturer refuses to honor the statutory obligation to recall it, I should be appalled that he could hide behind the original 10 year statute based upon manufacturer production, when in fact the duty upon the manufacturer arose only after the statute of limitations. It seems to me you could have a very strong case, for cutting off some remedies, but not all remedies, because remember, you could still sue other defendants even with our statute of limitations, after the defendant has done with his product. But to have a statute of limitations which runs even before the defendant has committed his own wrong strikes me as being foolish, dangerous, perverse, or worse. Then the question is precisely, which duties

are you going to worry about; and here I must say, the Price case is giving me some concern, because there is a suggestion there that if juries are allowed to say that a manufacturer, once he is allowed to put a machine on the market, is constantly under a continuous duty to update, modernize, and to warrant subsequent uses of the machines as to what's to come, and it seems to me as a substantive matter, if you have no standards for that, it is an open-ended source of confusion and despair. I, for one, would like to see that statute of limitations coupled with a substantive provision which gives you some clear guidelines as to precisely what the source of these substantive duties are going to be. For the most part, I would want to limit it, I think, to cases where the statutory and administrative control and maybe couple that with other provisions that it may be a duty to inform those people whom you know, in the event that there are reports back to you about the imminently dangerous characteristics and qualities in the machine. We try to deal with that to some extent in our duty to warn statute. We don't put it forward as, shall we way, a monument to perfection. It is an exceptionally hard area to go by. It may well be that you have to do it product by product. Drugs require one set of rules, automobiles another, machine tools another. I am not really that sure about it, but it seems to me that if you have a statute of limitations with the subsequent duties, and then you say that every time you don't correct that original defect you are in breach of your subsequent duty, what you have done is created a statute of limitations which requires the plaintiff to replea an original cause of action. That is not our intention in connection with the statute of limitations package, and if the statute is construed

that way, you can see why the commendable conservatorism of underwriters, which, I think, you have heard mentioned already before, will indeed be justified.

The second of the kinds of exceptions, I think, that one would want and that I have been able to identify is one which would concern reconditioned, refurbished and modernized products. Here, when you are dealing with a product originally put on the market by "A", 15 years later as we have done by "B", it seems to me that "B" to the extent that he is responsible for any wrong or for the condition of the product, and I would make his responsibility for that product total if he is going to put it out as a reconditioned product, ought not to be able to get the benefit of the statute of limitations which runs for "A". Again, we get into a very awful situation where the statute would run, not only before the occurrence of the injury, which is a difficult one, one concedes that freely, but also would run before the occurrence of the wrongful act.

The third of the exceptions that I think one could start to make is one that deals with the question of fraud. Now, there is a real problem as to how you describe fraud, willful at one time, gross misconduct on the part of the defendant. One doesn't want the jury to say that every conscious design choice was an open invitation for a jury to find that it was a fraudulent disclosure or concealment simply because they didn't put an additional guard on it. You want the sense to be that the defendant knew about the risk, thought that he would be able to escape liability by playing it fancy, and even though he thought the improvement was warranted, for some reason or another decided not to use it. So it seems to me you could isolate that class of cases that involves willful and wanton

misconduct of the sort for example which, in my judgment, would support a case of punitive damages against the product manufacturer. It seems to me then that no matter what the time, you would not want the statute of limitations to protect them. The only argument that you could make against that exception, which shows you the difficulties of the Committee that you have to face, is whether you can police it. If you can police it, I would like to see it in there. If it turns out to become a royal road for the evisceration of the statute of limitations, I would prefer that it be kept out.

CHAIRMAN KNOX: Well, you know, the problem that I see with the -- I mean I can readily understand the flat statute, and I think that is something we are really going to have to tussle with, because there is no effective statute at all now, as best I can tell.

DR. EPSTEIN: You know, Mr. Knox, I must admit....

CHAIRMAN KNOX: I mean I am assuming that we're looking from the standpoint of trying to reduce premiums. Now, maybe we are going to decide that we can't reduce premiums this way.

DR. EPSTEIN: You know, I don't think that anyone can come up here and say that the only thing we have to do is reduce premiums. It seems to me we have to....

CHAIRMAN KNOX: No, of course not.

DR. EPSTEIN: To reduce the premiums by eliminating those cases which are least meritorious, by getting rid of that portion which of course is the most unwarranted. If it turns out that even after these statute premiums remain what they are and you are happy with the substance of rules of liability that you have, and the answer is so be it, I mean, you know....

CHAIRMAN KNOX: I agree with you.

DR. EPSTEIN: It seems to me that that is it, but the hard question is, I would like to argue the mild view about it that when you put statutes forward, I think the first thing you have to do is assume that it is going to be a fair degree of judicial integrity in the way in which they respond. I mean, I know and I have seen cases, indeed, the recent statute of limitations in medical malpractice is one I recall, shall receive the tour de force interpretation in wrongful death cases by the California Supreme Court. And so, there is always the question that they will be, as it were, more plaintiff-oriented than the Legislature would be. But I think at least at the first approximation since you do reserve the right to amend it, I hope and pray that there are no constitutional issues which work in this kind of a case.

CHAIRMAN KNOX: Well, they always work, you can't avoid them.

DR. EPSTEIN: But I mean that they would not dominate. I would hope that after Schwall v. Jones, that the California Supreme Court would recognize the utter error and futility of its ways in the guest statute case. I mean the guest statute may or may not be a good thing, but to say it is a constitutional issue is to my mind utterly misguided. You might as well say that the statute of frauds raises constitutional questions.

CHAIRMAN KNOX: Well, you can always with a due process clause, it just depends on whether your life, liberty and property is being taken away in the courts.

DR. EPSTEIN: Well, you know, I mean if you say that of course every change in tort liability whether by the courts or by

the Legislature will make it a constitutional issue. If you expand liability, presumably somebody could come in today or tomorrow and say, "Aha, what you have done is deprive defendant of his life, liberty and property." If you have contracted, you have the same issue the other way around. I don't believe the Due Process Clause, the Equal Protection Clause, or the Eminent Domain Clause was ever designed to have such a bizarre result, which is to say that any shift in the substance of liability within the state, however minute, was to call upon a constitutional crisis. It seems to me that if you have statutes of limitations which go from two years to one year, that is a constitutional issue under this interpretation. Now, I think that one has to recognize, at least under the current trend that with respect to economic matters not regarding fundamental rights, race and the like, for example, the recent view in California in Schwall v. Jones is the correct one, which is, if you give them a fair degree of legislative deference, and so long as they are trying to respond socially identified and perceived problems, we are not going to rub too hard on the due process issue. I would hope that that view would prevail, and I think when you are writing legislative history you ought to address the constitutional matter so as to indicate that you consider them, it may even help. I mean you have to write as it were a brief for your own legislation.

CHAIRMAN KNOX: Well, no, just to get back to my question for a second though, is it, from the standpoint of clarifying the law in the public interests, is it better to have a flat statute or is it better to have a flat statute plus the exceptions you propose?

DR. EPSTEIN: I am in favor of the exceptions because

I think they can be managed. The only one that gives me real concern, well, the first and the third give me some concern, but I think, in fact, you can draft the third one so as to say, "provided that it is understood that there is no continuing duty on the part of the manufacturer to upgrade his product after he has parted with possession and control." Or you could simply, and alternatively, you could simply say that the subsequent duty exception is limited to those cases in which the obligation is imposed upon the defendant by regulation of public rule, and if you didn't like that, you would get the recall cases and the drug cases and you would leave out cases like Price, where somebody argues that 35 years after they put a product on the market, you want to go into the factory that owns the machine and tack on the guard. It seems to me then that maybe the answer is we change the exception somewhat from the way in which they are situated and are built, but you keep the principle and the exceptions.

I would like to try to get some equity out of this, and I recognize it's a trade-off, and I think that your original statement was very prescient on that point, correct. And then the question is, where do you draw, and I sweated enough since we first worked on this thing six months ago that the open-ended subsequent duty issue is one that you just cannot let lie. I am also persuaded that you really want to define the fraudulent exception fairly narrowly. Now, if I were to do it over again, I would tie that exception in our statute of limitations, more closely to the punitive damage statutes so as to indicate that we are really talking about the extraordinary case and not the usual

one, and the reputable manufacturers have nothing to fear from that.

CHAIRMAN KNOX: Well, you sort of have common law fraud, a false statement, reliance on the falsity and damage therefrom, but then a vicarious involvement because the reliance is not necessarily going to be by the individual injured.

DR. EPSTEIN: That is right, but I think you are going to have to satisfy it, and, I mean, the bystander cases, I have no desire to see that rule overshifted. That is not the source of the insurance thing. Casual conversation in the halls, this is where all my empiricism comes from, indicates that's less than 2 percent of the premium. If you think about the impacted area, rare is the bystander injured by the fall off the ladder; rare does the bystander sort of throw his hand into the machine tool. The only case that you have to worry about bystander liability really is, I think, auto cases. I don't know why, and there the statute of limitations won't touch it, because most automobiles on the road are under 10 years of age, so it seems to me that if you want to get to the bystander problem in some of these cases, you are going to have to work your way through the state of the art.

CHAIRMAN KNOX: No, but you have the third party claiming workers' comp. case. It is like the Price case.

DR. EPSTEIN: Yes.

CHAIRMAN KNOX: I mean, is the worker relying on the false statement? I don't think so.

DR. EPSTEIN: No, I mean....

CHAIRMAN KNOX: He is just doing what he is told.

DR. EPSTEIN: The argument that is really here is not that the plaintiff's cause of action is based on a misrepresentation theory, rather plaintiff's theory -- well, rather the plaintiff's theory is argued that not only is there a defect in the design of construction, but which is one that is known and asserted to by the defendant by the time they put it on the market, and so it is basically a willful and wanton version of the strict products liability, what would otherwise be a strict products liability.

The other point, too, is that there is also a weak misrepresentation claim that can be made, and I think Traynor was quite right, Judge Traynor, when he said that, implicitly, in the famous Greenman case, implicit in the presence of the machine on the market, is the representation that it will do the jobs for which it was intended. I think basically what happens is that you have this whole web of social interactions between individuals in which I put something there, a chair, and you know you are supposed to sit upon it, but not to put an army of 15 on it, and that the chair represents weight of the normal individual, and to some extent, it seems to me that you could say that the machine itself contains the representation and eliminates the vicarious representation argument that you are going to do. But if you define it narrowly enough with respect to the mental state, I think you could live with that kind of a statute, but again, you have to make your own assessment as to how you think the courts are going to respond to the situation. As to the basic statute, I think it is really a very principled one. It gets you out of all of these terrible confusions that you get in cases like Price, it doesn't deprive

the plaintiff of all remedy because in every products case somebody other than the manufacturer has control of the use of that product in the interim and those parties will not be protected by the 10 year statute of limitation. There will be problems with the Workmen's Compensation situation, but it seems to me that you have to answer this question flat out. If Workmen's Compensation is inadequate, then maybe you have to reexamine benefit structures and coverage, but I regard that as essentially beyond the scope of this Committee at this time.

CHAIRMAN KNOX: I have two questions on scope: one is, how would the AIA feel if we put in a tough statute that we also, at the same time, would concommitently put in a stronger regulation of insurance rates?

DR.EPSTEIN: Well, it seems to me, I would be appalled in some sense, because I think the only reason California has managed to survive the insurance prices here is that basically it has more competition in the marketplace. If you have these vast changes in exposure and risks equally, the resurgence of liability and a regulatory process, what you would simply do would be to dry up the amount of capital which would go in there, and everybody knows that the amount of business that you could write is a function of the amount of reserves that you could keep otherwise, that the best way that you could handle the insurance thing is to leave it open to market mechanism. This state has been....

CHAIRMAN KNOX: We have just witnessed the damndest market mechanism situation I have ever seen in my life. We were told, probably by the insurance people, that they were going to, now, this year, come up with a study of 20,000 cases. They are

going to share all of this information and they are going to provide the rates based upon the largest common denominator. Now, if that isn't a combination of restraint of trade, I have never seen it.

DR. EPSTEIN: No, again you have to be careful. The pooling of information....

CHAIRMAN KNOX: The pooling of underwriting information. They set the rates based on experience. They are going to pool all their experience and set the largest posssible rate. Isn't that what they said?

DR. EPSTEIN: They said that the information will be made available to each individual firm so that each firm can take it into account when it comes to the setting of the rate, What is going to happen, it seems quite clear to me that the minimal rates, either based upon the number of products put upon the market, the number of tires, the number of fillings of carbonated beverages or the percentage of sales, are going to decline in importance, as it turns out the risk becomes so large that individualized safety features are going to have to be taken into account. There is nothing about the ISO study that says that since all of you got the same study, that all of you are going to sit down in the same room and start to peg your rates together. I take it that it is prohibited by the anti-trust laws with respect to setting rates in the marketplace. The rates are going to be higher, it seems to me, than they were in 1950, 1960, 1965, no matter what this committee does. That is, it is very hard to go into an area as richly textured as the common law area, and sort of say, "friends, the clock says 1952 is the law, and we have a one cent statute, the products liability

law of 1952 shall govern in this state", and sure enough, they would say implicit in the earlier law is the later law, we would be right back to where we started from before.

CHAIRMAN KNOX: Let me ask you this question. We are tussling, and this committee is charged by the resolution creating this committee, to look at products liability. Are we really going to do anything for California business and/or California victims by comprehensive statute change in California alone or would we be better off to simply help draft federal legislation and strongly endorse it?

DR. EPSTEIN: I mean, again, I must say I regard that as one of the very hardest questions that you could possibly ask, and one to which you could go both ways. My instinct is that I would rather see it done at the state level first than at the federal level because it seems to me that the moment it goes to the federal level, you have no control over what is going to take place.

CHAIRMAN KNOX: There's a bill in the hopper back there....

DR. EPSTEIN: I know. It's not a very good one. There are many of them in the hoppers back there. It seems to me that you are dealing with common law substantive issues where all the expertise is located on the state level. Very little of them at this point are located on the federal type level. It seems to me, too, that the arguments that you can make in favor of some reform in the products liability measures are not only based upon cost to manufacture but also because recoveries are given in cases where in principle it ought to be denied. The constant refrain in California

is the plaintiff can do no wrong no matter what it is he has done is to me a great disservice, a great offense to principles of corrective justice, the principles of common law. The constant confrontation of defenses is something that one has to take into account, how they all become matters for the jury and then with heavy instructions that the presumption is strongly against them in each and every case in which they apply. It seems to me that you could do a great deal here for the manufacturing community. California is a very large part of this business. This is not South Dakota when it comes to either the buying of manufacturers or the buying of cases, and it seems to me, also, that legislation in California would be important in another respect. That is, if you get it through in a state like California, places that might otherwise say, why should we worry, we look to California as an example. And the courts here have been the most "progressive" (I use the word in quotes), and the Legislature's response to it, I think, would be a strong argument to getting statutes, either this statute or others like it through, and you would help the situation to a very large extent. If it failed at the state level, one might move to the federal level. But there, I don't know what the political forces are going to be applied, and I don't know what kind of a product is going to come out of the hopper. So it seems to me that the best thing that you could do is sort of face up to the local responsibility, and then if it turns out that federal legislation is needed, take that as a second bow to your arrow, arrow to your bow.

CHAIRMAN KNOX: I suppose, too, if it were -- I suppose if we are looking at the underwriters mending their ways, lowering the rates, for example, that it would take longer to validate federal legislation than it would state legislation.

DR. EPSTEIN: I think one of the nice things about the statute of limitations, you cannot make any representations that premium levels will go down, because there are still a lot of other things that remain in the hopper after it goes through, but you could say that the tendency of the legislation is going to be unambiguous. It will remove a very large number of products as potential sources of liability and allow the commerce to continue at its ordinary rate. I mean, one of the real inequities about a statute like this is you get a company that makes bad products in 1930, and it is out of business by 1940, you have a perfect cause of action but no defendent. The only people who are left are those who are good, and they survive in the marketplace, and what they are told is that they now are placed with an unanticipated tax on their revenue, which probably equals the entire net worth of the company that they represent. And, you know, the insurance companies, I think, are designed to provide a service at a profit, and the manufacturers feel the same way. They work perfectly well in market situations when you have sensible liability rules, but when you start to throw this huge, huge set of costs upon people, the market will take time to react, and it will not react in ways which people find happy. I mean they are basically, if you want to put it in crude terms, the products liability reforms or changes through the courts, I would say in California about '66 is when the trouble started to begin in this state until about the 70's, have

resulted in a wealth shift of billions of dollars and nobody responds very happily to that. Those who lose it feel grieved and those who get it grow, and they insist that their rights are going to be protected and nobody is going to take it away from them. What you have to do is to make a judgment as to how much of those gains are deserved and how much of them are ill-begotten. I don't envy you. It seems to me that the task is a very hard one but what I will state, what I will reemphasize, I am quite happy to advocate most of these reforms are products liability without the empirical data as to what the extent of the dislocations are because it seems to me as a matter of sheer substance, looking only to the equities of the individual cases, something has got to be done. Why the Niagara Machine and Tool Company should be hauled through the mud in a case like Price is simply beyond my comprehension.

CHAIRMAN KNOX: I appreciate the philosophical implications of what you are saying but as a practical politician, it is very difficult to change the law unless you are responding to a crisis.

DR. EPSTEIN: I understand.

CHAIRMAN KNOX: You know if you get up before a committee and say that it is right and just that we do this, frankly, unfortunately, it doesn't get very far.

DR. EPSTEIN: I want to put it this way. It seems to me that there is -- let me make the following kinds of arguments; I did not say that rightness and justice is the only reason why you make change. It seems to me that once the pressure comes on, and it is here, and it ought to be here, then what you try to do is do the best that you can. I mean you are all politicians, but there

is always a little bit of you I hope which is a statesman, and to the extent that we find both components....

CHAIRMAN KNOX: No, a statesman is a dead politician.

DR. EPSTEIN: Dead politician. Well, maybe we can resurrect him from the grave, I would say, but to put it this way, Mr. Knox, you can have a crisis and what you could do is make such a mess out of it by way of legislation that you will have two crises and it seems to me....

CHAIRMAN KNOX: That often happens.

DR. EPSTEIN: ...that also happens. What you've got to do is pick your spot and to go in there and get a very strong sense of the way in which things work. And it seems to me, you know, I could talk about the underwriting practices, I know something about the economics of the situation, but if you just look at the cases, what you will find out about it is that the simple proposition is that everybody is responsible for me but me, and so no matter what happens to you there is always going to be somebody else whom you could try to hook with a liability thing and the expansion of liability basically doesn't treat that as its fundamental publicly stated proposition. But when you get down to it, that's what is at work in all of these cases; that is, you will just find some little thread, however tenuous, upon which you can then hold some manufacturer and disregard the plaintiff's conduct in its entirety. It may well be, and I would say if I thought that I could draft a good statute on product modification, state of the art, contributory negligence, by which I mean a statute which was not only just but one which prohibited deviation

in the courts, I would not want the statute of limitations. But it seems to me that you've got such a climate of opinion in the Legislature, such a deference to the jury. We can't figure out what we will do. We will let them decide, because they don't have to publicize their reasons. You have to go to some broader gauged statutes than we otherwise have. And, in fact, one of the things that we did with the AIA package, we did it both ways. We had the broad gauged statute on the statute of limitations, we have a very complicated statute on duty to warn which is an effort to track out the elements of the cause of action, we have one on product modification which handles some of the problems but not all of the problems, and I could give you a string of hypotheticals that our statutes do not cover. The reason it doesn't cover is because we don't want the Encyclopedia Brittanica in the form of a product modification statute. You try and get 80% of it, and if we got the four or five other statutes through and they were respected, that would be fine. I think it would take a lot of pressure off the statute of limitations if they were construed in the manner which I would hope. But the equity of the statute always permits the courts to imply an exception. I would rather than have to fight the statute of limitations when it came from exceptions than to have to deal with the other statutes, because I could draft -- invent exceptions to them, some of them which would be desirable, some of them not. What is happening today is essentially the inquiry which we have before the court is utterly standardless. When you talk about asking whether a product is duty safe, that's not an answer. That's a question and nobody seems to be able to find any way to

get to that question and what you have now is a sense of the collective incremental judgment in the courts which has swung so far over in the wrong direction that no product is safe. If that machine principle won't do it, nothing will do it. There were 19 possible defenses in that case and yet you could still get a plaintiff's verdict over all of them.

CHAIRMAN KNOX: I have come to the conclusion -- we were always taught in law school that for every wrong there is to be a remedy. Now, we are learning that for every injury there has to be a remedy.

DR. EPSTEIN: We need a remedy. That's right.

CHAIRMAN KNOX: And that's the problem.

DR. EPSTEIN: That's a problem.

CHAIRMAN KNOX: Yes.

DR. EPSTEIN: And I mean -- I have always believed in the tort system. I have always believed in strict liability for construction, defense, protection for bystanders. Somehow or other somewhere between 1969 -- '66 to '69, the California courts have gone off the rail. I have some hopes lately in the last three or four opinions I have read coming out of the intermediate court have been decisions which have upheld the defendant's contention upon appeal, but these haven't set the thing back. They are rather like Price which is to say, we are not going to go three steps further. We are going to allow this thing to be a jury question instead of having directed verdict for plaintiff as a matter of law on facts as skimpy as the ones that were presented in the Price case.

CHAIRMAN KNOX: Any questions?

SENATOR BOB BEVERLY: If this witness gets into court very often, there must be a whole army of court reporters....

DR. EPSTEIN: I've never been to court in my life. I may have had some expertise but I would never hire me to try a case.

CHAIRMAN KNOX: All right, Mr. Hiestand.

MR. HIESTAND: Could you illustrate, using the statute of limitations how something like the cancer-causing drug DES or any sort of drug that years after it's released on the market is found to cause injury to people where it would fit in here -- how it would be covered by the exception or not?

DR. EPSTEIN: I gather you did not have, the committee thought an exception would be appropriate for carcinogenic drugs in the previous meetings. Let me tell you about the University of Chicago DES case. Maybe we could help change your mind. Now, the University of Chicago ran in a case, ran a study on DES in an effort to determine whether or not the drug was good at preventing miscarriages during the course of pregnancy. It turned out there was a woman at the Harlan Medical School who took care of diabetic patients and used DES at a very high success rate. The people thought that it was the drug that did it. It turned out that what did it was that this gal was so terrific when it came to handling pregnant mothers that she could have used no drug and gotten better results than anybody else with the best technology on the face of the earth. So they had a thousand people in two pools, the one pool got the drug and the other got a placebo, done in 1953,'54, somewhere around there, but they had no written consent form. They don't even have a record as to which people got the drug

and which people got a placebo check. Now, 20 years later, there is some evidence that DES may cause vaginal cancer. There is also a lot of evidence which says that the incidents are a lot lower than the people previously thought that they might have been. There is a great debate as to the probability, and it turns out that there is a probability of getting that condition from other causes so that each and every case is going to have to sort out the following issues: Was it the DES which did it or was it something else?

MR. HIESTAND: I don't want to get sidetracked, Dr. Epstein, if you had a clear case of a drug that 10 years, well 12 years, you have a 10-year statute of limitations, 12 years later it is found that this drug was clearly carcinogenic.

DR. EPSTEIN: I don't think you will ever have that case, never have it, and the reason I don't think you will have that case is because the ones that are being pushed forward today are the strongest and that's the DES cases. By the time you get through with it, which defendant, did the drug do it, were the warnings given, if they were given, were they adequate, if they weren't given, was any additional benefit which the plaintiff received more than sufficient to offset the condition? Here is a University that is going to have to spend hundreds upon hundreds of dollars to defend this case and I want you to know what the case is. The case is not for damage caused by the carcinogenic drugs. It is the upset and mental anguish which mothers have when the possibility that their daughters may yet get the cancer at some future unspecified day and it seems to me that that kind of a case is not my idea of one. I think, to be quite blunt about it, that when

you are dealing with new drugs, that if you want a risk distribution mechanism, the last thing you want to do is to force all of those costs back on the defendant, because the cost is not going to be random if there's a disaster. You will break every insurance company and every drug company by doing that. You'd rather this would be handled by first party mechanisms, and the second point is that it seems to me that when you have a system in which you have such exhaustive regulations, ex antum, designed to prevent these drugs from being released on the market by all kinds of tests, that what you should do is rely upon those regulatory mechanisms to handle these problems rather than try to turn your attention to the tort mechanism in order to deal with it. So that for my own money, is that if you start to deal with the tort remedy in these cases, it is just another perfect instance of trying to handle a situation where the issues you get involved in the case is simply beyond the capacity of any judicial body to handle in any kind of an intelligent way, and therefore, -- I'm sorry about these cases. I mean everyone finds them tragic, but it seems to me that the cost is too great. And I might add that there is another cost involved in this. Let's suppose we change this rule and say to every drug company, "Even if you follow every single precaution that is required of you by statute or by the state of the art which is ever hard and even though you tell the other fellow who takes it, you assume the risk either for yourself or for your heirs or descendants, as the case may be, that you are going to have this kind of liability, you have to then ask yourself, what's going to be the effect of this upon the

introduction of new drugs into the market. It seems to me today that the major problem that we have in the drug area is that the FDA and its assessment of errors simply takes the error of bad drugs into account but does not take into account the error of keeping good drugs off the market. Saccharine is a bizarre and extreme illustration of this inability to take into account two types of error within the regulatory process. We can't cure that, but it seems to me that, if in fact all the regulatory biases are in favor of protection to an unwarranted extent by it, to then throw on to that a kind of a tort liability with respect to future drugs will inhibit the development of drugs more effectively than the FDA could do it. One of the costs that you have to mention and measure is not only the costs of injured people who don't recover because of our statute of limitations or our state of the art legislation, you also have to take into account the people who will never be able to bring this suit against anybody by virtue of the fact that they were injured when some drug which was manufactured and in wide use elsewhere, might have been able to alleviate that condition under which they have suffered. This is not the place to go into harangue against the FDA and its drug kinds of policy but I do think that it is appropriate to mention that given those legislative biases that this might be the one thing that in the end will do more harm to the very public that you are trying to protect than the statute of limitations cum state of the art defense. I heard about from Jerry Wilson the exception drafted into the statute for carcinogenic drugs and I was somewhat distressed to hear it because it seems to me that if I were to try

to illustrate our statute of limitations with Case #2, I would have gone through the DES cases either in Detroit or against the University of Chicago and Ely Lilly as the perfect instance of a basic and traditional tort cases which usually involve, you know, 20 years ago a collision which lasted 15 seconds is now taken into something which is a worldwide search for truth about the state of the art 25 years ago. You cannot handle that through the judicial process. A jury may come up with a decision but the only reason it does so is because it knows darn well it doesn't have to defend it publicly but I think we have....

MR. HIESTAND: You indicated that if you had to do your statute of limitations over again, you would be making some changes, particularly in the exceptions area. Are you in the process of doing it over again or is your work with this statute essentially... .

DR. EPSTEIN: The work is never over. We will probably come back. As a matter of fact, I wrote one paper here because I wasn't quite sure how the committee would evolve and when I came to Los Angeles, I wrote another one. This paper which I have given you is, at this point, here it is, and I probably should write this thing up too and when and if I do, I and the AIA committee will start to put in some of the rework language for the statute of limitations. I am also quite happy to say if you want this, ask me outside the committee, precisely how would we reword this. I would be more than happy....

CHAIRMAN KNOX: We will undoubtedly be in touch with you. Anything further? Go ahead, Mr. McAlister.

ASSEMBLYMAN ALISTER MCALISTER: In Workmen's Compensation

law, there is a body of law known as cumulative trauma, where the workers are recovering for, for instance, cancer caused by exposure to asbestos and recovery 30, 40, 50 years after the initial exposure. Are there tort suits?

DR. EPSTEIN: Yes. Let me give you -- there is one tort suit which is not being brought. I think it is in New Jersey which has the following parameters which would indicate how bad the enterprise has gone. Every worker in an individual factory from 1925 to the present, say several thousand people, who were a lot, have brought actions in third parties against, and I think, every supplier of varnishes, paints, solvents, anything which vaporizes, and they have claimed that collectively they have caused accumulative trauma which they have suffered. What happens is the original action was brought by the thousand name plaintiffs against 250 named defendants. After that they went through the books and found other component manufacturers of supplies of all of this stuff and they joined them and it turns out that we now have literally squads of lawyers working not to decide the merits of the cases, all of which are individual and different, but just to coordinate the defense efforts between the parties. And it strikes me that those cumulative trauma cases are essentially unworkable within the Workmen's Compensation bracket, at least arguably in many situations, or have but limited viability within that context. In a third party tort action situation wherein fact, you have to figure out what each defendant did and what each defendant did not do, it simply is a case where in order to shift hundreds, thousands, ten thousands dollars worth -- many of these injuries are

very small -- of losses, you are going to have to invoke an injury which is five or six times as large and those cases are very new. That is, if I were to say one of the things you have to add, you really have to give another look to permissive joinder not only class action because cases like that which allow you to join 60 defendants and 50 plaintiffs, 300 possible actions and trials within the ordinary framework simply means that the administrative fees are vastly larger than any possible recovery which might be granted and I think that that is something which really has to be very high in your agenda because if they are in New Jersey, it won't be long before they are in California if they are not already.

CHAIRMAN KNOX: Thank you very much. I appreciate your attendance today. It is always very stimulating. Our last witness in the morning session will be Mr. Wylie Aitken of the California Trial Lawyers Association. While he is coming up, I would like to introduce another member of the Committee. Bruce Nestande, Assemblyman from Orange County. Mr. Aitken. You know the applause was for Professor Epstein, not for Nestande.

MR. WYLIE A. AITKEN: (See Appendix VIII) I have a written presentation with the....

SENATOR BEVERLY: Mr. Chairman, I saw Wylie on television this morning. He invited the entire San Diego area to attend the hearing. I don't know how they responded. A good job, by the way.

MR. AITKEN: Thank you. Having heard the first three speakers, I feel a little bit like the Appellate Justice in one of the more famous appellate cases where he indicated in his dissent

from the opinion, he had one sentence in the dissent that I dissent for the reasons stated by the majority. I think, in part, that's what we've seen here this morning. I would like to make a few observations. I am pleased, for instance, to hear that Firemen's Fund is willing to admit that shoddy products may in some way be contributing to the so-called products liability crisis. Now, if we would only get Firemen's Fund to go along with Truth in Advertising and add that fact to their full page ad in Time Magazine, we would all be a lot better off. I think it is also interesting to note that they have made it quite clear, I think, through Professor Epstein's testimony and the testimony we have heard here this morning regarding the Mutual Alliance and the AIA plans and proposals, that they have obviously made California a target state for what they believe are proposals that will lead to tort reform. I have yet to see any proposal come out of the liability insurance industry that was labeled under tort reform that did not mean some limitation of the rights of injured people and basically, our Association, of course is concerned. I suppose that we have been described by Professor Epstein as representing those people who are now supposedly the haves who are now trying to hold on to what they have. I think there are some myths that are present within the analysis of the products liability field that should be discussed. First of all, I think it is quite clear to anyone who has ever practiced law in this field that these are not cases that you file and suddenly somebody hands you a check or some type of recovery to your client. These are difficult cases. The doctrine of strict liability is not a doctrine of absolute

liability. There are still many difficult evidentiary issues and the case that Professor Epstein cited to you, the appellate case, to me restores my faith in the system that I already had, and I believe that these cases should be left with the courts. Obviously, the jury made a correct decision in that case and obviously the appellate decision was correct also, so I think that rather than speak against the system, I think the illustration really supports the system as it now presently exists. When the so-called products liability crisis first came upon us, we were told, of course, that there was some type of tort explosion going on within this country that somehow was increasing and causing the high insurance rates. Basically, the tort explosion was and always has been a myth. An opportunity on the way down here to review the latest Judicial Council statistics which tell us that 4.3% in the prior year was the percentage of civil filings that had to do with personal injury cases, other than automatic cases. That 4.3% represented all of your medical malpractice cases, all of your products cases, all of your premises cases and all of your government tort liability cases. Under the latest Judicial Council statistics, that 4.3% of all civil filings has not dropped to 4.1% of all civil filings, or in the area of products liability medical malpractice, etc. Hardly a crisis, hardly any indication that there is a so-called tort explosion within this state or any other state. Also, I think that it is interesting to note that their own publications raise serious questions as to why we allegedly have a crisis within products liability. Basically, the Business Insurance Journal, their own

publication, carried a story where it indicated that a very large broker was of the opinion that the insurance was being withheld from certain companies and certain small manufacturers merely to create a crisis and merely as an attempt to stampede legislators into so-called tort reform which again, always gets down to limitation of liability and taking away the rights of the injured.

SENATOR RUSSELL: May I ask a question, please?

CHAIRMAN KNOX: Certainly, Senator.

SENATOR RUSSELL: I would like you to give this Committee the reference of the insurance broker or the magazine or wherever that was. Can you do that, please?

MR. AITKEN: I will. I will be glad to. It is in the Business Insurance Journal. I don't have it with me but I will be glad to send it to the Committee. I have the copy of the issue back and I will be glad to send it to the Committee. Also, I am well aware....

CHAIRMAN KNOX: Maybe we better subscribe to it.

MR. AITKEN: It is a very fine publication, very interesting information in there. I also found during the course of the so-called medical malpractice crisis if one looked at Medical Economics, one found a great deal of interesting information as well. As this body is well aware, there has been the Interagency Task Force Report on products liability and I am sure this Committee has received a copy of that report and have had a chance to review it. But what was very interesting about that study produced by the Federal Government and not produced by trial lawyers, not produced by anyone who supposedly has a self-interest in this particular controversy, one of the conclusions that was overwhelming when one

reads the report is that it is impossible, under current rate-setting procedures and current insurance company book practices to even obtain any precise information as to how they set rates and why they set rates. What the study did indicate, though, through their own insurance study was that at least two factors are significant in why we have seen a substantial increase in insurance premiums to manufacturers. Number one, their bad rating practices and number two, stock market losses of 1972 and 1973. That was documented within the Interagency Tort Study. Also, interestingly enough, they also came to the conclusion that one of the reasons, and one of the substantial reasons, why we have products liability and products liability losses is because of the shoddy products and the unsafe products that are being put upon the marketplace. They indicated, for instance, at page 15 in that study that the evidence was that the products liability problem stems from the fact that some manufacturers are producing unreasonably unsafe products, that there are relatively new televisions that catch fire, garments that ignite, hammers that chip, ladders that break, machine tools that confront a worker with higher risks than are reasonable and that careful product liability prevention technique in the area of quality control may well have curbed many of these lawsuits. I think that goes to one of the points that I think we often overlook in terms of evaluating the tort system and that is that the tort system number one, above all, is geared to provide reasonable and fair compensation to those people who are injured through no fault of their own and secondly, we overlook the fact that the tort system has been very therapeutic in terms of preventing more of these unsafe products

to be distributed throughout the community. I saw an interesting interview that was featured in the Los Angeles Times with the Vice Chairman of the National Consumer Safety Council and he pointed out, for instance, that with a slight change in the caps that we put on medicine bottles, how many lives have been saved. He pointed out the fact that it cost one penny to the manufacturer to put the plastic cap on the aspirin bottle to prevent our children from getting into the medicine cabinet and consuming dangerous drugs. It was quite clear that the technology to put on that plastic one cent cap was present long before the industry responded and put the cap there. He also related a very interesting conversation with a manufacturer. This particular manufacturer came to the Consumer Safety Commission and proposed that he be allowed to distribute a 50 CC motorbike to 7-year olds and they had designed this bike for 7-year olds. Now, that, of course, came as a great shock to the Chairman of the National Consumer Safety Commission and it obviously raised the first initial question to this manufacturer -- do you realize how many young children will be injured if you put out a 50 cc motor bike for 7-year olds and he said, "Yes, I appreciate that. But can you imagine what kind of profit I could make with a product like that?" That was the statement that he made and that's what we are trying to curb by the existing tort system. I think it makes it quite clear to all of us that to, in effect, to allow that product to continue to go on, to allow high rates, and to allow that type of product to be insured, would be a dereliction, a failure of the duty of the insurance industry. I was pleased to hear the earlier comments by the

testimony from the insurance individuals who are here today that they are concentrating now on loss controls. They are putting the emphasis on loss prevention and I was pleased to hear that there were so many quality control engineers who are now going out into the community.

CHAIRMAN KNOX: Do you think it is appropriate to change any tort laws in this regard?

MR. AITKEN: I think that obviously there are matters that we can look into and if this Committee....

CHAIRMAN KNOX: Like what?

MR. AITKEN: Well, a question of what to do in the workers' compensation situation. I think there have been some interesting questions raised as to what happens when someone puts out a machine and that machine is then altered by the employer and that machine then injures an employee. Under the present law, you may well have a third party suit against the manufacturer but because of the Workmen's Compensation system being an exclusive remedy, there is no cause of action for the injured employee who received minimal compensation through the compensation system to bring a similar claim against the employer. I think that we certainly should look into the question of whether or not either in an indemnity action, after the original action, or part of the action filed by the plaintiff as to whether or not some of that cost where there is an abuse of the system, abuse of the machine, should not be transferred to the employer and should not be solely borne by the manufacturer. I think we should certainly look into that. We do have a tort study committee also within our Association. We are studying all of these areas and we will be

making a final report to this commission because obviously we are dealing with a system devised by human beings. It is an imperfect system and an imperfect world. There certainly could be improvements in every area of the law, including the tort system, but I would again emphasize the point that when the insurance industry comes forward with so-called proposals for improvement, every single one of them has to do with the question of limitations of rights and limitation on the injured party.

CHAIRMAN KNOX: What's your reaction of Price v. Niagara that was referred to by Professor Epstein where you had, as I recall, a machine manufactured in 1931 which had been substantially altered....

MR. AITKEN: I believe he indicated 1940.

CHAIRMAN KNOX: 1940 or whatever it was. Some time ago.

MR. AITKEN: Well, I think the reaction, as I indicated initially in my testimony was that that shows me the system is working. I don't think there is any way we can pre-screen every case that is going to come up and make some type of legislative determination that these lawsuits will be allowed to go forward but these will not. The example he gave, where the attorney brought that case and lost the case and then went on appeal and lost on appeal, to me illustrates why the system is good. Because that now is a bellwether case which will advise other lawyers not to invest a great deal of time, not to invest a great deal of their money in that type of case because the leading cases are the bellwether cases that help direct the system and recognize that lawyers who handle these cases have no interest in spending thousands of dollars in time and money

handling a case that they are going to lose at the jury level and then appeal and lose at the appellate level. There is no reason for those cases. So that opinion to me illustrates why the existing system works and illustrates why the juries listen to these facts and make intelligent decisions, why we should leave these cases.

CHAIRMAN KNOX: What about a suggestion of say a 10-year, or some such, statute of limitation with an exception for reconditioning for fraud or for duties to warn that could be built in?

MR. AITKEN: I really don't think you can do that for a number of reasons. It's got a number of problems with it. Number one, I think that many major products have life expectancies beyond ten years -- elevators, other types of products are expected to be used beyond 10 years. Also, in every proposal I've seen, it makes no difference whether or not there are already many pending lawsuits against that product. Theoretically, you could have a situation where at 9 years 50 lawsuits were filed and in 10 years the same product that was just as dangerous the year before suddenly now becomes immune from any further litigation and what happens if you clearly find that some product is still on the market and still being used, is clearly defective, and the ten years have passed and there is no incentive now to take that particular product off the market because what you've done is granted immunity to the manufacturer of that product. I think that the laws that now exist where basically the jury judges the case based on the state of the art that was available at the time the product was manufactured is the best type of statute of limitations that can be. That statute of limitations was exactly the statute of limitations that was applied in the Price v. Niagara case cited by Professor Epstein.

Because basically what the jury obviously determined was that the state of the art back in 1940 was such that this manufacturer should not be held liable. That is, in fact, a form of statute of limitations and they found for the defendant in that case. So I think the system itself, which judges the manufacturer based on the data that was available at the time of manufacture, is the fairest form of system.

CHAIRMAN KNOX: It is kind of ironic, as Dr. Epstein pointed out, what you do in a sense is penalize the good manufacturers because they are the ones that are still in business and have a deep pocket. Those who manufacture the really schlock stuff have probably gone broke and gone out of business and nobody will bother to sue them.

MR. AITKEN: That's probably true but the point is that....

CHAIRMAN KNOX: I don't know what you'd do about it.

MR. AITKEN: What would the 10-year statute of limitations accomplish in that regard? And I also would point out that obviously one of the things we are concerned about is the question of cost, and we certainly have seen no analysis that any such statute would have any effect upon rate setting. I am sure it would not. As a practical matter, probably .000 percent of the cases we are dealing with involve any product beyond ten years.

CHAIRMAN KNOX: How about reforms with respect to procedure? Do you think there is a little wastage in the -- I think we discussed this the other day.

MR. AITKEN: I don't think there is any question that we have to streamline....

CHAIRMAN KNOX: Is your Association going to come up with suggestions as to ways that we can make this whole process a little

less costly for both sides.

MR. AITKEN: We have a special committee looking purely into the question of court reform and court procedure because I think the real tragedy in the products liability field is the fact that the person who is injured has to wait two and three years to get their case to court and wait as long as sometimes four or five years to be compensated for their injury. That's the tragedy of the system. That's why we have to do something about court reform and procedures and more judges, because there is where I see that the system has truly been neglected.

SENATOR RUSSELL: Question.

CHAIRMAN KNOX: Yes, Senator Russell.

SENATOR RUSSELL: Professor Epstein indicated, at least I understood him to say, that there doesn't seem to be in the case that he mentioned and others, any standardized way of looking at things, any rhyme nor reason -- everything is up for grabs when it goes to the jury, and would you comment on that, whether you think that's the way it should be or that is the way it is or....

MR. AITKEN: I don't think that's the way it should be and that's the way it is not. There is nothing in terms of up for grabs as far as the jury system is concerned or the present law of products liability in California. The law is quite clear. If one puts on a product, that is, on the market that is defective, if that product because as a failure because it is defective and causes injury then that person is entitled to recover. That is not an up-for-grabs system and obviously what is and is not defective is a question of fact and that question of fact rightly belongs to

people picked at random from the community. I seriously question his statement that it is up for grabs. These are very difficult cases that are very clear jury instructions that have been developed in California as to what the law is and gives very, very clear guidance to the jury as to what they can and cannot decide and I think that statement is fallacious.

CHAIRMAN KNOX: Well, Senator, as you recall, I had a discussion with Professor Epstein up in Sacramento. There is an explosion in the field. I think you will have to agree because we have gone beyond just physical defect. We are going into defective design which -- or defect in design for the purpose intended or the foreseeable purpose or whatever it is. There is almost no limitation. It is a much larger field in the last ten years, eight years, than it was before.

MR. AITKEN: I think the concept of foreseeability as it has been applied in the products liability field is really nothing different than when we were in law school and studied Palsgraff and whether or not one could have anticipated the scale falling from the shelf. I think the question of foreseeability has been applied in all kinds of various situations and it is certainly true in the products liability field. I haven't seen any radical change or direction in the area of products liability since the concept of strict liability was adopted by the California Supreme Court. We are now just seeing case-by-case applications of what a defect is and what one can anticipate.

SENATOR RUSSELL: You don't think the defenses over the last ten years have been broadened by court decision?

MR. AITKEN: In the products liability field I don't think we have seen any dramatic change.

SENATOR RUSSELL: Then I guess I get from your statements and others from your field who have appeared before this Committee, and on medical malpractice also, that you really don't think that there needs to be much change except maybe some streamlining of action in the courts to do it more quickly but that the system is working well, that there is really no problem.

MR. AITKEN: Well, as I indicated, Senator, there are always problems in each area and we are certainly looking at it very strongly, but I would submit to you and it definitely is the position of our Association that the basic law as it now is, is basically fair and does not need any radical revision as suggested by the insurance associations. I think there is one thing that has always been overlooked in this whole question of the so-called tort explosion and the so-called change in law. We have spent four or five or six years of active propaganda in the area of consumerism. We have basically made Ralph Nader a national folk hero before someone at least became concerned with his so-called ethnic background. What I am saying is that what we have done is now, in effect, educated people on their rights, we in effect, we as lawyers, have made services more available. We are criticized for bringing too many cases because we are supposedly contributing to the tort explosion; on the other hand, I read numerous criticisms because we don't extend our services far enough. Now, I think you cannot have the best of both worlds. You are either going to have to decide that consumerism was good, extending legal rights to everybody in

the community was the right thing to do and opening the court system to all people who are injured was the proper step. I believe it was. You could not have the advent of consumerism yet ignore the court system, not appoint new judges and not streamline the process. We are in a "Catch 22" situation. I think there is where the problem is.

CHAIRMAN KNOX: Yes, Ms. Gorman.

MS. GORMAN: Do you foresee that the statute of limitations would actually increase cost to manufacturers in that if they have 10-year old equipment and as Mr. Epstein suggested, they post -- this is well known to everyone that the statute of limitations is 10 years -- that laborers are not going to work on machines that are more than 10 years old?

MR. AITKEN: That was the thing that I thought was amazing when he gave that example. Here you are a poor worker in a factory setting and here's this sign that says, "after 10 years the manufacturer of this machine will no longer be responsible to you," and then your boss comes along and says, "start working on that machine," and you suddenly say, "Oh, I'm not going to work on that machine. At 12 midnight that company becomes immune, if I hurt myself on that machine, so I am not going to work on that machine." What will promptly happen, of course, is he will be fired and he will be out of a job and hopefully, he will maybe get a job somewhere else. That's the effect of that kind of law and that kind of notice, and I think that highlights the lack of understanding of what the practical application of law is as opposed to the classroom setting.

SENATOR RUSSELL: How about the possibility of forcing the manufacturer, the company, to buy new equipment every ten years?

MR. AITKEN: Well, if you truly believe that at the end of the 10 years, that is going to be an unsafe product and there is a reasonable projection, then obviously it should be pulled off the market. I think it is interesting to note that we don't seem to have the type of recall system for anything other than automobiles. We have seen a fairly sophisticated system develop through the major manufacturers of automobiles. We constantly are being apprised and warned about defects in automobiles and they are being recalled at the expense of the manufacturer and then being corrected. I think we obviously have to look at the question of whether or not a recall system should be expanded much farther than it is so that the unsafe machine is recalled as fast as the unsafe automobile.

CHAIRMAN KNOX: Mr. Hiestand.

MR. HIESTAND: Is your organization going to make any recommendations regarding ways to save money in terms of cutting down the costs that go to both defense and plaintiff's lawyers for resolving these matters. I know you can streamline the courts and that might save some, but don't you have a feeling that, for instance, we have heard testimony that for every dollar that is actually paid in the products cases, 42 cents goes for the defense of them. In malpractice we have heard before that it is for every dollar that is paid out, at the most 33¢ gets to the injured person. That seems tremendously wasteful. Isn't it possible to resolve these disputes with say 10% going for the resolution, and the bulk of it

going to the injured party?

MR. AITKEN: There are obviously a number of factors involved in a premium -- broker's commission, attorney's fees, litigation costs and a lot of everything else, but in the area of attorney's fees, there is no question that we can make recommendations in our study on that point; for intance, we have seen an explosion, if one wants to use that term, in regard to, when one files a products liability case, I have seen many examples where the other defendants immediately sue six other possible distributors, manufacturers, component parts, other people they feel are responsible, basically what we call complaints for indemnity, if in fact they are justified at all, really should not arise until such time as there has been a payoff by the defendant. What's happened is that we will file a case against the manufacturer. The manufacturer will, in effect, file six cross complaints against other entities and suddenly now you've got one plaintiff's lawyer and seven defense attorneys. Now, it's got to be a high increase in cost to the system, so I don't think until somebody has actually paid some money out of their pocket, they should be so anxious to bring so many parties into the litigation. I think what you see in that instance is they are looking for somebody to share the cost with and they are every bit as guilty as we have been accused of so far as filing suits that I think sometimes are frivolous; that is, they just file and bring in a bunch of other people hopefully to get a contribution to cut the cost to that particular manufacturer; so we are going to propose that in terms of indemnity, if it is a true indemnity case, it should come out after the payout and not increase the operation of the

system and not prolong the trial, not overly complicate the issues because I think there is one place we can pick up some of that cost.

MR. HEISTAND: That could make it more expensive though because you would have essentially, if you've got an award for the plaintiff, you would be retrying the case later for indemnity to save the case....

MR. AITKEN: Well, the facts have already been established and most of those cases are tried through a court and not with the jury and most of those cases are resolved by the insured themselves. Most of the cases, in effect, mount the contribution of defense costs and then they resolve the case. I think once they pay and the case is over, they are going to be very reluctant to get involved in major additional litigation when they recognize the indemnity wasn't even proper in the first instance.

CHAIRMAN KNOX: Thank you very much. We appreciate your attendance here today.

ASSEMBLYMAN MORI: Jack, just a short question.

CHAIRMAN KNOX: Oh, I'm sorry.

ASSEMBLYMAN MORI: You mentioned the manufacturer bears the cost of recalling automobiles. We talked of costs. It seems to me that we want to minimize the costs. Then the manufacturer's cost only becomes the next season's consumer costs that whatever the cost is, the consumer generally ends up paying it anyway.

MR. AITKEN: Not entirely true but oftentimes it is true.

ASSEMBLYMAN MORI: Well, through increased prices or

diminished liability or rights or whatever.

MR. AITKEN: Right.

ASSEMBLYMAN MORI: I don't think liability becomes the question. I think certainly people are going to be liable for problems that exist. To me the question is, how do we minimize the probability of a problem occurring rather than trying to decrease the court costs and decrease attorneys fees in whatever event? It seems to me we need to diminish the probability of a problem occurring with the product. The cost is going to be borne somewhere, some place, and I think we all have to realize that if we want safer products, it is going to cost us more either through the courts or through the product itself. I think it is up to us to determine, where do we minimize those costs -- in the product itself, in the courts or with lawyers or where.

MR. AITKEN: I don't think there is any question, Assemblyman Mori, that you are right, and that the real solution, at least the long-term solution should be hopefully to produce safer products and eliminate the injury, eliminate the 30,000 deaths that occur every year because of consumer products. Let's eliminate the 110,000, the speaker mentioned disabilities, that occur every year because of consumer products. There is no question in my mind that I would rather have to close up my doors because nobody is being injured than to, in effect, take away the rights of the injured. So hopefully through a loss prevention program and with better quality control, that will be the best control factor possible.

CHAIRMAN KNOX: Thank you very much. We will recess now and be back here promptly at 2 p.m.

(BREAK FOR LUNCH)

CHAIRMAN KNOX: Mr. Behr or Mr. Bonaso, of the Management Analysis Center. Are either one of those gentlemen here? How about Mr. Norman Lynn. Mr. Lynn here? Mr. Cashion or Mr. Romney? You want to come on up. You gentlemen represent the California Product Liability Task Force. Is that correct? All right.

MR. GERALD CASHION: (See Appendix IX) Chairman Knox and Committee members, I am Gerald Cashion and I am President of Meyer Machinery Company located in Los Angeles and Redwood City and I am the representative of the California Product Liability Task Force, which is an unincorporated organization, association, and we are a group of wholesalers and distributors in the State of California, working together for one common purpose, that of the enacting of legislation at the state level to provide product liability laws. And how many businesses in California are affected by this? In the 1972 census there were approximately 24,000 wholesalers and distributors that generated some 28.9 billion dollars worth of revenue for our state and employ some 269,000 people. In our opinion, product liability has reached a crisis in this state for small businesses. The proliferation of product liability suits poses a threat to the industry and especially the small businessman, a threat unequal to that of the medical profession. It is driving insurance rates out of range for many small businesses. It is forcing some companies to close their doors. It is eroding the foundation of the industrial system and common marketplace. It is, as a result of this, pumping millions of dollars worth of inflation into the economy annually in the form of higher

prices for goods manufactured that must be paid by the consumer. This task force conducted a sample survey and out of 149 companies that responded as of July 8, 1977, in the two years 30% of them had a 50% increase in their product liability premiums. 19% had a 100% increase. The other 19% had a 300% increase. 8% of this group had a 400% increase and 24% of this group reported a 500% or better increase in their insurance premiums. We feel that a 3-year survey would have increased these percentages dramatically. Those reporting were companies that had 25 and less employees and we feel that it is a good cross section of the small business of our state. I would like to share some of my own experiences with you. The company that I now own is 49 years old. It employs some 30 people and in the last two years our insurance has increased from $2,400 for products liability to $27,000 with only the specification that I cut one-third of my business off by not selling any used equipment.

CHAIRMAN KNOX: Mr. Cashion, I don't like to interrupt you but we have a long agenda this afternoon. What we are primarily interested in here -- we know, not your personal experience, but we are well aware of the severity of this problem. What we are interested in is what you think we ought to do about it.

MR. CASHION: We, as a task force, think that you should have a statute of limitations. I disagree with our learned friend, the attorney. If he thinks there is no need for it, then why do the attorneys have a bill before you now for a statute of limitations.

CHAIRMAN KNOX: A very good point, I voted for it.

MR. CASHION: Then the other thing is....

CHAIRMAN KNOX: I have said, Mr. Cashion, now that

attorneys are being sued, the time has come to do something about this problem.

MR. CASHION: We think you should be in the same boat that we are and we will go on forever, because in 49 years we are still being sued for machines that were sold before some of us were born. There is no statute of limitations nor state of the arts. We need a state of the arts in this country because I am certainly sure the engineers that are designing equipment and products for the consumer today are doing the very best they can. You can see that in your automobile. We need a reform on tort law. We would need our Workmen's Compensation laws revamped to the point ultimately that could be the answer for any liability on injured persons. We feel as a group that these measures have to be done and have to be done now. We can't go on for three or four more years dragging along because some of us will not be here to be in business. We cannot pass on to the consumer as wholesalers and distributors the cost of this rising insurance. It has to come from some place.

CHAIRMAN KNOX: Do you have other suggestions besides the statute of limitations and the state of the art approach?

MR. CASHION: I would say that your workmen compensation laws, if we could change those, and also the....

CHAIRMAN KNOX: Change them in what fashion?

MR. CASHION: Well, 30 years ago that was the method that protected the workman against injury. If he was injured that was the avenue that he....

CHAIRMAN KNOX: Outlaw the third party claim.

MR. CASHION: Absolutely. We have no control over these products after we sell them. If I walked into your home, if I sold you a chair and 10 years later it had a cracked leg on it and I am sorry, Senator Knox, you can't sit in that chair anymore, you would throw me out of your home. The same thing when we go back to a plant that is using this equipment, or whatever product it might be, and we tell a man not to use that machine anymore that it is not safe because he had done this or done that to it for modification, he runs us out, so we have no control. We are the middle man and we are caught up in this to the point where the profits that we do make go for insurance. I think it is time now that we do something about this and that's about the summary of it.

CHAIRMAN KNOX: Okay. We appreciate that. Mr. Romney, is it?

MR. DICK ROMNEY: Yes, sir. (See Appendix X)

CHAIRMAN KNOX: Do you have something you would like to add in this regard?

MR. ROMNEY: I am answering your letter of June 6th wherein you asked me three questions. I am Dick Romney. I am President of Pac-Power, a firm in Walnut Creek and Woodland, California. We sell, service and maintain aerial manlift equipment and mobile digger derrick equipment like the public utilities use. Our customers are public utility companies, municipal governments, the State of California, the Federal Government and so forth. We employ 27 people. We are licensed by the State to perform

mobile crane certification. We represent two of the leading manufacturers in the midwest of these types of products. We have only been in business since 1973. I have been in the utility equipment field for 33 years. You asked three questions in the letter addressed to me. The first is how much have our premiums increased since 1974. When we were founded in '73 with a major insurance carrier, we were able to obtain $500,000 primary and $1,000,000 umbrella for about $3,000. In '74 the carrier declined to renew coverage and we had to seek an eastern and southeastern firm for the same $500,000 and $1,000,000 which ran us up to $3,220 for one and $3,112 for the other, or an increase of 100%. Before those policies expired, one carrier cancelled. The other one did expire and then we were able to get no help from any major carrier. We were finally given coverage with a Michigan firm for $21,250 for $300,000 coverage, with a $500 deductible. Now this is a million two hundred less coverage for a 335% increase but that isn't the bad part of the story. The Insurance Commissioner of Michigan forced this company out of the California market and we were cancelled ten days before Christmas. We had an audit in our agent's hands the night of the 10th day, yet it took us better than two months to get a refund on our unused premium and we received it on a short-rate cancellation basis. I was informed last week by a reliable insurance firm that this company is still selling insurance in California but many of the firms that were insured by them have not received return on their premium as yet. The second question was, have you been refused coverage by any insurance company and my answer to that is, yes. We have to date approached

vigorously 42 carriers. We have received coverage from none. I may back up for one moment. We have had one liability action since we've gone in business and we have suffered $900 in liability loss. None of the major carriers would insure us, as I mentioned. We have utilized a small-town agent. We have utilized a specializing broker in transportation equipment that knows our field very well and we have utilized three of the largest brokerage houses in San Francisco and to date we have been able to get no decent coverage. Three weeks ago, after a detailed plant inspection, documention and testing review with a carrier, we received this quotation, three weeks ago, for $100,000 coverage, and this is all they would offer us. With a $10,000 deductible per occurrence written on a claims made basis, they would be happy to extend us coverage for $63,000 premium. Now, I'm not very bright....

CHAIRMAN KNOX: You are getting close to where you should book it yourself.

MR. ROMNEY: Well, that's -- yes, sir -- this, as you say, I'm not very bright but that's spending 73¢ to protect 27¢ and that makes no sense was my conclusion.

CHAIRMAN KNOX: What do you think we ought to do about this?

MR. ROMNEY: I don't know.

CHAIRMAN KNOX: Oh. All right.

MR. ROMNEY: I think a statute of limitations would be the first thing. I only have one more short point to make.

CHAIRMAN KNOX: All right, go ahead.

MR. ROMNEY: We have been repeatedly turned down by major carriers and both these gentlemen who spoke for the insurance industry this morning, I can speak to personally, who write firms in other states doing the same job, representing the same lines we do that now have realistic premium costs. Salt Lake City, Denver, Portland and San Antonio, Texas are all examples. The Colorado Company in June saved some $19,000 in premiums in anticipation of their July first law that was passed and Texas efforts have been through the Insurance Commissioner. We have gone so far now that twelve of us western utility equipment dealers are investigating a captive insurance company. The money up front in an offshore Colorado company is staggering and it seems to me totally unrealistic that I must go into the insurance business to survive. The third question you asked -- do you know any companies that were unable to obtain coverage due to the cost of premiums. Yes, I know three here in California. Product liability is the most serious problem we face today. Premium costs have put a new partner in our business. The lack of product coverage is now spilling into the general liability market. We must have legislative relief in California or the legitimate dealers will be no more. Thank you, sir.

CHAIRMAN KNOX: Thank you very much, gentlemen. We appreciate your attendance. Oh, excuse me, Senator.

SENATOR RUSSELL: It is not a question but an observation. It is interesting to hear the gentleman representing the trial

lawyers say there was really no problem. Yet these gentlemen are here indicating that there is a problem of some kind.

MR. ROMNEY: I have spent half my time in the last six months on insurance arrangements.

MR. CASHION: Senator Russell, there is no problem the attorney says, that for 30 years we had no problem. Since 1967, 30 years of business prior to that, no suits, and 40 suits in the last 10 years. To me, that's a problem.

SENATOR RUSSELL: I would agree.

CHAIRMAN KNOX: Thank you very much, gentlemen. We appreciate it. We now have a distinguished professor from the University of Tennessee Law School, Professor Gerald Phillips.

PROFESSOR GERALD PHILLIPS: Mr. Chairman, Members of the panel, I appreciate your asking me to be here. Mr. Hiestand asked me in particular to comment on the proposals that Professor Epstein put forward this morning. I have some general comments and some more specific comments as well. I think there is no satisfactory statutory solution for product modification, state of the art, and post active improvements and duty to warn, questions that do not take into account issues of foreseeability. Proposed statutes, I think attempt to foreclose those questions to which I will mention in more detail later, in many instances, attempts to foreclose issues of forseeability in situations where they should not be. My own bias in terms of a proper solution at least, would be to introduce a comparative fault approach across the board, both for plaintiffs and defendants. Such a proposal has been put forward by the Commissions for Uniform State Acts and we are in the process of drafting such a proposal now.

SENATOR RUSSELL: I don't understand that, Mr. Chairman. Will you explain that?

CHAIRMAN KNOX: Senator Russell, thats.... Well, go ahead, Professor.

PROFESSOR PHILLIPS: If the plaintiff were found to be, for example, 30% negligent and another defendant found being 60% and the other defendants the remainder, the plaintiff would recover all of his damages less 30% and he would recover them in proportion against those two defendants, according to their degree of fault.

CHAIRMAN KNOX: The Li v. Taxicab case in California has abolished the old common law principle of contributory negligence as far as the plaintiff's action. If the plaintiff were even a little bit negligent, he was totally barred. They substituted comparative negligence but the problem is, of course, in products, we have what is called liability without fault, so there is some question as to whether the Li case applies in that situation. What the professor is suggesting is that we might want to have comparative fault, that is, if the plaintiff is 25% at fault and somebody else is 35%, and somebody else -- the fact the jury can make that decision.

SENATOR RUSSELL: You can have a multiple suit then.

CHAIRMAN KNOX: Well, you have a multiple suit anyway. This would just allow the jury to say -- to parcel out the fault as they felt it -- as they felt it lay.

SENATOR RUSSELL: They wouldn't be able to do that under previous....

PROFESSOR PHILLIPS: I don't think it has been done in California yet. It has been done in some states -- the comparative fault or comparative causation approach has been extended to so-called strict liability actions.

SENATOR RUSSELL: Excuse me. Under the current situation, it is not being done here. A person would be sued and he would be liable for the whole thing?

PROFESSOR PHILLIPS: The plaintiff's negligence would not be taken into account as I understand the present California law.

CHAIRMAN KNOX: That's right.

SENATOR RUSSELL: Thank you.

PROFESSOR PHILLIPS: Another problem that I think is substantial and has been touched on by several of the speakers today, has to do with the Workers Compensation situation. I can remember reading a recent case where the court found that the employer, or rather the fact finder found the employer with some 65% negligence, and the employee 10% negligent, and the manufacturer for the remainder, yet the manufacturer paid the entire liability in that case, the courts saying, we cannot do anything about this. It is a question for the Legislature. Now the proposal that Mr. Epstein put forward or the American Insurance Association put forward is that there be no subrogation liens and that the amount of worker's compensation be reduced from the amount of recovery against a third party. I think that is a good proposal so far as it goes but it does not go far enough. It seems to me if you adopted an across-the-board comparative fault, comparative causation approach, you would let the worker collect from his employer the amount of worker's compensation, whatever the limits may be and then sue

for the balance against the manufacturer reducing, however, from the recovery the amount of employer's fault, plus the amount of the employee's fault, if any. So that, for example, you might collect in worker's compensation $20,000 but the percentage of fault attributable to the employer might be $100,000. That would be lost so far as the recovery against the manufacturer but it should be. The manufacturer is not responsible for that fault and should not bear it. If it cannot be borne in the present worker's compensation system, if the rates cannot be raised, then there is no reason to shift it to the non-fault party. Now, addressing some of the proposals specifically, the statute of limitations proposal an outer cut-off limits has been adopted in a number of situations; in medical malpractice cases, construction industry statutes and under the Uniform Commerical Code, it is the sole basis of recovery, a 4-year statute of limitations running from the date of sale. Some constitutional question has been raised about these outer cut-off statutes and in some jurisdictions they have been declared unconstitutional. The question is certainly there as was discussed this morning. I think the three time period cut-offs suggested by....

CHAIRMAN KNOX: Was that on equal protection or due process....

PROFESSOR PHILLIPS: Due process. The three time cut-off periods that Dr. Epstein's statute proposes, I think, in itself presents a constitutional problem of inequality in protection. A different time period for the retailer, for the manufacturer and for the component part manufacturer. A sort of problem that

bothers me with the statute of limitations absolute cut-off has to do with the type of case like that of Ford Motor Company vs. Mathos of South Carolina, several years old. The Ford Motor Company manufactured a plastic ball to be put on its gear shift lever. They used black and they used white. White, it was known, was subject to deterioration by the ultra violet rays of the sun so that within a period of a year or a year and a half, the knob would become totally useless as a protective device in the event of impact. Underneath the knob was a very sharp-pointed gear shift lever. It came to a spear-like point. The plaintiff was impaled on the knob 13 years after the purchase of the automobile. Now, if that accident had occurred within a year or a year and a half after the sale of the car, it would have been exactly the same. It lay dormant for 13 years simply because no one was so unfortunate as to be thrown against it in a collision. Those cases, it seems to me, that type of case, where the product lies like a time bomb from the beginning and simply does not manifest itself until 10 years later, it strikes me as presenting a substantial inequity. Moreover, I do not think that you can equitably and perhaps not even constitutionally foreclose the various loopholes that may eat up the rule to continuing duty, loophole for example, the fraudulent concealment loophole. If your wrote a statute without those exceptions in it, the courts would engraft them on the statute and if you expressly said they were not to be exceptions, I think you would raise a very serious constitutional problem.

SENATOR RUSSELL: Question very briefly. Are you saying that if somebody had been injured the year or second year afterwards,

it would be okay, but the fact that no injury occurred in 13 years, that could be as good a claim as the second year. Is that what you are saying?

PROF. PHILLIPS: It seems to me the product is just as defective at the beginning as it was 13 years later. It was fortuitous that the accident came only 13 years later. Another problem about a state statute of limitations, and Professor Epstein touched on this, is to what extent would it really benefit your manufacturers and sellers in this state. Their products, I presume, go as much out of the state or perhaps more than they stay in the state. If they go out of the state, they would be subject to statutes of limitations elsewhere providing not this kind of protection. It would result in a disadvantage to California plaintiffs with perhaps not a very substantial advantage to California defendants.

CHAIRMAN KNOX: Well, that's the ultimate question, but I thought I wouldn't ask him that until we get through.

PROFESSOR PHILLIPS: There are a number of cases also involving continued use of a product. If you take a drug, for example, over a 5, 10, 15-year period, those cases, I presume, as the statute is written, would provide for recovery because a sale contributing to the injury had occurred within the 10-year period although a substantial portion of the sale contributing to the injury would fall outside the period. It seems to me those cases would remain under the coverage of the statute. If I may, I will move on to the product modification statute.

CHAIRMAN KNOX: All right.

PROF. PHILLIPPS: And this raises the whole question of forseeable modifications which the proposed statute does not take

account of. We have a case out of Tennessee which demonstrates the problem very well, I think. Guffy v. Erie Strader Company, 350 Federal, Section 378. It is a Third Circuit case, 1965, applying Tennessee law. There the defendant built a cement manufacturing installation for an employer and constructed conveyors of cement high off the ground and improperly constructed them so that the stone and the cement and so forth had spilled over out of the bin onto the platform below where the workers were watching the operation. In order to remedy that situation, the employer negligently, apparently, built a roof over the top of the platform. The roof was not adequately constructed nor was the collection of the droppage from the bins above cleaned off periodically as it should have been. Eventually with the build-up of the material on top of the roof, it fell on the workers underneath. The manufacturer of the faulty bins in the first instance was held liable for the entire injury to the employees. Why? Because was it not foreseeable that if someone constructs that type of situation, someone would attempt to avoid it, to take remedial measures? The court held, yes, I think that presents a good foreseeable case. There is the invited modification type of case -- Kessler v. Ford Machine Works, Inc., 501 Federal Second 617, is an Eighth Circuit case of 1974. There was a protective guard on top of a machine used for mixing wood cellulose fiber seeds, water and so forth for sowing of grass. The protective device there was such that it got in the way when you were trying to feed the machines. It made the machine practically unworkable. The employees naturally removed it, they folded it back, in order

to use the machine as it was meant to be used. The employer got his foot caught in the machine when he was trying to kick the cellulose blocks into it. Those cases, it seems to me, present proper jury questions as to foreseeability of alteration. Where you have a safety device that is doing its job and does not impede the operation of the machine and it is mindlessly taken off by an employee, I know of no court holding the manufacturer liable. If there are such cases, they are bad cases but bad cases cannot be prevented no matter what statute you try. There is another problem having to do with nondelegable duty. California has the landmark case, Vandermark v. Ford Motor Company, a 1964 case involving faulty final assembly alleged by the retailer of an automobile. Ford Motor Company says the fault may have quite possibly resulted from the action of the dealer, not I, when it left my hands. In an unassembled condition, it was not faulty. The alteration did it. The California Supreme Court said that is a nondelegable duty of final assembly. That rule has been followed in New Jersey. It probably would extend to a situation where the product was sent to the ultimate user to be assembled by the user. There is a substantial line of cases supporting the liability in that type of situation and I am not sure you would want to eliminate it.

Moving on to the state of the art, this to me seems to be the most drastic measure proposed but the most unjustified measure proposed in this packet of legislation. And I doubt that user expectations would support the proposal as stated in this supporting material. The rule that the state of the art will control liability was early turned over in negligence law, not just strict liability,

but negligence dating I think back to the 30's. The famous T. J.Hooper case by Judge Learned Hand where the entire industry practice was said to be lagging behind, or a jury could so find. If the entire industry does lag behind, this matter simply cannot be left to the industry. The courts have to be the final arbiter in this situation; otherwise you would have turned over....

SENATOR RUSSELL: In whose judgement, sir, do they lag behind? Who makes that decision?

PROFESSOR PHILLIPS: The expert testimony may be required, depending on the complication of the case. Some cases are such that it is a situation of common knowledge. You don't even have to have expert testimony. It could have been, it should have been done more safely. It would depend on the facts of the case. All I'm saying is you cannot leave that question ultimately to the person who is setting his own standards. It is very unsound it seems to me. There may not be a lot of cases where the state of the art will not control, but there is a sufficient residual that to take those out entirely it seems to me would be very unwise as well.

ASSEMBLYMAN MCALISTER: Mr. Chairman.

CHAIRMAN KNOX: Mr. McAlister.

ASSEMBLYMAN MCALISTER: As I understand it, the objection that the industry raises to the state of the art defense or the lack of the state of the art defense is that they are judged today by standards of today when they made the machinery a long time ago. Am I incorrect on that?

PROF. PHILLIPS: That's right. I was addressing myself here

solely to the question of the state of the art as it is defined in this packet which says, I believe it says, if the practice is substantially followed by any segment of the industry that will be a conclusive defense. The question you raised goes more directly I think to the next proposed statute which is the non-introduction of post-accident changes. That is most frequently the situation where you see a manufacturer being judged by post hoc standards. The rule used to be that you could not introduce evidence of subsequent changes made to improve your product taken after the injury had occurred because it was not necessarily probative or even if it were probative, the public policy of encouraging repair cut against allowing that evidence to come in. California, in a leading decision of the Ault case, held that it could come in, however, to prove feasibility of making the product safer, feasibility being the main consideration at least in design cases if not production defect cases as well. If that is the main issue in litigation it seems to me difficult to say that it is indeed not relevant. The manufacturer comes in and says, this could not have been done, it would not have worked, the trade-offs would have been too great. How do you respond to that. You say, it is being done. It is being done now. If it can be done now, why could it not have been done then? And shift the burden to the manufacturer to show if indeed it was scientifically impossible to do it then. The defense might lie in a number of jurisdictions today under an unavoidably unsafe defense. But most of these cases do not involve, in fact, very few involve, scientific impossibility at the time. For one reason or another decisions of production,

research and development or whatever, it is not done then until later.

CHAIRMAN KNOX: We used to do it in railroad crossing cases by having a jury view of the crossing to show that they put up a crossing subsequent to the accident. It was definitely, it was a strong view for a long time that you could not bring in subsequent....

PROF. PHILLIPPS: To prove negligence, but you can use it for other purposes.

CHAIRMAN KNOX: ...in fact, got it in.

PROF. PHILLIPPS: This, of course, this problem is a major problem. Where the subsequent repair or change or improvement is made by the defendant himself, and the jury is instructed, now ladies and gentlemen of the jury, this is not an admission of negligence or fault on the part of the defendant. They jury probably hears that in one ear and it goes out the other ear. That is the great danger. Whether or not they follow that instruction, nobody knows. If they followed it, there would be no problem I suppose. But I personally think that post-accident improvements at least when made by the defendant raise a very severe risk of undue prejudice to the defendant himself, but I don't see how you can solve the problem at least where the evidence is being used for purposes of impeachment. The defendant comes into court and says it would not be feasible to make a safer product and he has made a change in his own product subsequent to the injury. What do you naturally ask him in that situation on cross-examination. How can you say it is not feasible? You did it yourself. To cut off the right to ask that question, I think would constitute a very severe incursion

into the right of cross-examination which lies at the center of our adversarial system.

CHAIRMAN KNOX: Of course, perhaps the manufacturer could argue that until the accident occurred, he just didn't realize that the machine had the propensity to cause that kind of an injury.

PROF. PHILLIPPS: He certainly can't and he may persuade the jury. Moving on to the duty to warn proposal, Professor Epstein admits there, at least in his commentary, an admission that I think should have been made in more areas than here; namely, he says part of the problem at least is intractable or incapable of resolution by statutory determination because the cases depend upon facts and circumstances of each case, which is typical of tort law and always has been. He says, for example, determining by statute who must be warned, and the strength of the warning, is something that cannot be laid down in a meaningful standard way by legislation. He, however, does address a couple of questions, one being the question of causation, and he suggests that the absence of the warning should be the immediate cause of the injuries. I don't know that that language should make any difference really to the courts. It is used sometimes by some courts, and other courts not; approximate substantial cause, I doubt that that language without more would make any difference. Running throughout these cases are always complicated questions of causation. I do not think that the questions can or should be taken from the jury merely because they are not capable of scientific determination. I will give you an example of a case I was recently involved in, involving the sale of charcoal briquets.

Up until a couple of years ago, the uniform warning in the industry was and you may have seen it on the bottom of the bags, not for indoor use, cook only in well-ventilated areas. These briquets were used indoors in a non-well-ventilated area, resulting in the death of an entire family by carbon monoxide asphyxiation. The allegation of the plaintiff's attorneys were that the warning could have been more stringent and say, "if you use indoors," which the Federal Government now requires, "you may suffer death by asphyxiation.' That is now the present warning. Well, suppose that warning had been on that bag. These people were using the charcoal for heating purposes, their electricity having been turned off for lack of payment of the utility bill. Would they have gone on anyway, assuming that they had to have the charcoal? That's the only thing they had to heat with, and that perhaps their place was well ventilated enough anyway; cracks in the walls. Would they have? Who knows? Would you take that case from the jury, assuming that it is an adequate warning case otherwise, simply because we don't know if they would have heeded an adequate warning? I think those cases, in order to do justice, have to be left to the court or to the fact finder. The warning statute also effectively restricts recovery against retailers and non-manufacturing distributors to a situation of actual knowledge or actual misconduct. I see no reason why at least you would not retain a negligent standard for retailers and indeed there are situations where retailers stand in the shoes of manufacturers where they hold themselves out as the manufacturer of the product itself. In that situation, I suppose you would treat them and should treat them like manufacturers.

The last proposed statute is limitations on punitive damages to twice the amount of compensatory damages recoverable. There has been a longstanding debate in the law as to whether or not punitive damages should be recoverable at all, they being criminal in nature and so forth. However, you do see cases which cry out for the imposition of punitive damages and Dr. Epstein's side point is material -- the Gillam case where a television manufacturer sold a television knowing of the extreme risk of fire and continued selling them even though there were repeatedly cases of fire. That case simply required imposition of punitive damages. However, it seems to me that one thing you might want to consider is whether or not, as a matter of public policy, such damages should be uninsurable. If they can be absorbed, due to the insurance mechanism and passed on that way, the very punitive purpose of the damage is avoided. I think this is the extent of my comments.

CHAIRMAN KNOX: I will ask Senator Russell's question and that is, do you think there are any substantive changes in the general law of products liability as it has developed in the last 10 or 15 years that we ought to make?

PROF. PHILLIPS: Other than the workmen's compensation and comparative fault?

CHAIRMAN KNOX: Yes. Well, no I understand you made a constructive suggestion that we look at comparative fault but do you think there are any other changes that we should look at?

PROF. PHILLIPS: I think that in carrying that forward, you should also reduce the amount of recovery by the amount of the

employer's fault.

SENATOR RUSSELL: What is the workmen's comp case?

CHAIRMAN KNOX: Well, he is suggesting that a typical case is if a worker gets hurt on a machine and he had his Workmen's Compensation benefits and his attorney also files an action against the manufacturer and it is argued that if you had comparative fault that the jury could ascribe certain damages against the manufacturer but would also look at the amount of fault of the employer, for example, in taking off the safety guard or whatever else the individual has done, perhaps the place where the machine is or any other kind of fault. Is that the proposal?

PROF. PHILLIPS: Yes, the result....

CHAIRMAN KNOX: So that the manufacturer doesn't carry the full load. He carries whatever the jury thinks is appropriate.

ASSEMBLYMAN MCALISTER: Something that encourages the concept of worker's comp?

CHAIRMAN KNOX: No, he still gets his worker's comp. Of course, that's....

ASSEMBLYMAN MCALISTER: Encouraging from the employer's standpoint.

CHAIRMAN KNOX: Yes, encourages the employer to be more careful, I assume.

ASSEMBLYMAN MCALISTER: Also, violates the principle that the employer is liable only in the no-fault system of worker's comp.

CHAIRMAN KNOX: That's right.

ASSEMBLYMAN MCALISTER: I don't know if it is good or bad, but I mean it does.

PROF. PHILLIPS: The proposal I was putting forward would not change the present worker's comp liability of the employer except to eliminate his subrogation lien against a third party. What it would do in effect, where the employer is at fault, would be to reduce the amount of recovery of the employee, if the worker's compensation did not equal the amount of the fault of the employer.

CHAIRMAN KNOX: Let's put it in a concrete case because I am not sure we all understand it. Let's say there is $100,000 of exposure that the jury finds. The employee gets $25,000 in worker's comp benefits, medical care, disability rating and what have you. Now the normal case in California now if you recovered $100,000 against a third party, the first $25,000 goes to the worker's comp carrier, leaving $75,000 for the employee. Now, if the jury finds that the employer was 25% at fault, what happens?

PROF. PHILLIPS: Let's say that the jury finds them 50-50 at fault, there would be a collection of $50,000 only from the manufacturer. The employee would end up losing $25,000 because you cannot get it out of the person who is actually at fault, the employer, due to the limits on recovery.

CHAIRMAN KNOX: I am not sure I understand that. Let's use my example. It is $100,000 the jury finds that that's the damage that the employee suffered. He has received $25,000 from the worker's comp carrier. He gets $75,000 but the first $25,000

collected goes back to the worker's compensation carrier under the present law of California. Now, what happens under the comparative fault method that you are suggesting, if the jury finds that the employer is 25% at fault; in other words, $25,000?

PROF. PHILLIPS: No, it wouldn't go back if you eliminate the subrogation lien.

CHAIRMAN KNOX: You eliminate the subrogation lien.

PROF. PHILLIPS: Yes.

CHAIRMAN KNOX: Okay.

SENATOR RUSSELL: Is that what you advocate?

PROF. PHILLIPS: Yes.

SENATOR RUSSELL: Why?

PROF. PHILLIPS: The subrogation lien apparently has been a strong incentive for the breeding of litigation and indeed for the financing of litigation where the employer who is partly at fault, urges and cooperates actively with his employee in an action over against a third party. But what's most offensive about it, is the situation where the employer is substantially at fault. He knows of the dangerous condition. He does nothing about it whatsoever. He leaves it. He has been warned, (the Balito case, for example) and he brazenly goes ahead with the situation and yet he is being the one at fault is entitled to recover over.

SENATOR RUSSELL: The third party being the manufacturer.

CHAIRMAN KNOX: He gets his money back.

PROF. PHILLIPS: There is no equity in that at all.

CHAIRMAN KNOX: The employer gets his money back. He gets the first money back, even before attorney fees for the

plaintiff, which is outrageous.

PROF. PHILLIPS: Actually, if I understand the California procedure correctly, where the employer is at fault, the third party can recover back against the employer for the amount of the worker's compensation paid. There is a contribution to that extent, but only to that extent.

CHAIRMAN KNOX: The only penalty, unless the law has been changed in the last five or six years since I've looked at it, the only penalty against an employer for fault now is willful misconduct -- it used to be a 50% surcharge, but it is almost impossible to get it in California. It is very difficult. Well, that's interesting. All right. Any further questions? Thank you, Professor. We appreciate you being here. Oh, excuse me, Fred Hiestand has a question.

MR. HIESTAND: Could you just clarify the state of the art defense in terms of your comments for the committee, because, as I understood it, the state of the art defense would not preclude expert testimony as to what the state of the art is. I thought some of your remarks suggested that if you adopted the state of the art defense, you wouldn't have any expert testimony as to what the state of the art actually was at the time and whether it was relevant to the particular circumstances of the case.

PROF. PHILLIPS: No, what I was directing my attention to specifically was the statement in the proposed statute. When there are two or more possible product designs, the adoption of any design in substantial use in the defendant's trade or business

or an allied or similar trade shall be treated as being in compliance with the state of the art. So defining the state of the art at the time of manufacture leaves the determination of what is adequate to the conduct of, as defined here, substantial use.

MR. HIESTAND: So the law is a common denominator.

PROF. PHILLIPS: Exactly, exactly. This does not address the separate question of whether or not you should have a state of the art defense determined at the time of manufacture and if so, what would be that standard. That standard I suppose would be determined by, not law, but what was actually being done at the time and what was capable of being done. That is the true state of the art standard, it seems to me.

CHAIRMAN KNOX: Okay, Senator.

SENATOR RUSSELL: What you are saying -- your proposal then rests solely on the comparative negligence approach. That's what you feel would be helpful in addressing this problem....

PROF. PHILLIPS: And extending that to worker's situation, worker's compensation situation.

SENATOR RUSSELL: The other statute of limitations and warnings, and so forth, you do not support?

PROF. PHILLIPS: I think that you will have so many, of necessity, so many exceptions to an absolute cut-off period that you will not accomplish the purpose set out. That's without addressing, that's without even addressing the fundamental question of why should you cut off a valid claim that can be well shown such as in the Nicole Blackman case I mentioned in South Carolina.

SENATOR RUSSELL: So you would oppose then a flat statute

of limitations?

PROF. PHILLIPS: Yes.

SENATOR RUSSELL: And to add exemptions would be too complex?

PROF. PHILLIPS: Well, if you adopt a flat statute, I think you would need at least the three major exceptions discussed, three or four, and therefore, I am saying as a practical matter you won't accomplish what you set out to do with the statute.

SENATOR RUSSELL: You do not agree then that there is no problem. You do feel there is a problem that needs to be addressed.

PROF. PHILLIPS: Apparently there is.

CHAIRMAN KNOX: Okay. Thank you very kindly. Mr. Behr or Mr. Bonaso, are you here yet? Norman Lynn? Berry Griffin? Mr. Griffin.

MR. BERRY L. GRIFFIN: (See Appendix XI) Mr. Chairman, members of the Joint Committee on Tort Liability, my name is Berry Griffin, Risk and Benefits Manager of Baker International Corporation located in Orange, California. I appear here today as a practicing risk manager, as a member of the Orange Empire Chapter of the Risk and Insurance Management Society, or RIMS, and also as the National Vice President of RIMS in charge of Government and Industry Relations. Rather than telling a lot of goodies about RIMS, let's get down to the point. I'll have the goodies in the passouts. We risk managers are charged with the responsibility of protecting our employer's assets against the risk of loss as a result of static losses such as fire, earthquake, auto liability, products liability

generally considered as insurable risks, either through self-insurance, or the more traditional purchase of insurance. In other words, the professional risk manager spends 40 hours or more a week dealing with nothing but the management of the risks of his firm. I can assure you that we risk managers are very aware of the products liability problem facing not only the business community, but the entire citizenry of the State of California and the nation as a whole. And I can assure you that we face this problem daily. Much has been written about why we have a products liability problem today. Because so much has been written on the subject, and in the interest of brevity, I will not rehash the many reasons why we find ourselves in this position. What I would like to do is to propose solutions to the products liability insurance proposal so that manufacturers can find adequate insurance at an affordable price. Firstly, manufacturers should be producing products free from defect. Industry must continue these efforts. Several governmental agencies are carefully watching industry's efforts and believe me, they are. Secondly, much more must be done to educate the public concerning the tort system. Let the public know what happens to their insurance premiums and to the price of any product purchased when tort liability is abused. Thirdly, the insurance industry must get a handle on products liability. They must develop meaningful statistics that substantiate the enormous premiums that they now demand. Lastly, the American tort system, encompassing the judicial mechanism, is a viable concept which should be retained. The erosion of the fault concept of liability, the increased use

of the courts to redress wrongs, the costliness and inefficiency of the system evidence serious problems within the system. We support reasonable, meaningful legislation and action which will correct the basic casuses of our tort liability problem. Among these reforms, we recommend: One, enact a statute of limitations We recommend a 6-10 year statute from the time a particular product enters the stream of commerce.

CHAIRMAN KNOX: What do you mean by 6-10? Do you mean 6 or 10 or somewhere between 6 and 10?

MR. GRIFFIN: Somewhere between 6 and 10. We don't have unanimity among all of our representatives.

CHAIRMAN KNOX: I understand.

MR. GRIFFIN: Two, limit court awards to economic loss, including attorneys and court fees, thus eliminating pain and suffering awards, eliminating punitive damage awards and permitting disclosure of collateral source of recovery. This, we feel will reduce the size of court awards and encourage more reasonable settlement negotiations of claims long before trial.

Three, we recommend that all state worker's compensation laws should be improved to an adequate level and recoveries of the worker or his dependants be limited to the statutory worker's compensation for job-related injuries. Suits against fellow employees and third party suits against suppliers and manufacturers should be discouraged.

Fourth, comparative negligence -- RIMS supports this as a form of contribution among negligent parties, under which awards to injured parties should be reduced proportionately by their

negligence in causing their own damage or injuries.

Fifth, state of the art -- a law prohibiting the introduction of evidence of negligence, any improvements in products resulting from advancements in technology.

Sixth, enactment of a statute which would regulate plaintiff attorneys' contingent fees. We recommend a graduated scale or possibly in the alternative, court-awarded fees.

Seventh, compliance with federal or state standards -- such a compliance should be at least a rebuttable presumption that a product was not defective.

Eighth, contribution among tortfeasors. We support meaningful contribution among tortfeasors.

Ninth, advance payments -- RIMS supports evidence rulings which will exclude such payments from being disclosed or imply admission of liability, and permit such awards to be offset against subsequent awards.

Tenth, bifurcated trials -- we support the use of bifurcated trials, or separate trials, where the issues of liability or negligence are first tried and if liability is found, a second trial may be held on the issue of damages. This will separate the emotional issue of damages from the more objective issue of negligence.

Eleventh, advance notice of claim -- we will support a requirement that prior to any liability suit being filed, a notice of claim must be filed with the other party and a reasonable opportunity given to remedy the defect and compensate for economic loss to the claimant.

Twelfth, arbitration -- we will support a requirement for binding arbitration both as to liability and damages in certain types of cases so as to lighten the caseload on the courts. This, of course, would apply to the smaller cases.

Thirteenth, contingency fee system -- we recommend the contingency fee system be modified so as to reimburse the attorney on a graduated basis only on that portion of the award or settlement which exceeds the highest settlement offer made by defendants before an attorney was engaged by the claimant.

Fourteenth, payment of winner's costs -- we recommend the loser in court shall pay all court costs and attorney's fees to discourage the filing of spurious law suits and encourage more reasonable settlement negotations before trial and more important, before suit if filed.

Fifteenth, ad damnum -- we support the elimination of the ad damnum pleading because it is inflammatory -- because of its inflammatory nature.

CHAIRMAN KNOX: That means that you can't say, I sue you for a million dollars or something -- you just say, I'm suing you.

ASSEMBLYMAN MCALISTER: Didn't we do that in medical malpractice?

CHAIRMAN KNOX: Yes, it is done in the medical -- AB lXX, put that in.

MR. GRIFFIN: Sixteenth, installment payment of awards -- we can support the concept of commutation of awards to periodic payments to the claimants as an alternate to large sum payments

and possible reduction of awards in the event of the early demise of the claimant.

Thank you very much.

CHAIRMAN KNOX: Thank you for those modest suggestions. We will take them under submission. I'll submit them to the Trial Lawyers Association for their comments. No, I think you have raised an inventory on some of the issues before us and we appreciate it very much. Are there any questions? Ms. Gorman.

MS. GORMAN: Do you represent self-insureds?

MR. GRIFFIN: I am a self-insured, yes. I self-insure my worker's compensation. Baker does. Many, many RIMS members self-insure, at least a portion of their risk, if not all. My goodness, Standard Oil of New Jersey self-insures the first $10 million of their risk.

MS. GORMAN: Yes.

CHAIRMAN KNOX: If I had $10 million I'd do it too, but I don't have $10 million.

MS. GORMAN: What's been the experience among, say Standard Oil -- companies like Standard Oil of New Jersey in recent years?

MR. GRIFFIN: Well, I can't speak for Standard Oil. I think I can speak in general. They wouldn't be doing it if it wasn't saving them money.

MS. GORMAN: No. I understand that, but if they had a dramatic increase in the cost of claims in the last two or three years....

MR. GRIFFIN: They certainly have an increase in the cost of claims. It certainly does not nearly approximate the increase that they would have suffered in premiums if they had been insured from first dollar.

MS. GORMAN: Thank you.

CHAIRMAN KNOX: You are going to give us a copy of your statement?

MR. GRIFFIN: Sure.

CHAIRMAN KNOX: Thank you very much. Thank you very kindly, Mr. Griffin. Mr. William Simpson, of Simpson's Safety Equipment. Mr. Bob Steinberg of California Applicants' Attorneys Association.

MR. ROBERT STEINBERG: Mr. Chairman, members of the committee. I am Robert Steinberg and I am appearing on behalf of the California Applicant's Attorneys Association. Attorneys who are involved in representing injured employees, both for workers compensation benefits and on occasion for third party civil damages, and it has been my privilege to in the past to personally have representatives or employees in actions against third party manufacturers, some successfully and some not so successfully. I would like to share some perceptions that I have as an attorney involved in this practice with the Committee in an attempt to be of assistance to the committee in that area. I feel after listening to some of the testimony, both this morning and this afternoon, that there are certain misconceptions that may be prevalent concerning what exactly is going on in the battlefield and I would like to address myself briefly in that area. It appears that

the two major so-called reforms that have surfaced in the discussion so far here today have dealt with questions of limitations of actions and statute limitations problems and secondly, with the state of the art. As a matter of fact, the law today in California is that the injured employee, the injured plaintiff is required to prove that an article was defective at the time it left the hands of the manufacturer. It is my feeling in this area that we have a built-in statute of limitations in this area. Because of that and also because of the instructions that are given to juries in these cases that have been formulated by the various decisions of our appellate courts as to the duty of a manufacturer. Now, with respect to the state of the art problem which has been presented here, I would like to quote some rather direct language from the decision that has been mentioned here before Balito v. Improved Machinery, Inc., which was a case decided by the California Court of Appeal in 1972. It was a design case. And again, if I may just digress for a moment, it seems that from what has been presented here today that the problem lies not so much in the area of the manufacturing defect where the article that was manufactured and sold on the market just in a certain period of time fell apart because of the fact that a part was not up to the manufacturer's own specifications or was underspecified in some manner. The objections from the manufacturing side, from the insurance carrier's side, seem to be directed more of a design case and Balito was one of those cases. It contained some important language as to what an injured employee must prove in the course of his presenting his testimony. It says that strict liability for deficient design

of a product is premised on a finding that the product was unreasonably dangerous for its intended use and in turn, the unreasonableness of the danger must necessarily be derived from the state of the art at the time of its design. A danger is unreasonable when it is foreseeable and the manufacturer's ability, actual, constructive or potential, to forestall unreasonable danger is the measure of its duty in the design of its product. A manufacturer's failure to achieve its full potential and design and thereby forestall unreasonable danger forms the basis for its strict liability in tort. I submit that this is the -- if there is any official language that exists as to the responsibility or duty of the manufacturer under current California law, it is the language that I just extracted and read from the Balito decision. So my point is this that with respect to state of the art, we already have that. We already have the language of the Court of Appeals of this state saying that the responsibility of the manufacturer has to be determined on the basis of his potential in designing the product and be determined in part by the state of the art that existed at the time of the products manufacture. I believe that the crisis, the problem, if there be one, or the dimension of it, I believe is a self-correcting one. I believe the courts got us into this with Greenman and Vandermark in 1963 and 1964 and they are getting us out of it with cases such as Price v. Niagara which Professor Epstein referred to earlier. What Professor Epstein forgot to tell you, or omitted to tell you, was that the product involved in the Price case was an open-back inclinable punch press which was, in fact, manufactured in 1940

and was in fact manufactured in the State of New York and ultimately caused serious injury -- the loss of 3½ fingers from a young employee's right hand in California subsequently. But at the time it was manufactured in 1940 in the State of New York, it was manufactured in violation of existing statutory safety standards that existed in that state at the time and the evidence that was produced in that case brought out the existence of those standards, brought out the fact that what those standards were, but allowed any trial judge, as any court would allow, the manufacturer to state his piece, and he did and he presented his case, and he presented it well, and he presented it effectively, because the jury decided in that case that the manufacturer wasn't responsible because it was a multi-purpose machine and perhaps the responsibility rather than being placed on the manufacturer should have been placed upon others and the subsequent chain of possession and sale of the equipment. I am not suggesting that every case would be involving a punch press and involving the same issue would result in the same decision. What I am saying is that certainly where there is a case to be made on the part of the manufacturer and he is to be exonerated, should be exonerated, we see where Price v. Niagara has done that. And there are other cases in the same vein. I think the problem is this, that it has been stated here, that as one gentleman earlier stated that something like five or ten years ago we had no claims. This year we had 40 claims -- I don't recall the statistics he cited. But I don't think we can go back to 1952 or 1962 for that matter. This has been a recent phenomena. It wasn't until 1960 and a

decision of the California Supreme Court that an injured employee or an injured consumer anywhere had the right or even the standing in court to bring an action against a third party manufacturer with whom it had no connection whatsoever other than it was using a product that it once sold, that there had to be a direct contact, a direct relation, direct hands across the table agreement between the injured consumer, the injured worker and the manufacturer. So we are talking about something very recent. It wasn't until 1963 and 1964 with the landmark cases in California and Vandermark v. Ford and Greenman V. Yuba Power that the rule of strict liability in tort was developed. Now, it wasn't until a few years later that we saw an increase in the number of losses being filed because this was a new remedy available to injured consumers and injured workers. And I think we are saying perhaps that the crest of this kind of an interest and a pressure on this type of litigation and with more decisions like Price v. Niagara with another look at the field, with perhaps an ebbing in the consumerism movement which has been discussed here earlier -- I strongly feel that the problem is going to kind of seek its own level and it is going to self-correct. I think with respect to most of the problems that have been raised here, with respect to most of the reform that has been suggested, they exist and they are working. Professor Phillips discussed the comparative negligence situation. That issue is presently before the California Supreme Court right now and we are expecting a decision momentarily....

CHAIRMAN KNOX: Is it a products case?

MR. STEINBERG: A products case -- forgive me, it is not a products case -- that one case. But there are several cases presently before the Supreme Court dealing in employee or worker's comp subrogation, number one, dealing also with the application of comparative negligence in a product liability case. As soon as there are decisions in these several cases, we may end up with a decision from the high court momentarily, basically holding what Professor Phillips has suggested with respect to the subrogation.

CHAIRMAN KNOX: How do you feel about that?

MR. STEINBERG: Well, I have to concede that there is nothing today which, except the Occupational Safety and Health Administration enforcement procedures, that encourages employers to update their equipment, to do something to encourage them to see that a safer product is operated within their own working environment, that perhaps if the employer is unshielded from the limitations of the worker's compensation system where he is guilty of a violation of the safety statute or for gross negligence or something of that kind, perhaps we would have some economic deterrent focusing on the employer directly that might relieve the situation.

CHAIRMAN KNOX: All there is now is Cal-OSCHA and collective bargaining, I guess. Did you ever get that willful misconduct recovery?

MR. STEINBERG: Yes, we do but you are talking about a relatively small amount of money. It really doesn't have any economic deterrent involved in it. It doesn't have any economic bite, and it is my position that we've done a job in this field.

I am talking about the plaintiff's advocates, the plaintiffs themselves. I think we have seen corrective measures being taken in many fields and in many areas as a result of product liability suits. There have been changes in approaches by manufacturers. I receive calls constantly from manufacturers of new products knowing I am involved in the other side of the fence in this litigation, saying I am coming out with this product -- what do you think of it. Where are my problems? What kind of a warning should I put on it? I've got those three alternate designs. What should I do with it? This was unheard of 10 or 15 years ago. I think that certainly it is a social problem. We decided with agreement in the Vandermark decisions in 1963 and 1964 to afford this remedy. My point is, I don't think there is any way we can go back on that, that some of these problems are basically self-correcting.

CHAIRMAN KNOX: Okay. Questions? Thank you very much, Mr. Steinberg. We appreciate your attendance. I understand that the electronic importers and the furniture manufacturers are going to submit written statements. We have about 10 minutes, and I suppose it would be fair if we let Dr. Epstein raise a point of personal privilege at this point. In 10 minutes, Epstein, now.

PROFESSOR EPSTEIN: You know I don't know where to begin quite, so I will probably begin at the top of the list. I will deal, I think, first with some of the remarks Mr. Aitken made in the way in which I would want to respond to them. They concern the now fabled case of Price v. Niagara. I think that really my point about that case is, are several. First, that I don't get the same

message as he gets. I get the message, don't appeal and seek a directed verdict on the cases of that sort, but it seems to me also the court was quite sure that the jury was, on the strength of those facts presented in that case, entitled to find for the plaintiff and if so, no directed verdict would be given to the defendant So in many ways I think that the case could be read as a spur to the initiation of these suits even though it was not treated as a spur for the appeal. The second point that I wanted to make about that case was that it seems to show, to illustrate a real fundamental difference in approach between myself, I think on the one hand and Professor Phillips and Mr. Steinberg on the other. That is that's a case which 10 years ago, and here I think that the problem is not Greenman v. Yuba Power, it is not Vandermark, it is the erosion in defenses and the rise in design defect in duty to warn cases, all of which long followed the introduction of strict liability and the abolition of privity within the state and written statement which I have goes into that in some greater detail. But that was the case under which, and here by the way the manufacturer was not in violation of the statute. The statute referred to in-state use. It did not refer to a manufacturer's duty to make the machine conform to that in-state use and that was clearly discussed and debated in the course of the opinion. To that extent, I disagree with Mr. Steinberg. But it was a case in which custom, the state of the art, as to ordinary practice would have been a directed verdict under that kind of system, I think; that the open and obvious nature of the danger would have been a complete defense in this state before Olsen and

Cronin; that the question of whether or not there has been a cure of the original defect by the imposition of whatever safety in question would have been a complete superseding the cause defense as a matter of law. And if all three of those things had been taken and had been pushed into some kind of a foresight reasonableness test and what you really want to ask yourself is whether or not a system would withstand that kind of uncertainty. It may well be the rule which says that defective products hold you liable is a strict and clear one but when you get to the definition of what counts as a defect, you get yourself into the kinds of reasonableness that is required which it seems to me to be very difficult to deal with. The second point I would want to mention concerns our elevator case, which was talked about this morning. I think that really illustrates the opposite point. Elevators are the kind of heavy equipment that have to undergo annual inspection by the state. They are always installed and owned by somebody and they are repaired by somebody. If after 10 years that elevator gives out, the beauty of this statute of limitation I think is that it may exonerate the original manufacturer but certainly leaves action against owners and occupiers under an occupiers liability theory and against inspection and maintenance repairmen under some other kinds of substantive theory. You knock out one defendant which does not mean in many cases that you knock out a plaintiff's recovery. In addition, if there is a recall notice or an OSCHA notice or something of that sort, that also would start the treatment of the statute anew, and it should. So, that under those circumstances too when you understand the

statute not only as it is construed but with some fairly I think well drawn out and well thought out exceptions, that it is going to be a pretty sensible accommodation and a good statute.

Moving on. I disagree with Professor Phillips about the desirability and foreseeability as a concept of organization. As far as I am concerned, there is simply no way that that could be reduced to a set of standards which tell you what you do or do not do. We spent a long time in our state of the art statute and in our product modification statute worrying about crime to put that kind of language in there; but in the end, we thought that if you use that kind of language there is no point in going for legislation. If you don't use it, you may lose the odd case but at least you will be able to get the 95% cases which are covered by the statute correctly decided and to quote Mr. Aitken, if in an imperfect world you get that kind of results, I think you are doing very fine by the legislation. In particular, I don't think the Guffy case, which he mentioned, would be decided otherwise under this statute than it is there. Certainly since the modification wasn't of a product but of a protection. It seems to me very difficult for a manufacturer to say if third party takes efforts to prevent him from suffering liability which failed that he ought to be exonerated so that in my mind unless you change the operation of the conveyor belt in the business it seems to me that the statute would say, this is one where the original condition resulted in the harm in question and that you could recover from somebody under it. At least, I would want to interpret it that way, although again, he is quite right to say somebody could quite

possibly read the statute in the other kind of direction. I mean that kind of thing is something which is in principle possible to achieve. Dealing with some of the other points that have been mentioned very briefly. Another point about the statute of limitations, I think is very nice is that to the extent that you are dealing with new products and a changing environment, the statute of limitations will give no comfort to a kind of manufacturer who ought not to get it. It is the kind of thing, I think, where what you say about it is the statute that will protect products that are around and will not possibly come to bear on current products until 10 years afterwards and even then it would be subject to a number of possible regulatory exceptions. So it seems to me you have very few incentive effects with respect to current activity where I am not really interested in cutting our products liability law, but that it will have effect with respect to older products. With respect to Mr. Phillips' examples in the South Carolina case about the clutch box, it seems to me that that is the paradigmatic case where the statute falls short. I don't think when I put the statute forward that I pretended that you were going to get every case right with a statute of an automatic 10-year cut off, and oddly enough the ones that you want are defects in original conditions that are latent in which the injury occurs without any fault or participation of the plaintiff. You are going to lose a couple of those cases. You may well even in the automobile case have another defendant whom you could sue to recover some of it, or it may well be that after 13 years the car is so much more rickety than otherwise that even though the gear box assembly was not changed over that period, the rest of the

automobile was. So that I am not quite sure you could handle that case completely, but in the end it seems to me you have to make a judgment as to how many cases there are of that sort and how many there are of the sort like Price and the related cases. Dealing with the state of the art, what gets me troubled about the capability standard which has been proposed is essentially -- I don't know how you really litigate it any principled way. It seems to me to talk about capability, information about subsequent improvements come in as evidence as to what you might have done then, and that you get yourself into the type of situation where every case becomes completely open-ended as to what you can and cannot do; that is, in California for example, or in any state, it would be quite possible to take the legislative standard proposed example by the National Traffic Safety Statute of 1966 and read them back into pre'66 cases or preregulation cases. So for example, it is always technically possible to put a head rest on the back of an automobile that is not required by statute. Is any car which doesn't have a headrest behind the passenger going to be defective because it was within the state of the art to do that? I am terribly worried about that kind of a situation. It seems to me that we have to rely on a mix of market mechanisms on the one hand and statutes on the other hand. Go and to the state of the art.... To go beyond that I think creates more uncertainty than it is worth. Admittedly you will lose some cases, although I am always impressed when one looks at the Learned Hand formula of which I have always been an ardent opponent, in the T. J. Hooper. I don't know of a case in which the industry is lagging. I haven't read any. It has been sort of demonstrated.

It seems to me that what happens just so that the industry could have done something else and that's going to be sufficient and indeed my own view about the classical economic situation is it is very hard to find that situation existing over any period of time. The industry contains all sorts of individual firms who act in opposition to one another and to the extent that everybody in it is lagging, somebody is going to have a very strong economic incentive to go forward because you could sell safety just the same way you could sell any other kinds of view. My last point is about comparative negligence. I am not a particular fan of comparative negligence. This is not to say I am opposed to it. It is clearly better than the current California situation with regard to plaintiff's conduct in these types of lawsuits. I regard that as a true travesty. The question is once you have taken into account, what does it mean? One of the things that we have noticed is that when you look at states that do have comparative negligence, the plaintiff's conduct no matter how blatant, usually comes into to be something like 10, 13 maybe 20% of the total loss. Even if you allow comparative negligence, there is always a danger that the jury could tack on a little bit more on the damages so as to completely eliminate the effect of the offset. Also, I'm not very sure about how comparative negligence works in multi-party suits where some parties are present in the action and some parties are not. That was the point that was left open by the California court in Li and it seems to me in products, it is not a trivial point, it is the dominant point. It may well be that comparative negligence could work

reasonably well on an automobile type situation. I have much more doubts in its principle, in its operation later. There are other objections I could raise to this kind of intellectual scheme. My own preferences sort of vacillate from time to time between the efficiency of the complete bar, which I don't think to be terribly unjust; after all, the guy did bring it upon himself and one would say, yes, we do have a comparative negligence system but instead of trying to figure out the facts of each individual case what the comparison ought to be, the Legislature should say in each case the plaintiff is going to have to eat 50% of his losses to the extent that he has caused it. Try to eliminate from the fact the way in which the degrees of causation blend in with the nature of the wrongful conduct and the sequence of the occurrence. I don't know how you apportion joint costs in anything other than an arbitrary way. And if it is going to be arbitrary, it seems to me it ought to be done once and for all so at least you have uniformity. The danger of comparative negligence as a jury matter is it opens up the trial even broader, increases the litigation expenses, makes it more difficult to reach a settlement at the outset and in the end may result in no real relief because of the very tiny verdicts, or the very tiny reduction which is going to be attributable to plaintiffs. And the final statement, and I think this is one which the AIA agrees, I think it is a tragedy we have to be here with legislation. It seems to me we have gone so far off the rails from Greenman and from Vandermark -- not Vandermark, that's a bad case -- from Greenman v. Yuba Power, which is a good decision, and a fine case --

so far from it, that we are now forced to try and do common law, as it were in the abstract. I would much prefer to have the courts decide to go back 20 degrees from where they were. There is no way you can turn back the clock, but if you've got 20 or 30 more decisions -- it may take that many, not only from the intermediate courts but from the Supreme Court, which started to give you a few directed verdicts for defendant and started to affirm the current situation. I might say, let's hold off a little bit on this statute. But at this point, it seems to me you don't have that type of situation and that given that I find so many results to be just frightfully unjust in the individual case, I am very reluctant to say, well let's just let the whole thing sort it out from the time. You know as Mr. John Kane said, in the long run we are all dead, but in the short run a lot of people have a great many problems which, of course by varying....Okay, thank you.

CHAIRMAN KNOX: Thank you, Professor. Very good. I think the upshot of this is that we should just keep this committee in session for about five more years and the cycle will take care of everything. The meeting is adjourned. Thank you, very much.# # #

A P P E N D I C E S

APPENDIX I

California Legislature

Joint Committee on Tort Liability

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O P E N I N G S T A T E M E N T

John T. Knox, Chairman
Joint Committee on Tort Liability
State Building, Room B-109
1350 Front Street, San Diego
July 18, 1977

Today's hearing on products liability is the second in a series of hearings by the Joint Committee on Tort Liability on various aspects of tort liability problems in California. On July 11, in Los Angeles, we heard testimony on professional liability, and on July 22 we will be in San Francisco to hear testimony on insurance company underwriting practices.

The particular problem we are considering today is this: California manufacturers and consumers have, in recent years, been confronted by a crisis of potentially disastrous dimensions. In 1974, the latest year for which statistics are available, products liability losses and loss-related expenses totalled almost $200 million nationwide. If current actuarial studies are correct this figure may now be approaching $1 billion. While the breakdown is not precisely known for California, it is clear as in medical malpractice and other liability areas that California's share accounts for the largest portion of this amount. It is also clear that most

insured manufacturers in California have had premium increases ranging from one hundred to five thousand per cent.

We are told the cost of products liability insurance in many instances may exceed 20% of the manufacturer's sales receipts for essential products like medical supplies and packaged food items. For simple household products such as chairs and ladders this cost may be as much as 40% of their receipts.

These charges, of course, are eventually reflected in higher retail prices. As a result, an added burden is placed on the consumer's pocket book in an era of chronically high inflation. Small and medium size manufacturers, lacking the bargaining and economic power of the corporate giants, in many cases have been forced to go without coverage, or a funded self-insurance program. Still more serious are the reports our Committee has received that several manufacturers have ceased production altogether. Quite obviously, if this denotes a trend, we are on the verge of a calamitous situation for California business.

We are presented here with a dilemma: On the one hand, if we do nothing, the result could well be economically catastrophic; on the other hand, presently proposed legislation may only immunize manufacturers from suits, leaving large classes of injured parties without remedies and without manufacturers receiving a meaningful reduction in premiums.

Accordingly, the purpose of today's hearing is to consider the causes of and possible solutions to the problems facing manufacturers while also assuring victims of faulty products that they will be fully compensated for injuries they suffer.

Our witnesses include distinguished scholars and representatives of manufacturers, insurance underwriters and the legal profession. Their testimony will form a basis for interim recommendations we intend to make for legislation before the next session of the Legislature.

We are aware that the blame for the present situation has been laid on all sides. Responsibility has been fixed upon a myopic judiciary, avaracious insurers and lawyers, and careless manufacturers. The problem is indeed complex. We ask only that witnesses give primary consideration in their recommendations to the public's interest, even though this may not always coincide with their immediate economic interests.

# # #

FROM THE OFFICE OF:
ASSEMBLYMAN JOHN T. KNOX
STATE CAPITOL, ROOM 2148
SACRAMENTO, CA 95814

PRESS NOTICE

FOR IMMEDIATE RELEASE
July 14, 1977

CONTACT: FRED HIESTAND -- (916) 445-0118

LEGISLATIVE COMMITTEE INVESTIGATES PRODUCT LIABILITY CRISIS

SACRAMENTO--Products liability problems will be the topic of a public hearing to be conducted by the Joint Legislative Committee on Tort Liability in San Diego on Monday, July 18, 1977.

The Committee, headed by Assemblyman John T. Knox (D-Richmond), will hear testimony on the high cost and, in many cases, unavailability of products liability insurance and will consider proposed solutions to the current crisis. Products liability insurance costs, which may exceed 20% of a manufacturers sales receipts, are passed on to the consumer in the form of higher retail prices. Small manufacturers are the hardest hit by the rising cost of products coverage. A rapidly increasing number have been forced to go without liability coverage or shut down altogether.

The hearing will be held in the State Building, Room B-109, 1350 Front Street, San Diego, from 10:00 a.m. to 5:00 p.m., July 18.

Attachments:
Press Release for July 18, 1977
Agenda of Witnesses

APPENDIX II

Statement of D. K. (Ken) Holliday

To The Joint Legislative Committee on Tort Liability

State of California
San Diego - July 18, 1977

My name is Ken Holliday. I serve as Vice President responsible for Commercial Lines insurance for Sentry Insurance a Mutual Company. My background includes almost 19 years in the Insurance Industry, with the majority of that time involved with the underwriting function on Commercial Lines of business.

I have a B.B.A. Degree, with a major in insurance, and an L.L.B. Degree. I am a member of the Georgia Bar. I also hold the C.P.C.U. designation (Chartered Property and Casualty Underwriter).

I have been active for the past year and a half in several Industry Committees dealing with the subject of Products Liability. At I.S.O. (Insurance Services Office), I am Vice Chairman of a Products Liability Committee that is involved in several aspects of the Products Liability situation, including a major closed claim survey which covered over 20,000 products claims closed by 23 companies from July, 1976 to March, 1977. The final report on this survey will be completed by the end of the summer.

I also serve as Chairman of a Subcommittee of this Products Liability Committee which did a complete review of the standard insurance coverage being provided for Products Liability. At the Alliance of American Insurers, formerly the American Mutual Insurance Alliance, I am a member of a Products Liability Residual Market Task Force.

The National Association of Insurance Commissioners last year established a Task Force to study the Products Liability situation, and I serve on an Industry Advisory Committee to that Task Force. This Advisory Committee was asked last December to develop methods for the Insurance Industry to voluntarily work to solve the problems of availability of Products Liability insurance coverage. The Committee recommended that each state Insurance Commissioner appoint an Advisory Committee to review Products Liability complaints and find markets willing to provide coverage.

In February, such an Advisory Committee was established in Wisconsin and I presently serve as Chairman of that Committee.

For this Joint Legislative Committee's information, I am providing two copies of material dealing with some aspects of the Products Liability situation which I think you will find informative.

(1) an I.S.O. Report on Products Liability Statistical and Rating Procedures

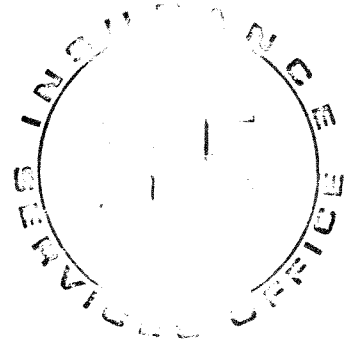
(2) an American Mutual Insurance Alliance pamphlet outlining the problems with proposed mandatory residual market mechanisms for Products Liability.

(3) Sections 3 and 5 of the Advisory Committee report to the NAIC Task Force on Products Liability.

APPENDIX III

PRODUCT LIABILITY INSURANCE

Background Report on Statistical and Rating Procedures



DECEMBER, 1976

PRODUCT LIABILITY INSURANCE

Background Report on Statistical
and Rating Procedures

Prepared by the Staff
of
Insurance Services Office

December 1976

* * *

At the June 1976 meeting of the National Association of Insurance Commissioners (NAIC) representatives of ISO alluded to a "Bridge Document" currently in preparation which will relate past history to the present and future product liability insurance environment. Its purpose is to bridge the gap between past standard ratemaking and statistical data, including the Closed Claim Survey as it reflects recent legislative and judicial action, and future conditions likely to have an impact in this area. Since it will be well into 1977 before the Closed Claim Survey and a valid analysis will be complete, and therefore, until the final Bridge Document can be prepared, the ISO staff has prepared the attached material to respond to immediate needs. Many of the topics addressed in this document are under study by the appropriate ISO insurer committees. It is entirely possible, therefore, that some of the procedures and descriptions contained in this paper may be superseded at a later date.

Many of the questions being asked today concern the availability of statistics, the types of coverage and the procedures used in pricing product liability insurance. The information which follows focuses on those concerns. None of this material is new; it has been available previously in the manual rules, policy forms, staff memoranda, statistical plans and the like. We hope that assembling it in one document will be educational and responsive to the questions about product liability insurance, and ISO's functions and activities in that area.

What is ISO?

Insurance Services Office (ISO) is a non-profit, unincorporated association of insurance companies providing extensive statistical, ratemaking, and research services for the property-liability insurance industry. ISO functions involve 13

different lines of insurance and 52 jurisdictions. An insurer may affiliate with ISO for various services for a single line of insurance, e.g., private passenger automobile, in a single state, for all lines of insurance in all states, or various combinations of lines and services in the states it desires them.

How is Product Liability Coverage Afforded?

Insurance contracts under which product liability coverage is afforded may be broadly categorized into three different types:

1. Monoline policies -- liability insurance policies which include coverage for the product liability exposure;
2. Commercial package policies -- insurance policies which include a standard combination of property and liability coverages generally sold to small and medium sized insureds; and
3. Composite rated, loss rated and large (a) rated policies -- insurance policies which may be of the monoline or package type but for which specific rating techniques are employed to determine the price to be paid by usually very large insureds.

Monoline Policies

These policies provide bodily injury (B.I.) and property damage (P.D.) liability coverage specifically for the product liability hazard of the insured. The basic limits of liability are $25,000 for each occurrence and $50,000 in the aggregate for all bodily injury claims arising out of occurrences during the policy period and $5,000 for property damage resulting from one occurrence, subject to an aggregate policy limit of $25,000 for all property damage claims. Increased

limits of liability for both Bodily Injury (B.I.) and Property Damage (P.D.) may be provided to those insureds desiring additional coverage.

The rules, classifications and rates for product liability coverage are found in the Product Liability Manual. The current classification plan defines over 400 separate classifications reflecting the major revision of 1974. At that time, approximately 120 of the then existing classifications were deleted and replaced with over 220 new classifications to provide a more refined breakdown of the types of product risks. In addition, many classes which had been (a) rated became manual rated and several manual rated classes became (a) rated. (The difference will be explained shortly.)

The most common units of exposure, that is, the bases used for determining the premium charge, are each $1,000 of sales or each $1,000 of receipts. There are several product classifications which have a specific unit exposure base more directly related to the particular class, e.g., number of tons, number of fillings, number of gallons.

For most of the defined classes (approximately 65%-75%) a rate will be shown on the rate pages of the ISO manual. For the risk (insured) assigned to one of those classes, the premium is calculated by multiplying the number of exposure units by the appropriate rate. This calculation produces the basic limits premium for the coverage, i.e., B.I. or P.D. and if higher limits of coverage are desired, an increased limits table is consulted to determine an appropriate factor by which to raise premiums to reflect the increased coverage.

The product liability manual rates are based on a review of countrywide experience under previous product liability policies. A complete explanation of the ratemaking procedures used by ISO is attached.

There are many classifications defined in the ISO product liability manual for which no rate is indicated on the rate pages, but the symbol (a) is shown instead. Approximately 25%-35% of the total number of classes are (a) rated. For the risks (insureds) to which these classes apply, the responsibility for determining the appropriate rate lies with the underwriter (the representative of the insurer who is responsible for risk acceptance). A statistically valid manual rate which would be appropriate for each insured in the (a) rated classes cannot be determined because of the extreme variability in their underlying hazard.

A good example of an (a) rated class is "valve manufacturers." Risks within this classification differ widely in the hazard that each presents, since such a variety of valves is manufactured, all with completely different applications. It is intuitively obvious, for example, that manufacturers of valves to be used in jet aircraft present a different risk than manufacturers of valves to be used in plumbing in private homes. In addition, different valve manufacturers may have different degrees of design capability, resulting in differences in hazard. Because of the importance of these and similar factors, rates are determined for each of these risks separately, based upon judgment and knowledge of all the characteristics peculiar to the risk.

ISO does make available to its companies suggested (a) rates which are intended as a rough indication of the average rate that would be appropriate for the classification as a whole, but might not be appropriate for any one risk defined by that classification.

While insureds covered by a monoline policy may be small, medium or even large risks, generally those purchasing a package policy or those which are composite rated, loss rated, and large (a) rated are large risks. Also, within the group of insureds covered by monoline policies

the (a) rated risks are usually larger than those which are manual rated. This is evident by the fact that the (a) rated classes comprise less than 35% of the total number of defined classes, but generate about 75% of the premium volume for all monoline policies.

Complete detailed statistics by classification are available for the manual rated classes, but only summary experience for the (a) rated classes is available at the present time. The key statistic required for classification experience to be included in the ratemaking data base is exposures and prior to the 1974 classification revision, exposures were not reported for the (a) rated classes. Therefore, although most the product liability premium and loss experience incurred in this country is reported to ISO, only a small percentage is reported in sufficient detail for rate review and analysis. The ISO statistical reporting procedures were changed in early 1974 to require refined classification detail including exposure counts for (a) rated risks so that in the future product liability rate revisions will reflect data for all monoline product classes, manual and (a) rated.

Package Policies

Commercial multi-peril (CMP) policies include a variety of coverages designed to meet the needs of medium to large insureds engaged in certain commercial enterprises. A typical commercial package policy provides a mandatory combination of coverages which are automatically included when the insured purchases the policy and includes both liability (third party) and property (first party) coverages. The liability section usually provides comprehensive liability coverage for all of the insured's operations, including the product liability exposure.

The package policy premium is generally determined by using the monoline rates, modified by a package discount. The large body of experience generated by these multiline policies is currently not included in the monoline ratemaking data base since the statistics are not recorded in sufficient detail to identify sublines. Although aggregate figures are unavailable, it is generally believed that multiline policies do generate substantial products experience.

The new ISO Commercial Statistical Plan (CSP) currently being prepared for implementation will capture complete detailed product liability statistics on a monoline basis for all multiline policies. Consequently, in the future it will be possible to combine the data produced under CSP with the monoline (manual and (a) rated) data for ratemaking purposes.

Composite Rated, Loss Rated & Large (a) Rated Policies

These insurance policies may provide coverage on a monoline or multiline (package) basis and are distinguished from the prior two broad groupings by the distinctive rating procedure used in determining the premium. Insureds rated under these procedures tend to be very large and the rating procedure itself may be negotiated between the insurer and insured.

Composite Rating

Composite rating was developed as an alternative to manual rating for the larger risks which present many different types of exposure requiring coverage under

several lines of insurance. Instead of using the traditional exposure base for class and type of coverage, a single, convenient exposure base (such as sales) is selected for use during the policy period for all coverages involved. A composite rate is calculated initially on the basis of a survey of the separate exposures in each rate class, for each coverage by applying the appropriate manual rate. The sum of the products of these exposures and rates is then divided by the selected exposure base to determine the composite rate for the risk. Composite rating is advantageous because of its simplicity and efficiency requiring as it does the auditing of only one exposure base.

Loss Rating

Within the Composite Rating Plan there is a further provision (Rule 9) that permits any risk developing $200,000 or more of losses at $10,000/$10,000/$10,000 limits in the latest three-year period to be "loss rated." Under this procedure, the actual past losses of the particular risk are used to determine the appropriate premium for that insured and a single composite rate is then estimated on the basis of the selected exposure base. As the eligibility requirement indicates, only the largest risks qualify for loss rating.

Large (a) Rating

This is a device which permits the rate for very large risks to be determined on the basis of the specific characteristics of that risk rather than on the class or manual rate which reflects the average experience of generally

smaller risks. Product liability has changed substantially since the introduction of large (a) rating and its relevance to current conditions is being carefully evaluated by ISO insurer committees.

This third group of composite rated, loss rated and large (a) rated risks generates a greater volume of total experience than either of the other two groups previously described, but that experience is for all of the coverages which are included in those policies. The product liability portion of that experience cannot be determined but it is known that a significant amount of the total products hazard is insured under policies rated by these devices.

What are the Sources of Data?

There are two primary sources of statistics: the insurer's Annual Statement and statistical plans. The Annual Statement is fundamentally an accounting document developed as a tool to assist the state regulators in their evaluation of an insurer's solvency and solidity. Each Annual Statement contains an exhibit displaying calendar year premiums, losses and loss ratios for the lines of insurance -- as defined for Annual Statement purposes. On this exhibit product liability data are included in the line: "liability other than automobile or medical malpractice." Therefore, product liability figures are not separated from all other general liability lines.

The second major source of data, statistical plans, does provide information separately for product liability insurance although, as noted, presently not on 100% of the coverage. The statistical plans are specifically designed to gather experience in sufficient detail so that it can be used for ratemaking purposes and/or to evaluate the underwriting results for each coverage and each line of insurance.

The most detailed experience currently available is for those risks which are

manual rated. As explained previously, this includes insureds whose product fits a classification for which a manual rate has been determined. The experience of all such insureds is compiled and reviewed to assess the propriety of the manual rates. For data to be usable in the ratemaking process, a key requirement is the reporting of exposures by classification. This detailed reporting is available for the manual rated classes and the summarized data is displayed in Attachment 1. It has been estimated that currently less than 10% of the product liability exposure is manual rated and used in the review of product liability manual rates.

Separate product liability summarized data is also available for (a) rated risks but detailed information, including exposures by classification, has not been reported in the past. As mentioned previously, however, a new statistical reporting requirement was introduced in 1974 so that now exposures for (a) rated risks are reported in classification detail. Consequently, in the future product liability rate analyses will review data for all the monoline classes, whether manual rated or (a) rated.

The other group of policies for which summarized data only are available is for the composite rated, loss rated, and large (a) rated risks. As explained previously, the product liability portion of these policies cannot be separately identified so that the available experience includes other general liability experience as well as product liability. The product liability portion of the premium volume has been estimated to be at least 20%-30% of the total premium generated by these rating procedures. The latest available data, summarized for each of the policy years, is displayed in Attachment 1.

The group of policies for which no statistics are available, the commercial package policies, may account for as much as 30% of the product liability exposure.

This data will become available under the reporting requirements of the new Commercial Statistical Plan which eventually will allow the combination of multi-line and monoline data for ratemaking.

What is ISO Doing to Improve the Data Base?

ISO and its insurer committees have taken several steps since early 1974 to improve and expand the data base that is used in the determination of product liability rates. A summary of changes and improvements is listed below:

1. Monoline policies: in 1974, statistical reporting requirements were amended to require reporting of exposures in classification detail for (a) rated risks.
2. Multiline policies: The new Commercial Statistical Plan will require complete coding in monoline detail of those risks insured under commercial package policies. The identification of exposures and losses (claims) in such detail will enable this experience to be reflected in the data base.
3. Composite rated risks: Effective January 1, 1977, composite rating for product liability will no longer be permitted for risks not eligible for loss rating. Risks desiring to include coverage of their product liability hazard will be required to do so separately, thus assuring that identifiable product liability exposures and losses will be maintained.

Other Activity -- The Product Liability Closed Claim Survey

ISO has initiated a study to capture detailed information on over 20,000 product liability claims closed by 23 major insurers during the last half of 1976.

It is expected that the final analysis of the data gathered in that study will be helpful to all parties seeking to find some solutions to the product liability problem.

What is ISO Doing to Increase Timeliness and Responsiveness of Data?

Several technical and procedural adjustments are underway which will improve the validity of the data base for ratemaking purposes. The improvements are merely summarized below. A reading of the ratemaking memorandum attached will facilitate a fuller understanding of these points.

1. Trend data (average claim cost) for product liability will be made available within six months after the end of the calendar quarter.
2. Claim costs will be developed on an incurred basis.
3. Loss development data will be maintained up to 123 months for B.I. coverage.
4. The due date (for insurers) for submission of product liability premium and exposure statistics to ISO will be moved up.
5. The processing of product liability data will now be scheduled ahead of less sensitive general liability sublines.

Continuing Pricing Complexities

1. The product classification plan contains an extremely large number of classes. Because of this, the experience for any one class is rarely statistically credible and it is extremely difficult to calculate equitable rates for particular classes and risks. Additionally, many of the class definitions are

not precise so that it is possible for some risks to fit the definition of several classes.

2. The product liability exposure base for most classes is sales or receipts. Although simple to report and to audit, the current sales base frequently does not measure the total hazard for many risks since, as presently used, it does not consider the potential for claims incurred during the present policy period for products manufactured years ago. Additionally, a better made, higher quality product with substantial safety features would be more expensive and thus produce a higher premium than an inferior product of the same type selling for less.

3. For product liability insurance, unlike most other lines, statistics are gathered and rates are determined on a countrywide basis, rather than state by state. For other lines the varying loss potential in different geographical areas has been, to a degree, influenced by the particular tort environment in an area. The same considerations do not hold true for many product classes. For example, a tire manufacturer in Ohio might be sued as a result of an accident occurring anywhere in the United States alleged to have been caused by the use of that product, and the suit might be brought in Ohio, in the state where the accident occurred, in the state where the purchase was made, the state in which the owner (driver) of the car was a resident, etc.

Conclusions

ISO insurer committees are aware of these and other technical problems which have an effect on rating and pricing for this line of insurance. While a great deal of work has been done and many changes have already been implemented, the ISO staff as well as its committees continue to work diligently to resolve the remaining difficulties.

Attachment 1

Insurance Services Office

December 1976

PRODUCT LIABILITY INSURANCE

Bodily Injury and Property Damage Combined

Policy Year Ended	Earned Premiums	Incurred Losses*	Loss Ratio
	Monoline - Manual Rated Classes		
12/31/71	$ 31,661,275	$ 21,110,940	.667
12/31/72	41,624,498	29,018,341	.697
12/31/73	49,560,259	35,431,429	.715
12/31/74#	44,748,085	32,679,452	.730
	Monoline - (a) Rated Classes		
12/31/71	$ 85,984,805	$ 97,574,782	1.135
12/31/72	120,110,961	96,906,925	.807
12/31/73	167,144,160	256,947,974	1.537
12/31/74#	158,531,975	199,568,635	1.259
	Composite Rated, Loss Rated & Large (a) Rated Classes Ø		
12/31/71	$219,806,307	$314,999,176	1.433
12/31/72	306,146,483	531,040,311	1.735
12/31/73	345,931,985	643,269,806	1.860
12/31/74#	331,154,141	704,734,414	2.128

*Losses are developed to an ultimate settlement basis and include all loss adjustment expense.

#Policy Year Ended 12/31/74 data are preliminary.

ØIncludes other General Liability experience besides product.

Attachment 2

Product Liability Insurance

Distribution of Total Products Liability Exposure

Types of Policies		Estimated % of Premium	Estimated % of # of Classes
MONOLINE	Manual Rated	25%	65%-75%
	(a) Rated	75%	25%-35%

MULTILINE

Commercial Package Policies
Commercial Multi-Peril (CMP)
ISO and Insurer Developed

SPECIAL RATING PROCEDURES

Composite Rated
Loss Rated
Large (a) Rated

The chart on the next page shows the steps required to process product data after the end of a policy year. It explains the time necessary to collect, edit, summarize and interpret these statistics properly. The time intervals shown on the chart are approximate, and anticipate no delays due to erroneous reportings that cannot be corrected by the reporting company within a reasonable time.

The steps at the top of the chart refer to processing of premium rather than loss statistics, since premiums are reported last and therefore have the significant impact upon the production schedule.

Explanation of Processing Phases
A policy year experience period includes all policies written in year 1 which ultimately expire during year 2.

1. Exposures and Premiums are valued by companies as of June 30
   Six months are allowed after the end of the policy year to audit the insured's sales during the policy period.

2. Exposures and Premiums are Reported to ISO
   Company submissions are due at ISO 4 months after the June 30 valuation.

3. Balance, Edit and Return Errors
   The company submissions are balanced to letters of transmittal and edited for statistical accuracy. Invalid data are returned to the reporting company for correction.

4. Process Error Corrections
   The invalid data are corrected by the reporting company and returned to ISO, where they are reprocessed (including re-examination).

5. Consolidate with Existing Data Base and Produce Preliminary Reports
   The data for the latest accounting period are sorted and consolidated with the data for prior accounting periods. Preliminary reports of the ratemaking data are produced for analytical purposes.

6. Review Preliminary Reports
   The preliminary reports of the ratemaking data are edited by the Data Services Division of ISO for reasonableness, based on guidelines established by the Actuarial Division of ISO. Questionable data are tracked to the original source for verification or correction.

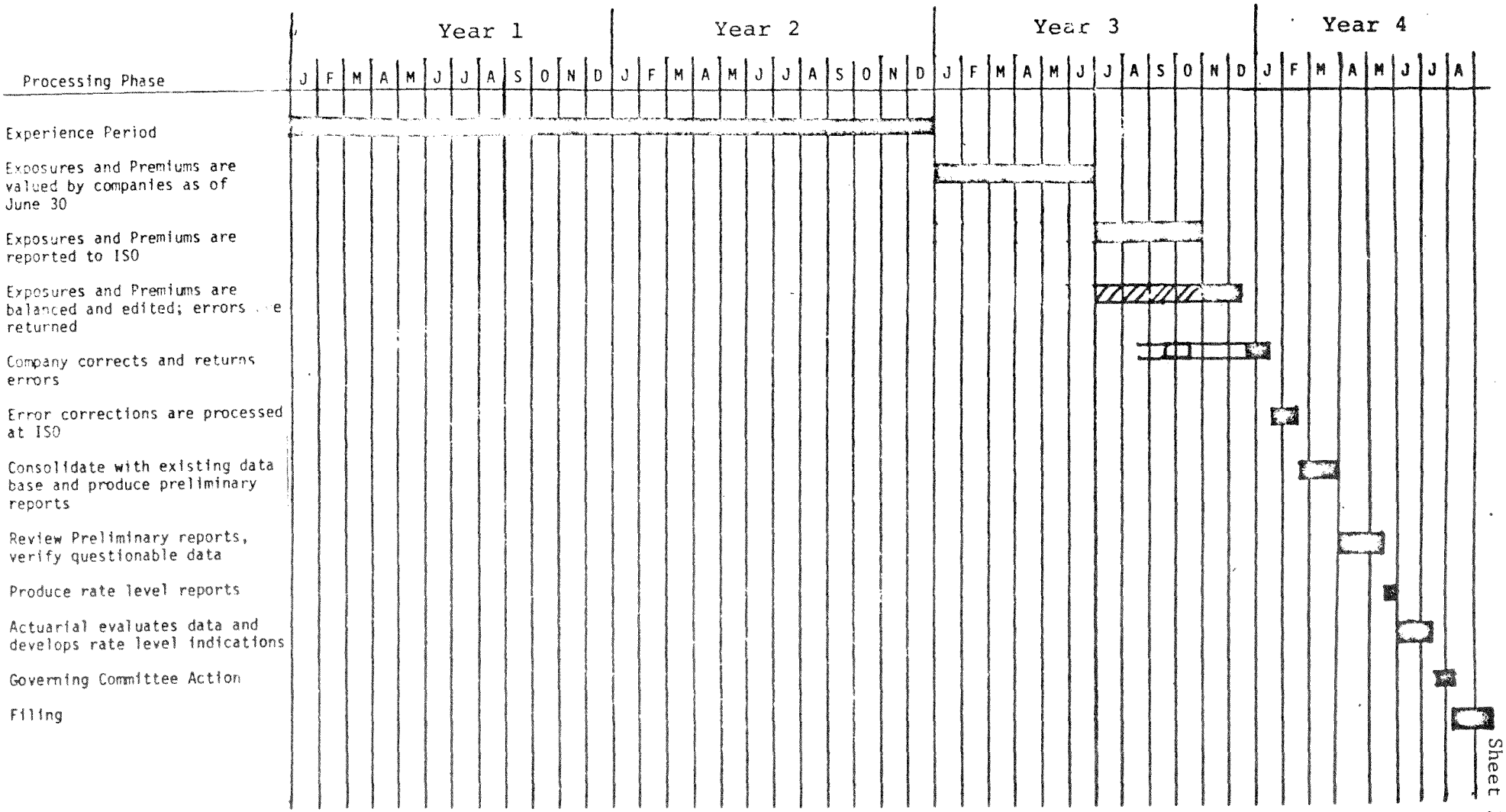
7. Produce Rate Level Reports
   After the preliminary reports have been edited, and any errors found corrected, all of the ratemaking exhibits required by the Actuarial Division are produced.

8. Actuarial Division Evaluates Data and Develops Rate Level Indications
   The Actuarial Division evaluates the ratemaking data and develops the rate level indications.

9. Governing Committee Action
   The rate level indications are presented to the Governing Committee for approval.

10. Filing - Rate filings are prepared, rates are calculated and filings sent to the appropriate ISO state office for filing with Insurance Department.

Products Liability Insurance
Present Schedule for Processing Products Liability Insurance Statistics



Attachment 3
Sheet 2

Attachment 4

PRODUCT LIABILITY INSURANCE RATEMAKING PRINCIPLES

To appreciate fully the product liability insurance situation, a basic understanding of the fundamental principles used in pricing this line of insurance is essential. This memorandum presents the ratemaking procedures used by Insurance Services Office (ISO). Several companies which write product liability insurance do not use the rates developed by ISO, but employ their own ratemaking methodology. The basic concepts and teminology in determining manual rates, however, are common to all insurers. Additionally, it must be kept in mind that many product liability risks are subject to (a) rating.

The price, or rate, for "basic limits" coverage is determined by an analysis of the actual countrywide experience under policies written in the past, separately (but using the same procedure) for bodily injury and property damage. Basic limits coverage provides up to $25,000 for each occurrence and $50,000 in the aggregate for all bodily injury claims arising out of occurrences during the year the policy is in force. ISO uses this 25/50 coverage as its base for ratemaking purposes. The corresponding property damage basic limits are $5,000/$25,000.

For product liability insurance as with other liability lines, experience is reviewed and analyzed on a "policy year" basis. That means that losses incurred on policies written in a given 12-month period are compared with premiums earned on those same policies. The experience for policy year 1972, for example, would consist of the premiums and losses on all policies with effective dates from January 1, 1972 through December 31, 1972 and expiration dates varying from January 1, 1973 to December 31, 1973, assuming all policies are in effect for one year.

When analyzing experience for ratemaking purposes, the premium used in the formula is that which would be produced if the current rates were to be charged to each insured. The losses used in the formula are incurred losses, as described below. As stated previously, the rates are for basic limits coverage so that premiums used in the formula are based upon the current rates for each classification of insured and the losses are also considered only up to that limit.

The incurred losses may be defined as the amount of money paid or payable to claimants including the amount of expenses involved in handling the claims. This figure consists of those losses and related loss adjustment expenses already paid and reserves set aside to cover known occurrences. Such reserves represent the best estimates by experienced claims persons for each individual case that has been reported. Each case reserve gives consideration to the nature and extent of the bodily injury and/or property damage involved, the merits of the case, current jury award patterns, the state of the law, and all other relevant factors.

The first report of these incurred losses and their related expenses, called loss adjustment expenses, encompasses losses evaluated three months after the close of the policy year, which is 27 months after the beginning of the policy year. The first report of policy year 1972, for example, covers losses evaluated as of March 31, 1974. All such reports submitted to ISO by individual insurers are consolidated and the aggregate figure is used in the ratemaking process.

The first report, however, does not contain any estimate or reserve for all those incidents which have occurred and which may produce future claims, but which have not yet been reported to the insurer (IBNR). It is expected that most of these claims will be made and reported during the next two to three years, although some may remain in a potential status for five or more years after the policy has expired. These late arising claims and the additional time it takes to finally dispose of them make up what is known as the "long tail" and they must be taken into account in making rates. Under the ISO ratemaking formula, these incurred but not reported claims are accounted for along with the maturing of loss data already reported, through the use of loss development factors.

Loss Development

As was stated previously, the first report of policy year incurred losses values those losses as of 27 months. In that report, as might be imagined, the amount of information and its accuracy regarding each incident will vary. Additionally, no estimate is included for incurred but not reported claims. However, further reports of the incurred losses for those same policies continue to be made at 12-month intervals.

To keep track of what happens with respect to each policy year, records are maintained to include additional information as it is received. Deferred reports and reports updating earlier ones, as more information pertaining to an injury becomes available, flow steadily from the local levels to a central point where they enter the statistical system. These subsequent reports reflect both newly reported cases and changes in cases previously reported. Those that arrive after the cut-off date for the "first reporting" become contributions to the next or "second reporting." The same holds true for the second, third, and subsequent reports. Each time information is gathered, estimates are made on newly reported claims (unknown as of the prior "latest" reporting but nevertheless chargeable to the original policy year when the incident occurred), estimates of previously reported claims are revised based on new information, and some previously reported claims are closed for different amounts than had been originally estimated.

ISO currently maintains losses through five complete reports or approximately six years after the beginning of the policy year. This procedure is being changed to continue capturing incurred loss data for a full ten years, or 123 months, for future loss development for bodily injury coverage.

Since the first report of incurred losses on a policy year basis will be quite immature, reflecting as it does only a very small portion of paid claims and no estimate at all of unknown claims, those losses must be adjusted to approximate the amount that ultimately will be paid in claims and related expenses arising from product incidents which occurred that year. This adjustment is accomplished by the use of a loss development factor, which is determined by comparing the more mature loss reports for prior years with the less mature reports for those same years. By means of this factor, the actual historical development which took place in the most recent past is measured and then applied to the latest policy year's incurred losses as of 27 months.

The estimated loss development from the first report to the second report is determined by measuring the average (mean) development that actually occurred for the three most recent policy years available.

A similar procedure is used to determine the development from the second report to the third, the third to the fourth, etc., up to the fifth report which contains losses valued as of 75 months. At that point, which is approximately six years after the beginning of the policy year, most of the incurred losses have been paid. The factor used to develop the first report of losses to the ultimate level is determined by multiplying successively the average factor (mean ratio) from the first to the second report, second to third, etc., up to the factor for developing from the fourth to the fifth. Based on the latest experience of all companies reporting to ISO, the factor to develop incurred losses from the first report to the fifth report is 1.876.

Even at the time of the fifth report the losses will still not be fully developed. More losses may be reported and payments on claims known but not yet settled probably will not exactly equal the reserves set aside as of the fifth report. In order to take this additional development from the fifth report to ultimate maturity into account, a factor equal to the development from the fourth to fifth report is applied to the losses developed through the fifth report. This factor is presently 1.02.

The application of loss development factors to the incurred losses and loss adjustment expenses develops these losses to a fully paid, ultimate settlement basis. By use of this technique, the necessary additional dollars are included in the incurred losses to pay for those claims and related expenses that the insurers will be required to pay in the future for the policy year being examined. This arithmetical procedure is used to approximate what the past incurred losses and adjustment expenses will ultimately turn out to be.

Since the goal of the ratemaking formula is to determine new rates which will be sufficient to pay claims that will occur in the future, a further adjustment is necessary before the incurred losses can be entered into the formula. The application of loss development factors produces an estimate only of what <u>past</u> losses will be when fully paid. What is needed is an estimate of <u>future</u> losses, since the revised rates will be charged for insurance policies issued in the future and the premium must be adequate to cover all the claims that will occur under those new policies. To bridge the gap between the level of past losses and the level of future losses, a trend factor is used.

Trend

Changes in product complexity, economic and social conditions and the legal environment have been numerous in recent years and have had a substantial effect on product liability claim settlements. Under a policy issued today and for a premium collected today, claims will occur and be paid under tomorrow's conditions with tomorrow's

dollars. The trend factor is an index which measures changes in the past with the expectation that those changes will continue at the same rate in the immediate future.

The ISO trend procedure measures changes in claim costs. To determine the annual percentage change in claim costs, the actual average paid claim costs for product liability insurance are fitted by a standard mathematical procedure to an exponential curve of best fit. Trends in claim frequency should also be taken into consideration. In the most recent years of available experience, however, there has been no significant trend in claim frequency for the data reported to ISO, so no such trend is reflected in the ratemaking procedure at the present time. It is widely believed that claim frequency is rapidly increasing at present, but this trend has not yet appeared in the statistics available for ratemaking data, due to the time lag.

These trends in losses are partially offset by the effect of increasing prices upon premiums. Because premiums for product liability insurance are calculated by multiplying the rate per $1,000 of sales times the sales volume measured in units of $1,000, an increase in price level causes a proportionate increase in premiums paid for identical coverage. An exposure offset factor which measures the annual percentage change in the exposure base (sales volume) due to price changes is determined by fitting the Consumer Price Index for Commodities to an exponential curve, using the same mathematical technique as in the loss trend.

On the basis of this procedure the present average annual changes in paid claim costs and sales volume are, respectively, +17.4% and +4.7%. Their combined effect is 1.174 ÷ 1.047 = 1.121 or +12.1%.

Bridging the Gap

Because the loss trend and exposure offset factors are used to bridge the gap between past and future experience, they are determined separately for each policy year. As noted previously, for a given policy year ending December 31, the experience consists of the premiums earned and losses incurred on all policies written during the preceding calendar year. For example, the policy year ending December 31, 1973 consists of the losses and premiums on policies written from January 1 through December 31, 1972, all of which expire during 1973.

Assuming even distributions of policy writing during a given policy year and of loss occurrences on the policies, the average date of loss occurrence for this policy year is that data midway between the point when the first policy could be written and the date the last policy would expire. For policy year ending December 31, 1973, the average date of loss occurrence would then be January 1, 1973.

Again assuming an even distribution of policy writings during a given policy year, the average date of writing (and thus exposure basis measurement) for this policy year is the date midway between the point when the first policy could have been written and the date the last policy could have been written. For the policy year ending December 31, 1973 the average date of writing is July 1, 1972.

The average date of loss occurrence for policies written at the new rate would be midway between the point when the first policy could be written at the new rates and the date when the last policy written at those rates would expire. (It is assumed that rates will be effective for a one-year period.) For rates becoming effective on policies written on or after July 1, 1975, for example, the average date of loss occurrence would be July 1, 1976. The trend factor for policy year ending December 31, 1973 must bridge the gap between January 1, 1973 and July 1, 1976 (three and one-half years). That factor is determined by compounding the annual trend factor of 1.174 over 3.5 years. The calculation is as follows: $(1.174)^{3.5} = 1.753$.

Similarly, the average date of writing for policies written on or after July 1, 1975 is January 1, 1976. The exposure offset factor for policy year ending December 1, 1973 must bridge the gap between July 1, 1972 and January 1, 1976 (also three and one-half years). The factor is determined by compounding the annual exposure offset factor of 1.047 over 3.5 years years. The calculation is as follows: $(1.047)^{3.5} = 1.174$.

The loss trend factor is then applied to the incurred losses and loss adjustment expenses reflecting loss development. The result is divided by the earned premiums at current rate levels adjusted by the exposure offset factor.

The quotient is called the loss ratio, and it represents an estimate of the percentage of premiums at present manual rates that will be required to pay claims and related expenses on policies issued during the effective period of the revised rates. For example, a loss ratio of 0.720, calculated as described above, indicates that $0.72 out of every premium dollar can be expected to be paid in this way in the future if the current premiums are not revised.

Expected Loss Ratio

In order to determine what change is required in the current level of rates, it is necessary that the actual loss ratio be compared with a standard. Under the ISO ratemaking formula, that standard is called the expected loss ratio. It is calculated by subtracting from 100 per cent the necessary expenses of doing business and an underwriting profit and contingency provision (expressed as a percentage of premium). It is estimated that 37.9% of the premium is required for underwriting expenses and 5% is included as a provision for underwriting profit and contingencies. Using the ISO figures of 37% for expenses and a 5% underwriting profit and contingency provision, the expected loss ratio is then 0.571: [100% - (37.9% + 5%)] = (100% - 42.9%) = 57.1% or 0.571.

Coming back to the ISO expected loss ratio of 0.571, in the example cited earlier a loss ratio of 0.720 was assumed to have been calculated. In order to determine the indicated rate level increase, the loss ratio including loss development and trend is divided by the expected loss ratio. In the example, 0.720 ÷ 0.571 = 1.261. The indicated rate level increase, therefore, is 26.1% in this example.

Classification

The rate actually charged to an insured depends upon both the industry and individual risk classification. The indicated rate level change as developed above is the estimated change which if applied to all classes would yield the expected loss ratio overall. However, the changes actually needed by individual classes vary above and below this indicated overall change. The rate change needed for a particular class generally cannot be determined solely from the experience of that class due to the effect of random loss fluctuations on the smaller volume of data. The experience of a class does generally have some credibility (reliability) though, so the review of classification rates gives each class a weight in determining its own indicated rate level change commensurate with the credibility of its experience. The remaining weight, which cannot reasonably be given to the class experience, is given to the experience of a large group of similar classes, such as all manufacturing classes. The average of all the resulting class indications is balanced back to the overall rate level indication in determining the class changes so that the combined effect of all of the class changes equals the overall rate level indication.

Increased Limits Rates

Charges for coverage in excess of the basic limit of liability ($25,000/$50,000) are calculated by applying the appropriate increased limits factors for the desired liability limits to the applicable basic limit manual rate for the class. For example, a manufacturer who desired to purchase coverage up to $100,000 per occurrence and $200,000 in the aggregate for all occurrences, might pay a premium calculated as 1.90 times the manual rate for the risk classification.

The ISO procedure provides that five years of countrywide experience be used in determining the required level of increased limits charges. The relatively frequent revision of these tables by ISO in recent years attests to the extraordinary rise in the level of claim settlement costs for product liability insurance, particularly in the area of increased limits.

APPENDIX IV

Why Mandatory Residual Market Mechanisms Won't Work For Product Liability Insurance

AMERICAN MUTUAL
INSURANCE ALLIANCE

January 31, 1977

Residual Market Mechanisms for Products Liability

I. Introduction

Rising claims, lawsuits

Both insurance regulatory officials and product manufacturers have expressed concern about the rising incidence of product liability claims and lawsuits, and about the complaints of some manufacturers that they are having difficulty in obtaining insurance coverages. The Task Force on Products Liability of the National Association of Insurance Commissioners has called on the insurance industry to examine the availability problem and to make recommendations concerning the possible need for some form of voluntary residual market plan.

The American Mutual Insurance Alliance has joined with other segments of the industry in formulating recommendations on a voluntary plan, and in addition has prepared this document pointing out why non-voluntary residual market plans are inappropriate for products liability.

The Alliance has reviewed recent product liability studies conducted by government agencies, by the industries most affected, by the casualty insurance business and by the defense bar. These studies have established that:

Price reflects loss

1. There is no "insurance availability crisis" in products liability. The cost of products liability coverage has risen substantially in recent years, in response to major increases in the incidence and cost of product claims, but the coverage is still generally available at a price reflecting the increased loss exposures.

For example, in the "briefing report" issued January 4, 1977, the Federal Interagency Task Force on Product Liability said, " . . . our study does suggest that the so-called products liability 'crisis' is *not* a crisis in the sense that a large sector of industry

cannot obtain products liability insurance or that the increased cost of such insurance has made a substantial impact on the price of many products."[1] In its summary of major findings, the report says that only a few companies have been unable to obtain products liability insurance, and adds that, "the problem appears to be more one of affordability, than availability."

Cost less than 1% of sales

2. The cost of product liability insurance has not had a major impact on the purchase price of most products. Research conducted by McKinsey & Company for the Federal Task Force, and separate research conducted by the Insurance Services Office,[2] both document this conclusion. The Federal Task Force report says, "our data shows that aside from a number of limited situations in the capital goods industry, products liability insurance accounts for less than 1% as a percentage of sales."

3. The casualty insurance industry has sustained large financial losses on its products liability business in recent years, and is now taking steps to obtain more timely and more detailed information[3] on the risk exposures generating those losses.

4. Rising costs of product injuries have caused industries and insurers to devote more time and resources toward product liability prevention techniques, thereby reducing public exposure to injury and economic loss.[4]

5. Tort reforms, improvement in insurance industry statistical and rating procedures, and increased emphasis on loss control offer the best prospects for alleviating product liability cost and availability problems. Documentation of this conclusion comes from a variety of sources:

- ☐ Manufacturer groups have testified before Congress, the Federal Interagency Task Force, NAIC and various state legislative hearings on the urgent need for more limited statutes of limitations, defenses based on misuse of products, and other legal reforms.

- The Federal Task Force's research showed that the rate of increase in product liability claims has been rising in excess of the rate of increase in actual product injuries.

- A 1976 survey of independent agents indicated that product liability insurance markets have been disrupted by "the growing number of products liability lawsuits and the increasing uncertainty as to what duties and standards will be imposed on the manufacturer under the rapidly changing law governing lawsuits." The Independent Insurance Agents of America, Inc., which conducted the survey, concluded that "A permanent solution to the products liability problem will not be found until the legislatures establish a law of products liability that will define what the duties and standards are and restore a degree of rationality and certainty so that underwriters can evaluate the risk that a particular manufacturer presents."[5]

- Two closed-claim studies of product liability cases conducted separately by the American Mutual Insurance Alliance and the Insurance Services Office indicate that statutes of limitations and other tort reforms could bring about substantial reductions in liability.

Pools do not reduce cost

6. Pooling of product liability risks would not reduce the cost of paying product liability claims, and therefore would not reduce the cost of product liability insurance coverage unless the premiums were subsidized from some external source. In this connection, McKinsey & Company, Inc. has written to the U. S. Department of Commerce to correct a misstatement of their findings in the Interagency Task Force's report of January 4, 1977. Specifically, McKinsey & Company protested the following statement on page 25 of the Federal Task Force report:

> "Our insurance contractor concluded that it might be desirable to establish a standby mechanism that would permit prompt action to deal with a product liability insurance cost or

availability problem should it become more serious."

The letter adds:

"The problem with this statement is the inclusion of the word 'cost'. In our report we tried to make clear that any special pooling mechanism, governmental or voluntary, does not address the problem of cost. The most relevant statement on that point in our report can be found on page ES-9. It reads:

> "One danger in authorizing such a program, even on a standby basis, is that this action may be viewed as a solution of the product liability problem. Actually, establishing another risk transfer mechanism will contribute nothing to removing the fundamental problem — the rising cost of product liability claims. Only reducing product-related accidents and tort reform can achieve that goal."[6]

It is against this factual background that the American Mutual Insurance Alliance has examined the concept of creating Joint Underwriting Associations or other residual market mechanisms for products liability insurance.

II. Major Finding of the AMIA Study

Mandated plans will not work

The Alliance concludes that mandated residual market plans for products liability are unnecessary, unworkable, and contrary to sound public policy. The record simply does not show that there is a product liability availability problem wide-spread enough to justify use of the state's police powers to create a state-mandated market. As indicated elsewhere in this report, the Alliance strongly urges that the emphasis be put instead on loss control efforts, reduction of legal uncertainty through tort reforms, and on voluntary efforts to provide coverages to product manufacturers.

The remainder of this paper deals in more detail with the prac-

tical and public policy issues involved in any attempt to mandate a compulsory, state-level residual market plan for products liability.

III. Feasibility of a Residual Market Plan for Products Liability

Even if the need existed for some kind of plan to guarantee the availability of products liability insurance coverage, the Alliance's examination of the problem indicates that it is not feasible to handle the job on a compulsory, state-by-state basis. Attempts to structure such a plan raise a host of social, legal and practical problems which defy solution.

Options Available

Several kinds of residual market mechanisms exist in other lines of insurance, including joint underwriting associations, assigned risk plans, joint reinsurance facilities, and state funds or pools, as well as federal schemes such as those for riot reinsurance and crime insurance. All of them, in one way or another, are designed to provide insurance coverages to risks unable to obtain coverage elsewhere.

Subsidy aspect recognized

Some residual market plans are funded and operated entirely by government. However, most of them result in private insurers assuming liability for the difficult-to-insure risks for an inadequate premium, and absorbing the excess losses that result. Although most residual market plans theoretically are supposed to be self-supporting, the subsidy aspect is frankly acknowledged in a recent NAIC staff report:

> "Various pooling arrangements have recently been implemented by numerous states in the medical malpractice field. These pooling arrangements cover a broad spectrum of plans, from joint underwriting associations to patient com-

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pensation funds, reinsurance exchanges and residual insurance authorities. Although no similar arrangements have been enacted in the products liability field, a number of such plans — joint underwriting associations, reinsurance exchanges and assigned risk placement facilities — are being actively studied. The principal goal of all these plans is twofold: To provide insurance coverage to insureds who are unable to obtain adequate coverage in the private market *and to provide such coverage at a 'reasonable' price*."[7] (emphasis added)

Cost the same

As has already been noted, pooling high-risk accounts in a separate residual market plan has absolutely no effect on the cost of paying for the claims generated by those accounts. The cost is the same, whether the liability is insured in a separate residual market plan or in the voluntary market. Thus, the only way a residual market plan could possibly reduce insurance cost would be to subsidize the plan by imposing part of the cost on some external source. The feasibility and equity of this approach will be discussed in another section.

Geographical Considerations

Coverage follows product

Geographical considerations dominate the question of product liability insurance. In order to protect the manufacturer of a product, coverage must extend to wherever the product is sold and used. Thus, the product liability problem cannot be localized within the borders of a single state. Products manufactured in one state may be distributed into every other state and even into foreign nations. The product liability loss exposure exists wherever the product is used, and may subject its manufacturer and distributor to the tort laws and judicial processes of the jurisdiction where injury or harm occurs.

This distinguishes products liability from other insurance lines where residual market plans have been created, and complicates any attempt to set up a residual market plan for products liability.

Much of the discussion of residual market solutions to products liability has assumed that the problems are basically similar to those encountered in medical malpractice, and that similar solutions could be used. Although there are some similarities, there are also some critical differences. Geographical dispersion is not a significant problem in medical malpractice cases because the location of the plaintiff, the cause of action, the defendant, the court, the witnesses, the evidence, the service of process upon the health care provider's liability insurance, and all other factors are geographically very close. Only in rare exceptions will any of these factors cross state boundaries. And even when this occurs the geographical separation is usually not very distant. This means a court and an insurance department and a legislature in a given state have an excellent chance of being able to exercise control and to resolve disputes concerning medical malpractice problems.

Many states involved

This is not the case with product liability. Components manufactured in several states may be assembled in another state to be sold to a wholesaler in a third state, resold to a jobber in a fourth state, retailed to a purchaser in another state, and cause injury anywhere in the world. The occurrence and magnitude of the loss will be strongly affected by the laws, social attitudes, wage levels, quality of medical care, and judicial processes of the jurisdiction where the loss occurred. However, the losses incurred by the product in other states (and possibly other nations) would have to be borne by the citizens of the state enacting the product liability residual market plan. As D. J. Brummond put it in his NAIC staff report:

> ". . . insurers who belong to a joint underwriting association in state 'A' must bear the financial burden of high jury awards which are handed down against their insureds in state 'B'. The self-sufficient character of joint underwriting plans will cause insurers in state 'A' — and their insureds who ultimately pay higher premiums — to subsidize generous awards of courts and jurors in state 'B'. This result differs greatly from the

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medical malpractice situation where jury awards and recoupment techniques operate in a single jurisdiction."

Bear own burden only

Past history indicates that each state is willing to bear only its own burden when it establishes residual market plans. It was for this reason that several states did not establish property insurance plans to participate in the federal risk reinsurance program. States also have attempted to make certain that they share only their own percentage of medical malpractice costs. This same principle has been exercised by numerous states with regard to their own automobile, fire and other insurance losses. It would be unrealistic to expect that principle to be ignored where there is an assessment in New Mexico or Alabama to cover California jury awards. Yet, this is precisely what would happen under a products liability residual market plan, since the coverage must follow the products wherever they may travel in interstate or international commerce.

Complexities of alternatives

If each state attempts to provide coverage only for products distributed within its borders, equally serious problems are created. This would be of little or no help to manufacturers whose products are sold extensively in other states, unless every other state adopted a similar plan. Such an arrangement would be almost impossible to administer, in any event, and would destroy the voluntary market. All manufacturers doing business into and in any given state would have to be required to contribute to a plan operating within that state. Some means would have to be found to determine the loss attributable to each product, and to monitor the extent of its sale in the state. In effect this would require underwriting each individual product in the plan. Then the plan could make an assessment against manufacturers doing each type of business in that state. Policing participation in such a plan obviously would be tantamount to keeping a thumb and finger on the pulse of every commercial artery in the state. The cost of operating such a plan would be huge in order to provide individual underwriting on a state-by-state, product-by-product, model-by-model basis. These com-

plexities would present interesting problems for all parties if some states adopted the latter plan while others enacted the former. There would be problems of credits for payments, rate making difficulties, and consternation among manufacturers.

Legal and Constitutional Considerations

Constitutional questions

Any attempt to compel participation in a state products liability plan raises serious legal issues. It is questionable whether any state can constitutionally compel insurers and their policyholders to subsidize out-of-state risks. The state's police and welfare powers are designed to protect its own citizens, not the injured citizens of other states. Can a state discriminately tax various of its citizens in order to protect the citizens of other states? It may well be an unconstitutional burden on interstate commerce when an insurer in state "A" is required to participate in a plan to benefit claimants in state "B" when claimants in state "A" have no such benefits for products manufactured in states other than state "A". It may also be an unconstitutional taking of property without due process of law when the solvency of an insurer is diluted by diversion of surplus into a mandatory pool benefiting claimants in states where the insurer is not doing business.

Social Priorities — Which Products Should be Guaranteed Coverage?

Leaving aside the problems inherent in the geographical dispersion of product liability risk exposures, proposals to establish a guaranteed market for products liability coverage raise serious public policy questions.

Safe at what price?

Is it sound public policy to assume that all products are equally entitled to guaranteed coverage, regardless of their hazards and social usefulness? If not, who is going to decide which products deserve coverage, and at what price? In its study of the products

liability problem, the Federal Interagency Task Force noted that, "A cause of the products liability problem that should not be ignored is that some manufacturers produce unsafe products."[8]

When health care providers went on strike in several states to demand relief from the medical malpractice situation, the threat to public health and safety was obvious. Is the state prepared to give equal priority to manufacturers of skateboards, fireworks, TV sets and pajamas?

If so, who is going to be compelled, directly or indirectly, to pay for the excess losses of products insured in the plan? Competing manufacturers of similar products? All other purchasers of products liability insurance? Purchasers of automobile, homeowners, and other lines of insurance? Taxpayers?

What about companies that self insure, or decide to go without products liability insurance — will they be required to pay their proportionate share of the losses generated by products insured in the plan? If not, the existence of the plan, and the burden it imposes on the voluntary market, will give firms able to do so an economic incentive to opt out of the insurance system and thereby escape those burdens.

IV. Practical Insurance Considerations

Any residual market plan for products liability must deal with a number of practical insurance considerations if it is to be workable and acceptable to insurers, to regulators and to the insuring public.

Eligibility Requirements — Who is Entitled to Coverage?

Determining eligibility

Unless a plan preempts the whole insurance field of products liability, it must have clear and objectively established eligibility requirements. For example, a plan would have to specify whether coverage in the plan is to be made available to all who

apply or available only to those unable to obtain coverage in the voluntary market. If coverage is available only to those unable to obtain insurance elsewhere, the plan would have to specify how "unavailability" is to be determined.

Subsidy issues

The evidence suggests that products liability coverage already is available at a price, and that the reason some product manufacturers are protesting or going without insurance is that they are unwilling to pay the price indicated by the risk exposure. Thus, the question arises whether "affordability" of voluntary market rates is to be one of the eligibility criteria for entry into the plan. If so, the plan would have to specify how "affordability" is to be measured. This raises anew all of the public policy questions about the equity of providing subsidies to certain products, and who is going to be required to provide the subsidy.

Any plan also would have to define what geographical limitations, if any, are to be imposed on eligibility for coverage. If eligibility is less than worldwide, what criteria are to be used to determine eligibility for coverage in the plan — e.g., plant location within the state, product sold within the state, manufacturer headquartered within the state? If the plan admits manufacturers from other states or nations, then a form of plan "shopping" will arise as manufacturers attempt to move their insurance to the state with the most favorable plan. Assuming some degree of subsidy, it would be detrimental to the state and its citizens to provide a subsidized haven for high-risk products.

Incentives for safety

Another key decision that must be made is whether initial and continued eligibility is to be made contingent upon an expressed willingness to comply with appropriate safety requirements. Insurers usually apply such criteria as part of their underwriting and pricing of product liability risks insured in the voluntary market. This provides manufacturers with a powerful economic incentive to improve or eliminate unsafe products. Government residual market plans such as crime insurance and flood insurance also impose eligibility requirements designed to reduce

the loss exposure. If a products liability plan is not going to permit normal underwriting by insurers, then it must designate someone else to do the job and specify the criteria to be used.

Framers of a products liability plan also would have to determine whether the plan would accept obviously poor financial risks, extremely large risks (e.g., General Motors), and manufacturers of very hazardous products such as explosives and aircraft. If not, where is the line to be drawn and who makes the decision?

Selectivity and equity

Requirements also would have to be established for the extent of participation in the plan. For example, if a product manufacturer, supplier or seller applies for coverage in the plan, must he place in the plan all products, locations and coverage levels, or will he be permitted to choose portions of his product risk to put in the plan? To put it another way, should a firm be permitted to insure its non-hazardous products in the voluntary market at favorable rates, and to place its hazardous risks in the plan at subsidized rates? If not, how would the eligibility requirement apply to conglomerates?

Rating Considerations

Determination of rates for product liability insurance differs substantially from the situation that exists for other lines of insurance where residual market plans have been created. Medical malpractice coverage, for example, involves a relatively few classifications of doctors and other health care providers. Automobiles and homes represent relatively homogenous risk exposures. All workers compensation risks are subject to a very elaborate classification system, developed over a long period of time, which sorts out variations in occupational exposures.

Product life hours or years

By contrast, there are thousands of different kinds of products on the market, some with a life as short as a few hours and others capable of remaining in use for 100 years or longer. The infinite variety and magnitude of risks involved in underwriting the

liability exposure of those products would confront any residual market plan with a difficult if not impossible classification and rating problem. Most product manufacturers who would be likely to seek coverage in such a plan are insured today under general liability policies which lump the product risk together with the manufacturer's various other liability exposures. Rates commonly are set on a judgment basis, based on an extensive underwriting investigation of each manufacturer's product exposures, claims experience and loss control performance.

Considering the complexities involved, it is difficult to see how the plan would be able to develop credible rates on a small group of worse-than-average risks — especially when losses won't be fully known for years.

Impact on Voluntary Insurance

Voluntary market disruptions

The existence of a residual market plan could well have a devastating effect on the voluntary insurance market. The eligibility criteria, the degree of subsidy involved, the rate classification used, loss control requirements, and the economic incentives involved, including allowances to insurers and commissions to producers, could all influence the extent of participation in the plan.

For example, when the commissions available to producers are higher for risks placed in the plan than in the voluntary market, there could be a heavy influx of risks into the plan. The key element is the total number of dollars of commission produced by the transaction, regardless of whether it results from the high commission rate or a low rate applied to higher premiums. Similarly, allowances to insurers for company expense could create advantages for some companies as compared to others.

Subsidy is critical factor

The amount of subsidy obviously is a critical factor. If product manufacturers can obtain coverage in the plan at substantially

lower rates than those available in the voluntary market, large numbers of risks will gravitate into the plan, thereby transferring part of their cost of doing business to their competitors, to other insurance policyholders, or to the taxpayer. (In Massachusetts, for example, the automobile residual market plan produced losses in excess of premiums amounting to about $163 per car in 1975 — a net loss equivalent to more than $29 for every registered car in the state.)

This process could quickly dry up the voluntary market, worsening the availability problems which the plan was intended to alleviate. It also is likely to encourage some insurers to pull out of that state or cease offering coverages that would subject them to the burdens of participation in the plan.

Claims and Loss Control Services

Claims service problems

The interstate and even international dispersion of the products liability risk creates difficult problems for a residual risk plan established on a limited geographical basis. It would be difficult for a state fund, for example, to provide claims and loss control services on a countrywide basis or international basis. Similar problems would confront many of the insurance carriers who might be forced to participate in the plan, particularly if they operated on a limited geographical basis. Even the largest insurers might have difficulty in providing adequate services for a highly specialized product exposure unless they had previously insured such risks and had developed the specialized expertise required.

The services to be provided by the plan are as important as the coverages. For example, would the plan provide a form of investigation and defense, or would the defense responsibility rest upon the insured? Defense costs add substantially to the losses incurred under the products liability coverage. On the other hand, an inadequate or inept investigation and defense would expose the plan's assets to excessive awards or settlements.

Quality of Coverage

One of the major tasks involved in the design of a residual market plan is to define what coverages the plan will provide.

What choices will the plan offer as to policy limits, deductibles, excess coverages, co-insurance, premium payment plans? What types of rating plans will be offered? What policy limits will be provided?

Another key decision is whether coverage will be offered on a "claims incurred" or "claims made" basis. A decision to switch to a "claims made" basis involves complexities that require more extensive study than is possible in the scope of this paper.

Insuring Capacity and Solidity

Limits on risk capacity

Any plan, regardless of how subsidized or by whom organized, will have a maximum risk-carrying capacity. Therefore, some provision must be made for limiting the liability of the plan, including criteria for determining when the plan has reached its maximum insuring capacity, and some provision for restricting the acceptance of new business when the plan has reached its maximum safe capacity.

A plan also should include contingency arrangements in the event that losses exceed the assets or the assessment limits of the plan. It may have to purchase reinsurance or have contingent access to the tax base in order to handle shock losses.

The legislatures of most states have enacted medical malpractice legislation designed to make this coverage self-supporting, including stabilization funds and provisions for premium tax offsets to cover any excess losses that might occur.

V. Conclusion and Recommendation

For all the reasons cited in this paper, the Alliance strongly recommends against regulatory or legislative attempts to create a non-voluntary residual market mechanism for products liability. We believe the existing market problems can best be worked out on a voluntary basis within each state.

[1] U. S. Commerce Department, Interagency Task Force on Product Liability (hereafter "Commerce Report"), p. 40.
[2] Insurance Services Office, "Display of Suggested ISO Product Liability Rates and Classifications in Effect Between January 1973 and August 1976," December 1976.
[3] Insurance Services Office, Product Liability Insurance, Background Report on Statistical and Rating Procedures, December 1976.
[4] Commerce Report, p. 7.
[5] Statement of policy adopted by the Independent Insurance Agents of America, Inc., January 20, 1977.
[6] Letter dated January 24, 1977 from Philip H. Dutter of McKinsey & Company, Inc. to Homer Moyer, U. S. Department of Commerce.
[7] Brummond, Report to NAIC D-2 Subcommittee on Products Liability, November 29, 1976.
[8] Commerce Report, p. 11.

APPENDIX V

SECTION 3 AND SECTION 5

OF THE

ADVISORY COMMITTEE REPORT

TO

TASK FORCE ON PRODUCTS LIABILITY

OF

AVAILABILITY OF ESSENTIAL INSURANCE (D2) SUBCOMMITTEE

OF THE

NAIC

February 15, 1977

Section 3. The Problem of Availability and the Recommended Voluntary Market Mechanism

While we know of no evidence that there exists a general market "crisis" with respect to the unavailability of products liability insurance in the United States,[1] there is a great deal of evidence that some products liability risks have not and apparently cannot find a market for their insurance needs. For these risks a crisis may exist, and there is therefore an availability problem which must be addressed.

To understand this availability problem requires a basic understanding of the products liability insurance market. It is a market of markedly varying exposures. Each risk is almost unique unto itself. Each presents an exposure which will differ materially from others within the same industry and even with respect to different product lines produced by the same risk. It is the function of the insurance underwriter to assess each risk based on the obtainable facts pertaining to it and to price it accordingly. Even risks which are within a classification for which a manual rate exists must be assessed in terms of any extraordinary loss potential which might exist.

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[1] The January 1, 1977 Briefing Report of the Federal Interagency Task Force on Product Liability, included as a major finding the statement that

> "3. Only a few companies have been unable to obtain product liability insurance. The problem appears to be more one of affordability, than availability." (Executive Summary, p. 11)

This statement is consistent with specific information developed in a number of states. Insurers writing products liability insurance are generally continuing to provide viable markets consistent with underwriting standards and pricing flexibility. There are no indications that the products market is disappearing. Contrast this with the medical malpractice market for individual physicians and surgeons where many former writers of the coverage have virtually withdrawn from the market.

The exercise of sound underwriting judgment is critical to the ability of the insurer to produce a reasonable profit on the line of business and to minimize the potential for sustaining massive underwriting losses on it.

These underwriting judgments require a highly sophisticated knowledge of the exposures presented, and a well-managed insurer will, from its home office, its branch and field offices, and its producers, apply essentially the same sophisticated appraisal of all the business presented to it. Although judgments of individual company underwriters may vary somewhat one from the other, possibly dependent on the individuals' varying experience and sophistication, it is the insurer's objective to maintain substantial overall consistency in these judgments.

The collective judgments exercised by a company in writing and pricing, or rejecting business will determine its operating results for the line. An individual company's exposure to loss on this line of business is enormous.

A company's judgment on a risk will depend on many factors, and frequently will require an assessment, among other things, of the risk's management experience and competence, its past and prospective implementation of essential loss and claims control measures, its quality control program, the nature of the product, the markets in which it sells, whether it is a new product or an older product manufactured in a different way, its distribution system, whether the product is to be a component of another product, the hazardousness of that other product, and, overall, a determination of the risk's exposure to loss relative to the limits of exposure sought and the premium necessary to cover the exposure to loss and the insurer's

losses, expenses, and a margin for profit and contingencies which reflects the greater unpredictability and the inherent volatility of so much of this business.

The individual risks written present exposures not only to losses but also to loss adjustment claims handling expenses of very great magnitude. Minimum premium requirements are in fact predicated on the high cost of handling product liability claims, whether or not liability for loss is established. The 32.1% ratio of loss adjustment expenses to losses for the general liability line of business, of which products liability is a major component, is one of the highest for any line of insurance (compare it to 15.9% for private passenger auto, and 26.1% for medical malpractice insurance); for products liability insurance the ratio is 42.8%[1].

For some risks the premium may even be equal to or greater than the limits of coverage provided. This would be the case where the risk is subject to a high claim frequency and it is opting, in effect, to buy the insurer's claims services, possibly in order to facilitate the risk's access to the major excess and surplus lines markets.

For other risks the premium will be substantially lower in relation to the limits of coverage afforded.

For most risks the premium can be derived as a function of sales, but in viewing the relationship between sales and premium, risks with a greater potential for loss will generally be paying a premium which is a higher percentage of sales than less hazardous enterprises.

Woven throughout the entire fabric of the products liability insurance market are a number of other highly significant factors

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1 ISO Closed Claims Survey, December, 1976, p. 78. (High costs result from legal fees and other defense costs)

to bear in mind:

1. There are numerous potential writers of products liability insurance, in both admitted and surplus lines markets;
2. Not all may be writing in all jurisdictions at the same time;
3. Products liability insurance may be written in the state in which the risk's principal office, principal plant, administrative office, is located, or in some other state;
4. The coverage provided covers the insured no matter where the loss occurs or where a judgment is rendered in the U.S. or Canada, so long as the insured would be legally liable for it;
5. In writing products liability insurance the insurer is providing coverage for losses incurred during the policy period which may have arisen out of products manufactured scores of years earlier -- the insurer is, in effect, "buying the tail" (compared to medical malpractice where it is "selling the tail");
6. Each of the insurers providing a products liability insurance market operates entirely independently of the others in underwriting (which includes the acceptance, rejection, or renewal of business) and, except where bureau manual rates are applicable, in pricing -- what one insurer may not find acceptable, others may accept willingly;

7. The producer through whom a risk seeks coverage may not represent or do business with an insurer willing to write the business, but other producers may represent an insurer which does write such coverage;

8. Some producers, like some companies, are more or less sophisticated than others in developing essential information about a products liability risk and in finding a market in which to place it, including a surplus lines market or a market to satisfy any excess limit needs;

9. Anticipated loss adjustment expenses, which are generally high in relation to losses for this line of business, can vary greatly between classes of products risks, and must be considered in appropriately pricing the particular risk; and

10. The very great disparity between types of risks, and even between different product lines produced by the same risk, with respect to loss development and trend factors.

It is evident that products liability insurance is a highly sophisticated line of business which depends greatly on the exercise of prudent underwriting judgment in reviewing and pricing business. Substantial underwriting and pricing flexibility is generally available, however, underwriting results for general

liability insurance during the past several years have been very unprofitable.[1]

Because of the flexibility in providing a market, underwriting results for general liability insurance appear to be improving and management attitudes towards the products market appear to be more positive than negative. Nevertheless there is a concern on the part of insureds and producers with the availability of products liability insurance.

So it was in Connecticut where on December 10, 1976, at a meeting held by the Insurance Department, large numbers of people -- producers, manufacturers, and dynamite blasters -- turned up to claim that products liability insurance was not available to them.

The insurance industry responded with a request for an Industry Advisory Committee in Connecticut to be appointed by the Insurance Commissioner to review all specific allegations and complaints submitted, to assist producers in placing business, and obtaining extensions of coverage or renewals of expiring policies pending location of alternative markets.

The Committee's Underwriting Task Force, within a two week span, under virtually impossible crash conditions was able to winnow its way through stacks of alleged complaints submitted through the agents' associations and the Commissioner's office. At the end of that period the Committee reported to the Commissioner that out of almost 165 complaints, 34 required a renewal or extension

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[1] The products liability exposure is one of the major components of the general liability line of business. Underwriting results for that line in 1973, 1974, and 1975 were 117.1%, 125.9%, and 116.5% respectively (A.M.Best Review and Preview, January 3, 1977). The 1975 underwriting result for g.l., excluding medical malpractice, the first year it became available on an industry basis, was 114.3%.

of coverage and the Committee was able to effectuate one or the other, thus allowing the Task Force to assist the producer in seeking out alternative markets, that only five risks had an availability problem, and of these two involved distributors of foreign devices (a French campstove and a Japanese butane gas container) who failed to seek vendor's coverage from the manufacturer, one involved a newly patented device designed to melt tumors about which insufficient information had been provided, but is now being sought, and two involved manufacturers whose products liability coverage currently excluded coverage for the aircraft parts they manufactured and who were not aware of the availability of such coverage through the U.S.A.I.G.

The Commissioner responded with great praise for the work performed by the Committee and continued it and its function into the future.

The Committee's effectiveness was and is dependent on four critical factors:

1. Shortly after the Committee's appointment and at the invitation of the Committee the Connecticut Association of Insurance Agents joined it and provided the services of a highly knowledgeable staff member to work with the Underwriting Task Force in contacting producers and companies, in delineating problems, in seeking extensions of coverage or renewals, in recommending alternative markets, and in providing information to producers on the pricing and placing of business --

without this cooperative effort the Committee could not have been fully responsive to the Commissioner's charge;

2. A cadre of company underwriters from leading writers of products liability insurance who worked knowledgeably and effectively in utilizing all available resources including local casualty underwriting managers of several companies;

3. A viable, responsive products liability insurance market; and

4. An Insurance Commissioner who was willing to try a voluntary good faith effort on the part of the industry before invoking an involuntary mechanism, and who, when convinced of the diligence and effectiveness of the voluntary effort shelved the involuntary mechanism as not needed.[1]

The Connecticut experience serves to verify prior assertions that the term "crisis" may be a misnomer if applied to the products liability market. There may be, however, market problems involving this line of business which should be addressed.

It is herein proposed that in any jurisdiction in which the regulator has received a substantial number of current complaints from producers or risks with respect to the availability of products liability insurance, or in which the regulator otherwise has reason to believe that a market problem exists, the regulator shall contact

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[1] Other regulators, most recently the New Hampshire Commissioner, have continued to be of similar disposition.

the Chairman of the Industry Advisory Committee to the NAIC Task Force on Products Liability or a special subcommittee to be appointed for the function to determine whether a local committee is necessary and, if appropriate, to assist in the appointment of such a Industry Advisory Committee for the particular state to be organized and authorized to act in the manner indicated below.

It is recommended that the Committee be composed of:

1. An appropriate number of licensed producers with knowledge and background in underwriting and pricing products liability business;
2. Knowledgeable representatives of four or more insurers writing products liability insurance in the state; and
3. The Insurance Department.

The Committee shall utilize all available expertise and other resources, including, but not limited to the aid and assistance of appropriate committees of producer associations, and local casualty managers of insurers.

The duties of this Committee shall include:

1. Reviewing all products liability insurance availability problems referred to it by the Commissioner to be certain that all markets have been explored and assist controlling producers in placing business where necessary;
2. Negotiating extensions of coverage with prior carrier where necessary to permit additional exploration of the market or accumulation of needed underwriting data;

3. Where the Committee is otherwise unable to assist the producer in otherwise placing a risk in a voluntary admitted or surplus lines market, the Committee shall encourage the development of alternative voluntary markets, including a referral program involving the use of volunteering designated insurers participating in a voluntary quota share reinsurance agreement with other volunteering insurers under which qualified risks can be referred on a risk by risk basis for underwriting and pricing and acceptance or rejection;

4. The Committee shall not less frequently than monthly report to the regulator on its activities, and shall include in such report its assessment of specific availability problems with its recommendations, if any, with respect to them; and

5. The Committee must, at all times, function subject to the caveat that no referral program can be without underwriting judgment or pricing flexibility, must not be viewed as an invitation to dumping, and must be responsive as a voluntary mechanism and not become or be viewed as that which it was created to avoid -- i.e., a mandatory pool, or as a competitor with the voluntary market.

It is our judgment, backed up now by our experience in Connecticut that the most meaningful response possible to products liability availability problems without jeopardizing the present viable voluntary market is an Industry Advisory Committee to function

as herein described, created and appointed by the regulator in any state having sufficient problems to warrant its creation.

Section 5. Tort Reform. Why Is It Essential? Who Are Active? What Are the Proposals?

The Committee pointed out earlier in Section 3 that the basic problem is one of cost. Cost is a factor in at least two ways from the standpoint of an insurer. The risk of loss may become so great either as a result of the chance of a disastrous loss or because of frequency of losses that the risk is no longer insurable. In which case insurance is not available at any cost. Or the chance of the large loss or the frequency of recurring losses may become sufficiently great that the premium which must be charged becomes very large. In this case the insurer is willing to provide insurance but the buyer is either unwilling or in extreme cases unable to purchase it. We are dealing here with commercial risks where the cost is an expense of doing business, but in some cases, particularly small manufacturers with jumbo exposures, the problems has become extremely acute.

One possible solution to the cost problem if society wishes to preserve the current tort system without change is subsidization by government. This seems impractical at the state level and highly questionable at the federal level where the priority in relation to other needs is low particularly if alternate practical solutions exist.

The fast, easy and impractical solution is some form of mandatory market mechanism where insurers are forced to write business. The faults of such a system have been pointed out fully in the previous section.

The only practical way to meet the problem is to reduce the risk and in turn the cost. Recognition of this fact has resulted in studies

by many of the possibilities and areas of tort reform.

Your committee does not view its current role such that it should recommend any one program or attempt to design a program. In any event time was not available. However, the Committee has attempted to fulfill its obligations to the Task Force in this area by (1) attempting to collect information on at least some of the parties working in this field, (2) to provide an outline of the subjects of possible programs using as basis a paper which is incorporated prepared for the use of the trade associations, (3) incorporating a statement by the Independent Insurance Agents showing a representative position of a producers organization and (4) attaching to the Committee's basic copy of the report addressed to Judge Price copies of a number of the programs currently being considered.

A partial list of those active in the area of tort reform was prepared by Paul Kipp and is as follows:

1. THE MULTI-ASSOCIATION ACTION COMMITTEE an ad hoc group sponsored by the Sporting Goods Manufacturers Association. This committee has twenty-one state action committees established that will strive for tort reform as set forth in Kansas Senate Bill 852 (Revised)[1]. We understand about fifty trade associations are members of this ad hoc group.
2. THE DEFENSE RESEARCH INSTITUTE has drafted a position paper calling for tort reform.
3. THE RISK AND INSURANCE MANAGEMENT SOCIETY. It has published a report of its Task Force on Tort Reform, has surveyed its membership and made the results of the survey available to the D-2 Committee of the NAIC, to the Federal Inter-

[1] Renumbered S.B. 2007.

agency Task Force and to the California Citizens' Committee on Product Liability. It is also holding seminars on product liability and tort reform in various cities. It is supporting the efforts of MAAC.

4. THE AMERICAN INSURANCE ASSOCIATION has drafted tort reform legislation.
5. THE AMERICAN MUTUAL INSURANCE ALLIANCE is actively seeking tort reform in the various states.
6. THE NATIONAL ASSOCIATION OF INDEPENDENT INSURERS is actively seeking tort reform in the various states.
7. RETORT, INC.
   c/o Mr. E. H. Rosenberg
   Thomson National Press Co.
   Franklin, Massachusetts. 02038
8. U.S. SENATOR PEARSON OF KANSAS has introduced legislation calling for a national product liability insurance pool. S.403.
9. THE SENATE SELECT COMMITTEE ON SMALL BUSINESS ADMINISTRATION is sponsoring legislation that will make reinsurance available for small business risks.

Those who have or are conducting surveys or studies include;

1. Retort Inc.
2. National Machine Tool Builders Assoc.
3. Farm and Industrial Equipment Institute
4. The Risk and Insurance Management Society
5. The American Mutual Insurance Alliance
6. The Insurance Services Office (Closed Claim Study)
7. The Federal Interagency Task Force
8. The Machinery and Allied Products Institute

9. Various Chamber of Commerce and Manufacturer Associations

10. Insurance Information Institute (Movie)

Others interested in the problem:

1. Independent Insurance Agents of America
   85 John Street
   New York, New York. 10038

2. American Machine Tool Distributors Association
   1500 Massachusetts Avenue, N.W.
   Washington, D.C. 20005

3. Chamber of Commerce of the United States
   1615 "H" Street, N.W.
   Washington, D.C. 20063
   c/o Andrew A. Melgard, Director,
   Economic Security, Education and Manpower Section

4. Massachusetts Bar Association
   One Center Plaza
   Boston, Massachusetts. 02108
   c/o George N. Keches, Legislative Counsel

5. National Federation of Independent Business
   150 West Twentieth Avenue
   San Mateo, California. 94403
   c/o George J. Burger, Jr., Assistant to President

6. National Tool, Die & Precision Machining Association
   9300 Livingston Road
   Washington, D.C. 20022
   c/o William E. Hardman

7. New York State Bar Association
One Elk Street
Albany, New York. 12207
c/o Mr. John E. Birny

8. National Association of Manufacturers
1776 "F" Street, N.W.
Washington, D.C. 20006
c/o Richard D. Godown, Senior Vice President and General Counsel

9. Nissen Corporation
930 - 27th Avenue, S.W.
Cedar Rapids, Iowa.
c/o Robert J. Bevencur, Executive Vice President

10. Pennsylvania Chamber of Commerce
222 North Third Street
Harrisburg, Pennsylvania. 17101

11. The Association of Trial Lawyers of America
1620 "I" Street, N.W.
Washington, D.C. 20006
c/o C. Thomas Bendorf, Director, National Affairs

12. The Ohio Manufacturers Association
100 East Broad Street
Columbus, Ohio. 43215
c/o Virginia D. Thrall, Assistant Director
Midwestern Office

13. U.S. Small Business Administration
Washington, D.C. 20416
c/o Maureen C. Glebes

14. Valve Manufacturers Asso[illegible]

6845 Elm Street, Suite [illegible]

McLean, VA. 22101

c/o William Hopf

There have been a substantial [illegible] of specific proposals for tort reform. The best [illegible] of the proposals the committee could find was prepared for [illegible] of the trade associations outlining the subjects generally agreed [illegible] as being suitable for incorporation in a program as well as some additional possibilities. In incorporating this paper in the report the Committee wishes to emphasize again that it does not represent any single program and in fact the introductory language to the [illegible] points out that it is merely a discussion of the various proposals and not a comparison of them.

The outline is as follows:

1. Statute of limitations. It is generally agreed that any change in the statute of limitations relative to product related injury will have the greatest effect in relieving one of the most pressing problems facing product manufacturers today. This is the problem of the product which has been out of the control of the manufacturer for 10 or 12 years and still may cause an injury which will be the subject of a lawsuit against the manufacturer.

   There is no desire to bar a deserving claimant from his right to seek compensation for negligently caused injury. However, there must be some reasonable balance between the right of a claimant to be compensated

for his injuries and the right of a manufacturer to have some basis to determine the length of his potential liability.

Generally, the thrust of the various proposals under consideration by the associations would have the statute of limitations begin to run from the time the manufacturer first sold the product, or from the time that he was parted from the possession or control and run for a specified period of years ranging from 6 to 12, thereafter.

2. Product modification and alteration. There is general agreement that there should be a defense to a product liability action if the injury resulted from the use of a product which has been modified or altered by some one other than the defendant. There have been instances in which manufactuers have been held liable for injuries resulting from products which have been modified or altered subsequent to leaving the manufacturer's control, and in some instances, altered to the point of changing the purpose for which the product was intended to be used.

Manufacturers should be able to rely on the fact that a product will be used in substantially the form in which it was manufactured and for the purpose for which it was manufactured. In addition, they should be able to rely on the fact that eventual users of the product will provide reasonable maintenance of the product.

3. State of the art defenses. It is felt that a manufacturer should have a determination of whether or not a product

was defective based upon tehnological knowledge and the state of the art in existence at the time that the product was manufactured. Determination of defect should not be based upon technical knowledge available or changes in the product itself subsequent to the manufacture of the original product.

The liability of the manufacturer should be based upon the knowledge available to him at the time of manufacture, and not on the subsequent change in technological knowledge or manufacturing techniques which have been developed or come into common use. Neither should liability be based upon changes or modifications or improvements made in the specific product or any similar product subsequent to the manufacture or in any such changes made in the product subject to the injury on which the litigation is based.

Legislation could be developed which would make changes in technological knowledge, changes in specific products, and post-accident repair or improvement inadmissible in evidence, and plan the jury's deliberation to a determination to what the state of the art was at the time the product was manufactured.

The state of the art defense is most vital and most valid in the so-called design defect cases. In these cases the delicate cost to benefit and engineering balances which a manufacturer must make ought not to become jury questions if the decision is made in accord with substantially accepted practice.

4. Duty to warn. Reasonable limitations should be placed upon the manufacturer's duty to instruct in the usage of a

product and duty to warn of potential hazards. He should not be required to foresee all possible uses to which his product might be put, whether intended or not, not to foresee the consequences of all possible unintended use.

A manufacturer should be required to produce a product which is reasonably safe for its normal intended use and provide instructions in the use of that product which are reasonably prudent and a person can understand and follow. He should also be required to warn of any hidden hazard which might make the product unfit for its intended use of which might not be readily recognized by a reasonably prudent person.

Legislative proposals are under consideration which would mitigate the manufacturer's burden of anticipating and warning against almost unlimited possible hazards which could be associated with the use of his product.

In many cases involving the duty to warn the existence of hazard and the absence of a warning have inferentially supported other elements of a prima facie case. Legislative efforts have been made to codify the elements. Thus, the plaintiff should be required to prove that the product involved actually caused the harm allegedly sustained, that the plaintiff would have responded to the warning with alternate actions, and that had the plaintiff responded to the warning lesser harm would have followed.

5. Punitive damages. It is generally felt that claims for punitive damages have gone far beyond the purpose for which they were originally conceived, not only in the products liability area, but in other areas of tort law as well.

The original concept in punitive damages was to provide, in cases in which the defendant's conduct was unconscionable, a penalty upon him and additional compensation for the injured party. However, recently, claims for punitive damages have become an almost automatic part of any complaint whether or not the defendant was guilty of gross or unconscionable conduct.

It should be noted that in a products liability action against a corporate manufacturer the "punishment" of punitive damages is borne by the company's stockholders who did not participate in the wrongful act or, more likely, by the buyers of the company's products. Since most products are mass produced, the spectre of multiple punishments by punitive damages in a series of actions involving the same product is also present.

It is generally agreed that there should be some limitation upon the awarding of punitive damages. Some have indicated that it would be desirable to eliminate punitive damages in all civil actions. However, others feel that reasonable limitations can be developed which will reduce the instances in which punitive damages are awarded but will retain the right to award them in meritorious cases.

The above concepts are those upon which there is general agreement as to their desirability and beneficial effect upon the products liability problem. Other proposals have been suggested, upon which there is not a general agreement, but which are currently under study. Some of these are as follows:

a. Governmental standards. It has been suggested that in

a products liability action, evidence that a product complies with applicable federal or state standards or regulations with respect to design, manufacturing or testing of a product, should create a defense that the product was not defective. This could take the form of an absolute defense or a rebuttable presumption. In addition, it has been suggested that evidence that applicable governmental standards are mandatory requirements from which a manufacturer cannot deviate should preclude liability if the product complies with such standards.

b. Codification of the theory of strict liability. Although a majority of states have adopted the theory of strict liability in tort with respect to products, the conditions under which the theory is applied vary widely from state to state.

It has been suggested that in those states which have adopted a doctrine of strict liability, an attempt be made to statutorily set out the conditions which will be necessary for the doctrine to be opposed, and the definition of such terminology as "defective condition." and "unreasonably dangerous."

c. Elimination of the ad damnum. It has been suggested that the money demand in most claims no longer has a real relationship to the sum which would actually be accepted in settlement or a relationship to the amount the case is actually worth. In addition, it is felt that demands for large money judgments tend to inflate

in the minds of the public and juries the value of a particular personal injury case.

It has therefore been suggested that pleadings demanding relief in the form of unliquidated damages make a prayer for general relief and, if necessary, state that the amount claimed is within the jurisdictional limits of the court.

d. Reduction of unnecessary litigation through the elimination of lien and subrogation rights of the employer and his worker's compensation insurer. Employers and their compensation carriers have been active in the pursuit of worker's compensation lines in subrogation. These rights have stirred much litigation with consequential legal expenses.

e. Regulation of contingent fees. By regulating the contingent fee, the take-home award of the injured party will be increased and the cost of the court system reduced proportionately. This regulation or limitation of the contingent fee could be accomplished by placing the control of the size of the contingent fee and the supervision of its use with the proper legislative or judicial authority. The contingent fee scale should be one in which the fee rates decrease as the recovery amount increases. This should also result in a reduction of the number of nuisance cases filed.

f. Modification of the collateral source rule. The collateral source rule should be modified so as to render admissible

all evidence of the nature and extent of all benefits and services received (or to be received) by the claimant as a result of his alleged injuries and damages. Evidence of the re-marriage of the surviving spouse should likewise be admissible in an action for wrongful death. Such a modification would allow the jury to be given all facts about the case before them. Duplicate recoveries in personal injuries would be eliminated to a degree with resulting cost savings in the reparations system.

g. Limitation on pain and suffering awards. The law establishing the measure of damages which may be awarded in tort liability litigation is largely court-made law which provides only vague and general guidelines. This leaves the jury virtually unlimited discretion as to the amount of damages to be awarded. This unlimited discretion results in unfair variations in awards between different claimants and has produced constantly increasing levels of damage awards which have contributed greatly to the crisis in which liability insurance costs have become unmanageable. To keep total costs to a level which can be managed by insurance and which is socially acceptable, limitations on awards are needed. It is a matter of simple justice that the negligent party in a liability suit should reimburse the injured person for all economic losses resulting from an accident. Non-economic loss, often referred to in the courts as pain and suffering, is almost impossible to measure in dollars and cents. A strict statutory limitation

on pain and suffering awards by either a specific dollar amount or some multiple of out-of-pocket damages should result in cost savings. Such a limitation to meet constitutional requirements would have to be applied to the total tort reparations system.

The IIAA National Board of State Directors, Executive Committee and Commercial Lines Committee within the past month has adopted a statement of position on the products liability insurance problem. While time has not permitted official review by other producer organizations, the statement in the opinion of the representatives of the Professional Agents Association and the National Brokers Association generally represents the position of those organizations. The statement is as follows:

The Independent Insurance Agents of America, Inc. (IIAA), representing over 34,000 independent insurance agencies throughout the nation and 126,000 licensed independent agents, strongly believes that the liability insurance mechanism has traditionally served American business well in the products liability area and that every effort should be made now so that businesses which produce safe products can continue to procure essential products liability coverage.

In 1976 IIAA surveyed a significant percentage of its membership, numerous companies with whom its members do business, and, outside of the insurance industry, a multitude of other trade associations, consumer organizations and governmental entities, to attempt to ascertain the scope of the products liability problem. The results of those surveys uniformly have shown that there are severe dislocations in the products liability insurance markets, manifested by spiralling

premiums and unavailability of insurance in certain cases. The results show that two basic, related reasons for these dislocations are the growing number of products liability lawsuits and the increasing uncertainty as to what duties and standards will be imposed on the manufacturer under the rapidly changing law governing lawsuits.

Our surveys have made it clear to us that a permanent solution to the products liability problem will not be found until the legislatures establish a law of products liability that will define what these duties and standards are and restore a degree of rationality and certainty so that underwriters can evaluate the risk that a particular manufacturer presents. It is not our intention to discuss specific statutes in this statement. IIAA and its affiliated state associations are actively studying these statutes and in some states proposed laws are already being endorsed and presented to the legislatures.

It is also plain to us that similar problems are currently being experienced in all liability lines. Where feasible, statutes should be drawn to cover these other lines. Such a comprehensive legislative package will get the support of the many groups who are substantially affected by this problem. IIAA and its affiliated associations will work with interested parties to bring about meaningful reform that is fair to all concerned. The legislative effort must be emphasized and implementation should begin immediately. Only through revisions of liability laws can we ever hope to attain permanent and orderly solutions to this problem. The members of IIAA thus pledge their efforts to support the drafting of legislation to this end.

IIAA calls upon the insurance industry to establish two high level task forces which IIAA would assist in every way possible. The

first task force would be charged with ascertaining what the insurance industry is currently doing to promote product safety, what additional measures the industry should undertake in this area, and a timetable for implementing these additional measures. This task force might want to seek the input of manufacturing groups currently working on this problem.

The second task force should be charged with reviewing current insurance industry practices in the underwriting, rating and claims areas to find what changes can be made to help relieve the current dislocations in the products liability insurance market.

IIAA further invites representatives of all affected groups to join together to study needed legislative reform. To this end IIAA invites the review and analysis of legislative proposals by the many interested groups. We hope that the recently released IIAA research report, "A Survey of Specific Statutes That Have Been Proposed to Deal With The Products Liability Problem", can serve as a basis for this work, since the report incorporates the research of many of these groups.

Regardless of our belief in and support for the foregoing as the proper method toward a long-term solution, interim solutions for those immediately affected must also be dealt with. We call upon the insurance industry to encourage the Insurance Commissioner of each state to appoint an "Industry Advisory Committee" having agency, company and department representation. This committee would review specific complaints, and, with the assistance of the Insurance Department, would do all in its power to resolve these complaints satisfactorily Part of the committee's task would be to inform agents of where the current opportunities are in the products liability market, because this market is undergoing changes continually. Another important task

of the committee would be to encourage companies to continue to provide coverage at affordable rates. This proposal for an "Industry Advisory Committee" is based on the recent experience in Connecticut where such a voluntary committee has been successful in identifying the problem areas and resolving the great majority of complaints.

In summary, we propose that all interested parties join together, recognizing that solutions will not come easily. Interim solutions such as joint underwriting associations, reinsurance facilities or assigned risk plans only serve to magnify the problems by curtailing or destroying the voluntary market. Real solutions lie in product safety, enlightened insurance industry treatment of products liability and tort reform. Interim insurance marketing solutions must be the responsibility of insureds, agents and companies working together to find markets while the real solutions take shape.

APPENDIX VI

Statement by
J. Creighton White, Vice President
Fireman's Fund Insurance Companies

Prepared for
The Joint Committee on Tort Liability

San Diego, California
July 18, 1977

Chairman Knox, members of the Committee:

My name is J. Creighton White. I am vice president of Fireman's Fund Insurance Companies. I have nationwide responsibility for Commercial Automobile and Liability Underwriting. The remarks I make here today are directed at underwriting practices in the product liability area.

Fireman's Fund is the seventh largest property-liability insurance group in the country and a major market in California for all types of personal and commercial property and liability coverages. It has substantial interest in the findings of this committee. Last year Fireman's Fund wrote in excess of $10-million in net identifiable premiums for product liability coverage. About 15 per cent of that amount, or $1.5 million, was in California.

The policy of Fireman's Fund regarding product liability coverage is the same as with other lines of insurance. We want the business, but only when it is adequately priced.

(more)

The "adequate price" for product liability insurance has, however, become very difficult to ascertain, because of new doctrines and procedures in the tort liability system that inflated the legal scope of liability and spawned enormous increases in litigation and jury verdicts. The Chairman of the U.S. Consumer Product Safety Commission recently stated that in California, product liability awards have increased 800 per cent since 1965. He also affirmed that there is now an average of ten $100,000 product-related awards every week in the state. This activity has transformed the product liability ~~line~~ from a miscellaneous, rather minor exposure to a most volatile, difficult one, and in a very short period of time.

Naturally enough, then, product liability underwriters are taking close look at applications for the coverage, and are charging premiums sufficient to cover the loss potential and expenses.

Fireman's Fund underwriters are directed to review very carefully those businesses that seek our product liability coverage, to assess the probabilities of large or catastrophic loss and to make necessary judgments relating to acceptability of the risk and pricing of the coverage.

The questions our underwriters are asking now give an indication of the breadth of the product liability exposure. For example:

* Is product safety one of the primary considerations in new product design and in redesign of products already being manufactured? How thoroughly are product designs tested?

(more)

* Are any of the components of the product made by subcontractors? If so, what are their qualifications and procedures? Many product liability claims stem from failure of a subcontractor's component.

* What is the quality control program, and how is it organized?

* Is the product assembled at a factory, by the distributor, or by the consumer? A failure by any to properly assemble the product could generate a loss. Therefore, if it's to be assembled outside the factory, are instructions provided? Are they in basic, easy-to-read language? Do they point out safe methods of assembly and use? Do the instructions warn of inherent operating dangers, no matter how obvious?

* Do hazardous products bear a conspicuous warning and antidote information? Inadequate labels have given rise to product liability verdicts.

* Has proposed advertising material been reviewed by engineering and legal experts for technical accuracy? Statements and illustrations used are, in some instances, considered to be express warranties.

* What stand-by procedures have been established to accomplish modification or recall of the product if it shows potential for causing harm? There must be some means of locating purchasers if it becomes necessary to warn them of a hazard and to correct the situation.

* Is the manufacturer's attitude toward product liability concerns positive or negative? It's been our experience that safety programs of any type are effective only when top management is committed.

(more)

* What is the financial standing of the manufacturing concern? It has also been our experience that, when businesses are compelled to make economies, safety programs are among the first to feel the cut-backs.

Often applicants for product liability coverage are deficient in one or more areas, but when they are willing to adhere to our loss control recommendations, the problems can be corrected. Consumers are protected. Underwriters can assume the risk profitably, and thus develop capacity to accommodate the always growing insurance needs of our society.

As I perceive the product liability market today, the situation is more one of affordability of the coverage than of availability. There are ready sources of product liability insurance in California and across the country, provided the premiums coming in are sufficient to pay losses, expenses, and leave a profit.

Manufacturers who don't keep the safety of consumers foremost, who put shoddy, unsafe products into the stream of commerce will always have a tough time getting product liability coverage, barring any government-imposed requirement to the contrary. After all, the insurance industry protects against the chance of loss, not a certainty of loss. This may be bad news for manufacturers of products that cause a lot of avoidable harm, but I think it's good news for the general public. By exercising its prerogative of risk selection on the basis of loss experience and loss potential, and without imposing abstract moral judgments, the insurance industry plays a natural check-and-balance role in the country's marketplace.

(more)

Another check-and-balance in the marketplace is the tort liability system this committee is studying. In my opinion the tort system, in matters of product liability and other areas of liability as well, has recently become more of a check than a balance. Fireman's Fund has gone on record saying the need for consumers to have ample recourse to any loss must be put back into balance with what society can afford to pay and that balance can be achieved only through reform of the tort system.

I appreciate the opportunity to be here today to share my views on this subject. I shall be pleased to answer any questions you may have. Thank you.

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EXHIBIT #I

NATIONWIDE
1976 PRODUCT LIABILITY
ISO CLOSED CLAIM SURVEY
PRELIMINARY REPORT

7,791 records were analyzed with total payments of 60 million dollars:

Overall Averages

	Average Payment Per Claim	Average Payment Per Incident
Bodily Injury only	16,201	29,261
Property Damage only	4,931	9,182
Total (all)	12,252	22,211

a) For each $1.00 of loss there was an additional 42¢ of expenses incurred by the insurance company in defending the claim.

b) 30¢ for every dollar of product liability loss involved claims wherein the employer was negligent to some degree.

c) Excluding claims on products which are consumed almost immediately, over 45% of all claims do not occur until more than six years subsequent to the date of manufacture.

d) Employees injured during the course of employment received the highest average payment for BI ($128,684), perhaps due to the severity of work-place incidents.

e) The employer of the injured employee was negligent in half of the employee injury cases. Related claim payments were two thirds of the payments dollars. Preliminary analysis indicated over 30% of the total products loss dollars go to employees of negligent employers.

f) Food products seem to cause the largest number of claims, but in general account for a comparative small portion to the total dollars paid.

g) Over 92% of the cases didnot involve product modification. Those involving some modification (8%) had significantly higher average payment involving 18% of total payment dollars.

h) Only 5% of Bodily Injury and 9% of Property Damage Claims went all the way to a court verdict.

EXHIBIT #2

INSURANCE SERVICES OFFICE PRODUCT LIABILITY EXPERIENCE REPORT

DECEMBER 1971 - DECEMBER 1974

BODILY INJURY AND PROPERTY DAMAGE COMBINED

Policy Year Ended*	Earned Premiums	Incurred Losses***	Loss Ratio****
		Manually Rated Classes	
12/31/71	$ 31,661,275	$ (21,110,940)	66.7%
12/31/72	41,624,498	(29,018,341)	69.7
12/31/73	49,560,259	(35,431,429)	71.5
12/31/74**	44,748,085	(32,679,452)	73.0
	(a) Rated Classes, excluding large (a) rated cases		
12/31/71	85,984,805	(97,574,782)	113.5%
12/31/72	120,110,961	(96,906,925)	80.7
12/31/73	167,144,160	(256,947,974)	153.7
12/31/74**	158,531,975	(199,568,635)	125.9

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* - The reason more recent data are not available is due to the desire to report incurred losses as accurately as possible. When a loss is reported, a reserve is established based on the company's best estimate of the ultimate settlement or award and related expenses. However, as time passes, some of these claims will be paid and, based on further information, reserves on others can be restated to more accurately reflect the potential loss. Thus, while incurred loss data for more recent years could be compiled, it would be subject to a greater degree of uncertainity.

** - Preliminary data as of 12/1/76.

*** - Incurred losses include loss adjustment expenses as well as amounts paid to claimants and reserves on claims reported but not yet paid. Loss adjustment expenses amount to about one-third of incurred losses. They consist mainly of payments to defense attorneys, salaries for claim adjusters, and overhead expenses.

**** - Since underwriting expenses average around 25 percent of premium, a loss ratio over 75 percent represents an underwriting loss.

SOURCE: Products Liability Insurance Study. U. S. Department of Commerce

NOTE: (a) - Rated classes involve classifications which represent wide differences in exposures within the class. Rates are arrived at by underwriting judgement as applied to the particular insured. Most manufacturers of industrial goods fall into this category.

EXHIBIT #3

NET PREMIUM-TO-SURPLUS RATIO

(Excluding Value of Life Insurance Subsidiaries)

	1966	1968	1970	1972	1974	1975
10 largest writers of miscellaneous liability insurance	1.60	1.79	2.46	1.82	4.84	3.74
All Industry	1.67	1.60	2.09	1.63	2.74	2.50

Source: Best's Aggregates and Averages, Best's Insurance Reports, Best's Insurance Securities Research Service, McKinsey & Co. calculations.

EXHIBIT #4

FIREMAN'S FUND INSURANCE COMPANY

NATIONWIDE PRODUCTS LIABILITY EXPERIENCE[1]
(BI & PD COMBINED)

Calendar Year	Net Premium Written	Net Premium Earned	Losses Incurred (Ex-IBNR)[2]	IBNR	Total Losses Incurred
1972	$3,327,526	$3,895,836	$3,963,111	NA	$3,963,111[3]
1973	2,092,245	3,403,292	3,386,781	$ -26,276	3,360,505
1974	3,161,312	3,107,032	2,586,273	-3,266	2,583,007
1975	4,752,610	4,072,305	2,846,998	472,454	3,319,452
1976	9,645,132	8,139,430	4,067,579	1,635,228	5,702,807

Calendar Year	Loss Ratio	Unallocated Loss Adjustment Expense Ratio[4]	Statutory Underwriting Expense Ratio[5]	Dividend Ratio[5]	Statutory Trade Ratio	Statutory Trade Profit (Loss)
1972	101.7%	11.2%	39.0%	-.3%	151.6%	(2,010,251)
1973	98.7	10.9	37.0	.9	147.5	(1,616,564)
1974	83.1	9.1	38.8	-1.8	129.2	(907,253)
1975	81.5	9.0	37.3	-.2	127.6	(1,123,956)
1976	70.1	7.7	30.8	.6	109.2	(748,828)

1) Excluding Composite, Large "a" Rated, and Loss Rated Business.
2) Including Allocated Loss Adjustment Expense Incurred.
3) 1972 Total Losses Incurred do not Include IBNR
4) Estimated as 11.0% of Total Loss Incurred; Factor promulgated by ISO
5) Based on Nationwide Ratios for All General Liability Sublines.

EXHIBIT #5

FIREMAN'S FUND INSURANCE COMPANY

PRODUCTS LIABILITY EXPERIENCE

POLICY YEAR DATA

VALUED AS OF MARCH 1977

CALIFORNIA - BI

	Premium Earned	Losses* Incurred	Loss Ratio
1971	$ 619,043	$451,238	72.90
1972	479,432	374,044	78.02
1973	338,811	235,998	69.67
1974	349,476	250,963	71.81
1975	783,018	313,922	40.09

CALIFORNIA - PD

1971	$ 369,721	$266,306	72.03
1972	302,565	113,454	37.50
1973	238,425	235,591	98.81
1974	260,962	181,747	69.65
1975	680,734	112,386	16.51

CALIFORNIA - TOTAL

1971	$ 988,764	$717,544	72.57
1972	781,997	487,498	62.34
1973	577,236	471,589	81.71
1974	600,438	432,710	72.07
1975	1,463,742	426,308	29.13

*Including paid allocated adjustment expense

NOTE: Actuarial estimates indicate that, at a minimum (utilizing basic limits loss development factors) the California Bodily Injury loss ratio will ultimately develop to:

1971	-	74.3
1972	-	81.0
1973	-	80.0
1974	-	99.0
1975	-	71.0

APPENDIX VII

CRASHWORTHY VEHICLES: AX THE QUIET, BUT COMPLETE, REVOLUTION IN PRODUCTS LIABILITY LAW

A STATEMENT BY

RICHARD A. EPSTEIN
PROFESSOR OF LAW

TO THE JOINT COMMITTEE ON TORT LIABILITY
OF THE CALIFORNIA LEGISLATURE
ON BEHALF OF THE
AMERICAN INSURANCE ASSOCIATION

San Diego

July 18, 1977

CRASHWORTHY VEHICLES: AX THE QUIET, BUT COMPLETE, REVOLUTION IN PRODUCTS LIABILITY LAW

The past year has witnessed an extensive reexamination of the entire law of products liability. The United States government has commissioned the Interagency Task Force to undertake a comprehensive review of products liability law; many states have initiated their own legislative studies of the area; and many private organizations, including the American Insurance Association, have developed packages for legislative reform. In the current outburst of activity it had always been taken for granted that there had been radical and far-reaching changes in the substantive law since, to choose a convenient date, the publication of the Restatement (Second) of Torts in 1965. With the fact of change safely recognized, the important issues were: first, did the identifiable changes on balance represent an improvement in the substantive law; and second, if they did not, was it possible to correct past mistakes, be it by legislative or judicial action.

It therefore comes as somewhat of a surprise to learn that there is no need to justify modern innovations in products liability law simply because there are no such modern innovations which require justification. In particular I refer to the remarks of Mr. Craig Spangenberg, Chairman of the National Affairs Committee of the Association of Trial Lawyers of America. In his remarks of April 27, 1977 before the United States Senate

Subcommittee on Consumers of the Committee on Commerce, Science and Transportation, he spoke on behalf of A.T.L.A. as follows:

> "there has been little change in the doctrines of liability in the last ten years, and almost none in the last five. The requirement of privity was abolished, in suits against manufacturers, well before 1965."

And earlier in his remarks he drew his inescapable conclusion:

> "We see no evidence that products marketed today are of better design, better material, safer and more durable. On the contrary, as consumers we see products that are flimsier, lighter, cheaper in material and design, and overwhelmingly plastic. If the safety index in improving, it does not show up in the statistics. The primary cause of the product liability problem is defective products sold by the manufacturers and retailers."

I think that the above statements are wrong and misleading and give a totally false impression of the revolution in the substantive law of products liability which continues to run its course to this very day.

The nub of the matter is not the safety indexes and it is not the privity requirement. The safety indexes to which Mr. Spangenberg refers speak only of the safety of the product in use; and products which are improperly used will cause damage even if they are in no way defective.

To learn whether the current level of accidents is attributable to bad products, to bad use, or to some other cause requires a detailed study of each individual incident. Many thoughtful commentators have noted that the expansion of plaintiff's rights in products liability actions could have adverse effects upon safety by removing the incentives that product users have for their own safety and well-being. The proposition is of course empirical and may yet be false. It may of course be true as well. Only a detailed study of individual occurrences, and not casual citation of aggregate phenomena, will help answer this question.

The privity doctrine too is not the source of the current uneasiness. The traditional privity requirement held (subject to some exceptions) that only an immediate purchaser could sue an immediate seller for damages caused by a defective product. The impact of the rule was of course enormous. One of its implications was that no person who purchased a dangerous product through a retailer could have any recourse against its manufacturer. Another was that no worker could even sue a manufacturer or retailer who dealt with his employer. I have no desire to defend the privity doctrine in all its rigor and do not think that this is the time to explore all of the confused reasons that led 19th century courts to embrace it in the first instance. Suffice it to say that the rejection of the privity

limitation brings into the legal system a large number of cases which would have been excluded under the old regime. The crucial question is not whether privity should be abolished; rather the question is how ought the claims brought into the system be treated once the privity limitation is overcome. I shall comment on the normative questions during the course of this paper but first wish to show the magnitude of the changes in products liability law that occurred long after the abolition of privity. The major reason why there are more "defective" products on the market is because the term "defect" in the past 10 years has, as a term of art, taken on such a broad meaning that it is possible today at least to argue that almost any product is defective no matter how well it is constructed.

The burden of this enterprise is in one sense too vast for this paper, as the law of products liability covers all manner of products, from ordinary canned foods to the most complex industrial machinery. Changes in it have been everywhere.

Rather than discussing the movement in products liability law in the abstract, I think it is better to fasten attention upon a single doctrine with a single line of products, while noting at the outset the story told here could be reproduced in other connections as well. I therefore choose to concentrate my attention upon an important

line of cases -- those concerned with the liability of manufacturers for injuries allegedly caused by "uncrashworthy vehicles." In essence the plaintiff in the typical uncrashworthiness case alleges that there is some defect in the defendant's automobile -- in most cases a defect in design -- which either caused or enhanced the plaintiff's injuries when the plaintiff was involved in a collision. In many cases the plaintiff alleges that the car did not protect him as it should have; in others, usually involving bystanders, that it enhanced the injuries that were otherwise inflicted. At one level the plaintiff's cause of action looks familiar. There is the usual split in the jurisdictions over whether the plaintiff's cause of action, when recognized, is based upon a theory of negligence or a theory of strict liability, and the usual uncertainty as to what difference, if any, the distinction makes. There are also the familiar references to causation, negligence, defect and design, coupled with a discussion of the possible defenses that are open to the defendant. In one sense it could be argued that these crashworthiness cases do not mark any real departure from the traditional common law principles of liability. But a closer look at the evolution of the doctrine gives a very different story.

For our purposes it is only necessary to go back as far as 1958, to the California case of Hatch v. Ford Motor Company, 163 Cal. App. 2d 393,329 P.2d 695 (1958). The plaintiff was a boy, aged six, who lost his eye when he ran into a pointed ornament whose tip extended beyond the front end of the radiator grill. A local statute made it unlawful for the defendant to construct the car in this particular manner. The plaintiff brought his action for damages under two theories. His first claim asserted that the defendant was in breach of its common law duty of ordinary care; his second was predicated specifically upon a breach of the regulatory statute. The trial court dismissed both of plaintiff's causes of action as a matter of law; its decision was affirmed on appeal. With respect to the common law negligence action, the Appellate Court held that the defendant did not owe any general duty of care to the public at large and to the plaintiff in particular to "prevent the type of injury sustained by the plaintiff when said automobile was at rest, properly parked on the highway", and it noted as well that plaintiff's attorney furnished the court with no cases which supported the recognition of a duty that would make the jury "an arbiter" on the question of design.

The plaintiff's cause of action on the statute also failed. Even though it was clear that the statute did place an affirmative duty upon the defendant, the court

barred recovery because the injury was not of the type which the statute intended to prevent. The statute, it said,

> "was designed to decrease the hazard created by the driving of said automobile upon the highways where its negligent operation might cause it to come in contact with others. It was not designed to protect those who, solely by reason of their own act or omission, might come in contact with it as an inert object lawfully standing unattended on the highway."

In essence the opinion rested upon the assertion that the defendant was under no duty to guard the plaintiff against this sort of contigency where the moving force, literally understood, was not the defendant (who was "an inert object" etc.) but the plaintiff. The central point that here emerges is that the duty limitation remained a significant issue in all products liability cases even after the passing of the privity limitation. How many duties, of what description and against what contingencies, will be imposed upon a product manufacturer?

The Hatch case then represents the early and complete rejection of any crashworthy vehicle doctrine. The next point at which to assess the legal situation is 1965, for in that year the American Law Institute published the Restatement (Second) of Torts, which contained a new section 402A announcing a general principle of strict liability of the sellers of products "in a defective con-

dition unreasonably dangerous to the user or consumer or to his property." The section also expressly rejected two defenses which might have otherwise been available in a products liability case. First it confirmed the death of the privity limitation by treating as immaterial the absence of a direct contractual relationship between the plaintiff and the defendant. Second it accepted (largely in advance of the cases which it was supposed to be re-stating) the doctrine of strict liability by treating as ineffective the defense that the defendant had "exercised all possible care in the preparation and sale of his product."

It is clear that the strict liability provisions of §402A marked an important doctrinal shift from the first Restatement of 1934, which contained no provision analogous to §402A. A closer reading of the comments to §402A and of the other sections in its chapter (entitled quaintly "The Liability of Persons Supplying Chattels for the Use of Others.") suggest in retrospect however that the changes were not as vast as some might suppose. The central concept within the Restatement provision is that of "defective condition unreasonably dangerous." The expression itself, apart from its obvious clumsiness, is

not self-defining, particularly as it applies to all products of whatever kind and description. We get a sense of what it intended only by examining the cases which the draftsman thought fell within its ambit. The specific instances are prosaic, largely limited to food and drugs. The Restatement talks of whiskey "with dangerous amounts of fusel oil", or tobacco "containing something like marijuana", or bad butter "contaminated with fish oil." The original preoccupation is with food and drugs in §402A and is understandable in that the earlier versions of §402A confined its operation first to food and drugs, and then in a later draft to products "intended for intimate body use." The expansion of the provision to cover all products was probably made (here I know of no good contemporary discussion of the point) on the assumption that the defects to be embraced by the broader provisions were to be analogized to those previously mentioned. In effect the only class of defects clearly covered by the section is the class of construction defects, as they are now called, as when the plaintiff is injured by a machine which improperly functions because, say, it lacked a washer or a seal on a crucial part of the equipment. So interpreted the scope of the section turns out by hindsight to be modest indeed.

There is yet another sense in which §402A of the Restatement represents only a limited change in the substantive law. Before the adoption of the strict liability standard in products liability cases, the courts in virtually all jurisdictions allowed the plaintiff, where the defect in the product was established, to hurdle the negligence barrier with the aid of the presumption of res ipsa loquitur. The effect of res ipsa was to place the defendant under a very heavy burden to establish that he had acted with the requisite due care. The use of the presumption was very useful in these cases because it helped eliminate from trial the troublesome question of just how much inspection and care should be given to prevent accidents. Questions of degree admit of no precise answer, and their elimination in this context not only served (properly in my opinion) to expand liability, but also to simplify the adjudication or settlement of product related claims.

The attention given to §402A should not, however, be allowed to obscure the fact that there were many design defect cases on the books at the time of the Restatement. Nor should it obscure the fact that other provisions of the Restatement (sections 395 to 398) were directed towards the application of negligence theories to cases of bad design.

Yet here it is necessary to emphasize yet again how far removed from the crashworthy vehicle cases were the typical design negligence cases first decided only around the time of the publication of the Restatement.

The typical design case involved a product sold by the defendant which when used in the very way in which the defendant had intended it to be used was of insufficient strength or safety to bear the stresses and strains associated with such use. To illustrate the nature of the limitations upon liability, it is useful to recount some of the cases in which the plaintiff recovered under this type of theory. Thus a rather "heavy set" woman was allowed to recover when she fell out of an S-shaped chrome chair designed by the defendants, when the center of gravity of the chair was unusually far forward, because the chair did not have the stability needed for its intended function. Garbutt v. Schechter, 167 Cal. App. 2d 306,334 P.2d 225 (1959). Likewise the plaintiff recovered when his car exploded when he turned the key in the ignition; gas fumes had escaped from the tank to be trapped in the trunk compartment where they were set off by a spark created when the ignition was turned on. Blitzstein v. Ford Motor Co., 288 F.2d 739 (5th Cir. 1961). The plaintiff was allowed to recover as well when the towing attachment on the defendant's Corvair broke as the car was being towed in the man-

ner specified by the defendant, when the towed automobile was released from the tow truck striking another automobile. Selmo v. Baratono, 28 Mich. App. 217, 184 N.W. 2d 367 (1970). The plaintiff was also entitled to recover when the aluminum ladder which he used collapsed under his weight. Lifritz v. Sears, Roebuck & Co., 472 S.W.2d 28 (1971); and when a ramp upon which his trailer was being driven collapsed under its weight. Berry v. Fruehauf Trailer Co., 371 Mich. 428, 124 N.W.2d 290 (1963). Indeed the very California case which first adopted the rule of strict products liability, Greenman v. Yuba Power, 59 Cal.2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1962), was a design defect case of this sort because it involved a situation in which the claimed defect was the existence of "inadequate set screws" to hold wood in place during the normal use of a lathe of defendant's manufacture.

All of these cases (whether decided on a negligence or a strict liability theory) can easily be fit into a conception of defect slightly broader than that embraced by the original text of Restatement 402A, but still eminently workable and eminently defensible: the defendant will be responsible for whatever forces are released in the use and operation of his product where these forces are the ones to which the product must be subjected as a matter of course

with ordinary use. The difficult question in these cases is which uses are regarded as ordinary and which are not, a question which should not be answered with reference to the manufacturer's subjective and unexpressed intentions about the way in which the product should be used. The discovery of the public limitations upon product use and performance may be tricky (how heavy a load can be lifted with a half-inch rope) but the cases already referred to should indicate that it is by no means an unmanageable task. As Justice Traynor, the architect of strict products liability in Greenman, said in the course of his opinion: "Implicit in the machine's presence on the market, however, was the representation that it would safely do the jobs for which it was built." It is that implicit representation which needs to be determined, both to create liability and to limit it.

The strict liability doctrines of the Second Restatement and the design negligence cases of the early 1960's were, even when taken in combination, a far cry from the general recognition of liability in uncrashworthy vehicle cases. Indeed the state of the law in 1967 is well illustrated by an article of Ralph Nader and Joseph Page: Automobile Design and the Judicial Process, 55 Calif. L. Rev. 645 (1967). It should come as no surprise that the

authors were in favor of imposing a general duty upon manufacturers to make crashworthy vehicles, but even with their own intellectual orientation they recognized that the current body of case law gave no support whatsoever for the recognition of that duty. The then most recent case on the issue, Evans v. General Motors, 359 F.2d 822 (7th Cir. 1966) had just held that "a manufacturer is not under the duty to make his automobile accident-proof or fool-proof; nor must he render the vehicle "more" safe where the danger to be avoided is obvious to all." It then dismissed the plaintiff's cause of action based upon the theory that the defendant's Chevrolet station wagon was negligently designed in that it had an X-frame without side protection for the decedent who had been killed when another vehicle collided with the left side of the wagon. Nader and Page attack the logic of the Evans opinion, arguing that the decision simply misstated the essential problem by insisting upon talking of a duty to design a "fool-proof" car. They argued that the duty contemplated only required the defendant to proceed with reasonable care to design a car which was reasonably safe.

The Nader article also recognized the limitations upon the plaintiff's new cause of action. "Even if the defendant's conduct was substandard, however, each new plaintiff must prove that the conduct caused the harm; the defendant has in each case

the defenses of contributory fault, assumption of risk and abnormal use." (p. 663)

The uncrashworthy vehicle cases came out of the law reviews and into the courts with the now famous decision of Larsen v. General Motors Corp., 391 F.2d 495 (8th Cir. 1968). Doctrinally speaking, the point in question was whether the involvement of an automobile in a road crash was an "intended use" of the vehicle. The court held that it should be so treated because of the foreseeable certainty of involvement in collisions, however unwanted they might be. The Evans case, decided but two years before was discussed and rejected, as the court held that "general negligence priciples" should be extended to crashworthy vehicle cases.

The endorsement of a general ngeligence standard leaves of course a great deal of uncertainty as to what is expected of any given defendant in any particular case, for that standard opens still wider the intractible question of just how much precaution must be taken against what sorts of harms. In other areas of admitted negligence liability, routine running down cases for example, the courts have sought with but mixed success to find more particular standards to counteract the vagueness of the general negligence rule,

and to that end they have turned to both statutes and custom as sources of the standard of care.

With respect to automobiles there are today fairly exhaustive statutory standards under the National Traffic and Motor Vehicle Safety Act of 1966. It is moreover quite proper to base private causes of action upon these standards because the standards themselves give explicit direction to vehicle manufacturers as to what must be done with their products. The question of how much, always the bane of the negligence inquiry, is in effect hammered out in an administrative hearing where the pros and cons of certain safety precautions can be resolved with inputs from all interested parties. The results of these deliberations may not always be wise, but for the purposes of the tort system this is quite immaterial, as a manufacturer faced with definite and clear standards knows that he deviates from them only at his peril. The manufacturer can, where statutes are the sole standard of care, use the statute as a "safe harbor" against tortious liability, while remaining free to better his product still further to meet market demands for additional safety.

The argument just made presupposes that the statutes involved form the sole standard of care, such that compliance with the statutory norm carries with it, at least in crashworthy vehicle cases, insulation from the threat of

tortious liability. This is not, however, the position under the current law. With reference to motor vehicles, the 1966 National Safety Act makes it quite clear that compliance with the statutory requirements is not a complete defense, by providing: "Compliance with a Federal motor vehicle safety standard issued under this subchapter does not exempt any person from any liability under common law." (Section 108c)

This provision is crucial for understanding the doctrinal developments in the crashworthy vehicle cases, for it raises the question of what supplementary standards should determine, not whether an automobile is safe in ordinary use, but whether is it safe enough to withstand severe impacts from without. At this point the inquiry turns to the relationship between custom and state of the art on the one hand, and the "general cost-benefit" formula on the other. In dealing with this issue, Larsen treated the state of the art as the standard against which to measure the suitability of the defendant's vehicle. The court did not, however, attempt to resolve one major ambiguity that lurked within its basic rule. One possible approach was to treat the state of the art as analogous to the usual role of custom in medical malpractice cases, such that any defendant who complied

with that state of the art, as measured by current practice, escaped all liability, even if the standard was in time superseded. This approach would mean it would not be possible, at least in the context of private damage actions, to challenge the practices of an entire industry (or even that of a substantial proportion of it) on the grounds that the standards themselves were lax under some aggressive application of the reasonable care test. The state of the art becomes the safe harbor, although one less definite than that offered by statute.

The courts in most jurisdictions, including California, have taken, however, the alternative position that the custom within the industry is simply evidence on the question of reasonable care, but that the ultimate issue of negligence is one to be decided by the jury in each individual case on the full totality of the evidence. And here they rely upon the famous opinion of Learned Hand in The T. J. Hooper, 60 F.2d 737 (2d Cir. 1932). [And see for my criticism of the T. J. Hooper rule Epstein, Medical Malpractice: The Case for Contract, 1 Am. Bar. Found. Res. J. 87 (1976).] The problem with the T. J. Hooper approach quite simply is that it leaves us with no standards whatsoever by which any given sort of product should be judged. All agree that the design of any product requires the trade-off of, among other things, price, quality, ease

of operation, safety and durability. Even the expenditure of infinite resources on product safety leaves open the finite chance of product danger. The objective of absolute safety only can be met, not by taking reasonable precautions but by stopping straight away the manufacture of all products. Repetition of the general negligence formula used in Larsen only tells us what we already know, that the balance needs to be drawn. It does not tell us where or how. In effect the law on the subject is reduced to little more than a laundry list, as the jury is told to take into account: the utility of the product to the user and the public as a whole, the likelihood that it will cause injury, the seriousness of the injury caused, the availability of substitutes, the cost of eliminating the defects without impairing the essential worth of the product or without making it too expensive, the ability of the user to avoid the damage, the user's knowledge of the product or the knowledge of the product held by the public at large given the obvious product features, and the ability to spread the loss through liability insurance. (See for this list Wade, On the Nature of Strict Tort Liability for Products, 44 Miss. L.J., 837-838 (1973).

The application of this formula cannot be done by any court or any jury which conscientiously tries to measure with precision each of these factors mentioned in the

formula. And, even if the measurement hurdles are surmounted, there is nothing about this list which tells us how the different factors should be combined in order to reach our answer. Juries may be instructed about this formula and may do their best to come in with proper verdicts. But we should never confuse the fact of a decision with the disciplined application of this elaborate and indefinite calculus. The former is always present; the latter is never possible. The state of the art is never the perfect standard, but the reasonable care standard in all its sophistication is no standard at all.

This formal elaboration of the design defect standard shows how different design defect cases are from construction defect cases, once we move away from the restricted interpretation of intended use. In the construction defect area the movement towards strict liability was fully supportable largely on the ground it reduced the defect question to a comparison between the product and the manufacturer's own specifications. The questions of how much care, how much quality control, how large a failure rate, etc. never were answerable, and the strict liability standard dispensed with the need to answer them. Likewise in the design defect cases involving product failure in ordinary use, the strict liability standard could properly apply in the sense that the manufacturer should be held to the standard of performance for which it was designed. The rig should support its

own weight, and the car should not explode when the key is turned in the ignition.

The acceptance of the crashworthiness doctrine in automobile cases, however, now makes it quite impossible to decide cases simply by squaring the product against the standard. Now it becomes first necessary, without adequate guidelines, to decide what the standard is. Here, moreover, it is not simply enough to prove that the product as designed is defective or unsafe. The acceptance of a general negligence theory in design defect cases places a far greater pressure on the general causation requirements of the law of torts, for it is simply not possible to relate the particular injuries which the plaintiff suffered to the design defects of the defendant's product unless we have an exact knowledge, not only of the forces to which the product is subjected, but also of the extent to which those forces could have been resisted if the car had been of an acceptable design. Thus if it is decided for example that a gas tank is too close to the exterior of an automobile, the question of liability requires us to know exactly where it should be placed and to know as well how it would have resisted the blow if it had been put into that position. Indeed it requires more, as we must know if the relocation of other parts of the car would have created some alternative source of danger given the external pressures applied.

Even if there is some sense that the jury knows what is wrong, there is little hope that there will be any reasonable agreement as to what is right. How much protection is enough protection?

We have said enough to show that design defect cases involving crashworthiness quickly take on a surrealistic air as the plaintiff hires an expert who will testify to the jury that some additional safety precaution (but only that which might have prevented or reduced this accident) would have been well worth its cost. Then given the wide degree of discretion that is left to juries in cases of this type, it will be up to the jury to decide whether the marginal costs of the additional precaution are greater or less than the marginal benefits to be gained. There will often be no effort to provide the jury with an actual alternative design, or to show that the design in question will not create more problems than it solves. In some cases the defendant may be lucky enough to get a directed verdict after a long and expensive trial, but in most the decision will remain one for the jury.

A brief glance at the reported cases helps illustrate the extent to which liability is possible under design defect theories. Thus cases have held that the jury is to decide whether or not an automobile gas tank could have been more safely positioned to avoid the fire damage that

resulted when the car was struck from the left rear by another vehicle going somewhere between 65 and 85 miles per hour. Self v. General Motors , 42 Cal. App. 3d 1, 116 Cal. Rptr. 575 (1974). Or whether the hood of an automobile should be designed to enable the driver to see under it in the event that it opened, because left unlatched, while the car was in motion. Roach v. Kononen, 269 Or. 457, 525 P.2d 125 (1974). Or whether the front posts of a Volkswagen minibus were sufficiently strong to withstand the force of a head on collision with another vehicle. Seattle-First Nat'l Bank v. Volkswagen of America, 11 Wash. App. 929, 525 P.2d 286 (1974). Or whether the divider which separates the headlight from the turn light should have been designed with a softer material in order to protect another motorist who was run down by a careless driver. Knippen v. Ford Motor Company, 546 F.2d. 993 (D.C. Cir. 1976). Or whether the doors of an automobile should be designed to make sure that an unlocked door does not fall open when struck in the side by another automobile. Melia v. Ford Motor Company, 534 F.2d 795 (8th Cir. 1976).

There are of course some cases in which the defendant is able to prevail in spite of a jury verdict against him. Thus the plaintiff's jury verdict was overturned on appeal when the court decided that it was improper to instruct the jury that a Volkswagen bus should have the same

resistance against a head on collision as a Ford sedan with an eight cylinder engine in front of the passenger compartment. Driesonstok v. Volkswagen, 489 F.2d 1066 (4th Cir. 1974). Likewise in a recent California case the appellate court reversed a jury verdict for the plaintiff where the claimed design defect was the hinging of the rear doors in a four door car from the rear panel. Kurli v. Ford Motor Co., 69 Cal. App. 3d 115, ____ Cal. Rptr. ____ (1977).

If these cases show the extremes to which cases can go before they are taken from the jury (and then only upon appeal), then it seems clear that there is far too much play in the joints in crashworthiness cases. The source of the problem to my mind lies in the fact that the reasonable care formula, always the soft-underbelly of the tort law, cannot possibly deal with the range of problems that are raised once the common law duties are extended as they were in Larsen. The formula creates the illusion of precision where there is but unprincipled chaos. Complete acceptance of statutory and state of the art standards is needed if the tort system is to remain workable.

The discussion as it has taken place has assumed that all crashworthiness cases should be decided upon a negligence theory. One of the important developments which has taken place after Larsen has been to treat the crashworthiness cases under the strict liability principles, either

contained in or patterned upon §402A of the Restatement. California, in the important case of Cronin v. Olsen, 8 Cal. 3d 121, 501 P.2d 1151, 104 Cal. Rptr. 433 (1972), now treats crashworthiness cases under such a strict liability standard, indeed one tougher than that contained in the Restatement itself.

It is important to note the consequences that do and do not follow from the shift to strict liability.

First, whatever its precise doctrinal nuances, the standard involved becomes somewhat higher than it would otherwise be under a negligence standard. One possible interpretation of the shift is to say that the strict liability standard means that in all cases the defendant should be charged with knowledge of the dangerous condition of the product in question, whether or not he could have discovered it with reasonable care, and to then ask whether the defendant with such knowledge would have taken some precaution against it. Wade, supra. Another way to look at the shift is to treat it as demanding the best possible set of design choices, not those which might have been reasonably suited under the circumstances.

Second, no matter which of these (or indeed any other) interpretation is adopted of a strict liability requirement in design defect cases, it is still clear that they

involve issues that sharply separate them from the construction defect cases. Restatement §402A treats as immaterial the degree of care involved in the preparation of the product; yet there is no doubt that the costs of discovering and implementing a new design technology must remain relevant under a strict liability test for design defects no matter how it is phrased. Strict liability still demands the same tradeoffs as negligence, for the only way that such tradeoffs can be eliminated is to hold a manufacturer of an automobile responsible for all harms to passengers in that vehicle no matter how they were caused. This the courts are still not prepared to do. And short of this position the movement to strict liability only helps shift the balance in each case further to the plaintiff's side.

Third, the shift to a strict liability standard has enabled the California Supreme Court to circumvent at least traditional rules of evidence. The California Civil Code provides that the introduction of a product improvement or modification after any accident shall not be admissible to establish the negligence of the defendant. In Ault v. International Harvester Co.,. 13 Cal. 3d 113, 528 P.2d 1148, 117 Cal. Rptr. 812 (1974) the court held that where the plaintiff's action was based upon a theory of strict

liability the evidentiary bar did not apply, because the defendant's wrong was not based upon "negligence or culpable conduct." The decision is criticized in the American Insurance Association Product Liability Package, and here I wish to note only that the ability to introduce all manner of subsequent design changes in products liability actions since the Ault decision has served to increase the probabilities of success for the plaintiff, especially in those areas in which rapid technological advance has made improvement the rule instead of the exception.

Fourth, the characterization of design defect cases as strict liability actions has severely undercut the affirmative defenses based upon plaintiff's wrongful conduct which were once available to defendants in products liability actions. Recall for the moment the observations of Nader and Page that the defendant in the crashworthiness cases had recourse to the defenses of abnormal use, assumption of risk and contributory negligence. Today all of these defenses have been sharply cut back.

The more recent cases make it quite clear that as the defendant can design a product which will guard a plaintiff against most forms of misuse, only those types of misuse which are completely unforeseeable will constitute a defense.

Contributory negligence too has been completely eliminated in design defect actions, the argument being that as negligence has no place in the plaintiff's case, so too it has no place in the defense to it. The hostility towards contributory negligence has a strong appeal in the case of contaminated foods and drugs which were the main preoccupation of the Second Restatement. It makes no sense to ask a consumer to finger bits of tuna fish in order to search for slivers of tin. But with design defect cases the possible types of contributory negligence consist of more than searching for a latent defect in a product which the defendant represented as fit for human consumption. Now the conduct of the plaintiff which is ignored is the running of a red light or speeding upon the open highway, [see Melia v. Ford Motor Co., 534 F.2d 795 (8th Cir. 1976).] All of these would be sufficient to hold the driver of an automobile accountable for the injuries of third parties even if his car contained some defect of design or construction, and they should make him responsible for his own injuries as well. The expansion of the prima facie case does not invite, as has been suggested, the contraction of available defenses. To the contrary it suggests the greater need to preserve these defenses lest the defendant's conduct be treated in law alone as the only source of plaintiff's injury.

Innocent plaintiffs should be protected, but all plaintiffs should not be regarded as innocent as a matter of law.

Assumption of risk has also been transformed, so that today it is applicable only where a plaintiff, with a specific knowledge of the defect and of the type of harm to which he is exposed, proceeds to encounter the risk unreasonably and voluntarily. Whereas the obligation of the defendant is cast in terms of reasonable foresight, with most anything which does happen being foreseeable, the obligation of the plaintiff is cast in much narrower terms. See Luque v. Mclean, 8 Cal.3d 136, 501 P.2d 1163, 104 Cal. Rptr. 443 (1972). If the defendant in Dreisonstok cannot get a directed verdict on assumption of risk where the plaintiff-passenger knows that there is no engine in front of the passenger compartment, then it is clear too that this defense too has been eroded nearly to the vanishing point.

The sum and substance of these observations should now be clear. The law of products liability has been the subject of constant transformation, both in California and elsewhere, and at no time has that change been greater than in the last ten years. The crashworthiness cases provide but one illustration that typifies that pattern across the law of products liability. Before 1968 there was no duty to make a car which could protect its occupants against collision. Then there was a duty to take reasonable care to prevent the occupants

against such harm. Subsequently the negligence was, at least in California, replaced by some form of a strict liability standard. And finally the affirmative defenses based upon either state of the art or the plaintiff's conduct have either been restricted or eliminated, to the point where the defendant in the normal case will have left to him the denial of the defect or of its causal relationship to the injury. The story told with uncrashworthy vehicles could be told with machine tools or with commercial drugs (think only of the swine flu cases and recognize that not a single cause of action rests upon the ground that the vaccines themselves were poorly prepared), or with many other consumer or industrial products. Everywhere the tempo of change has been rapid and everywhere the changes have worked in favor of recovery. With some of those changes there can I think be little quarrel, as the law of the late 50's was too restrictive. Other of the changes, however, are not welcome, and we must resist the tendency to convert the tort system into a system of universal entitlement for injured parties. I have already expressed some of my misgivings with the more recent shifts in the rules governing design liability. There is still time to argue the merits of the substantive shifts once it is conceded by all that the

shifts have indeed taken place. It is, however, simply wrong to say that the "primary cause of the product liability problem is defective products . . .." They may be part of the problem, but so too are defective laws.

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APPENDIX VIII

PRODUCTS LIABILITY -- A POSITION PAPER PRESENTED TO THE JOINT LEGISLATIVE COMMITTEE ON TORT REFORM ON JULY 18, 1977 BY WYLIE A. AITKEN, PRESIDENT, CALIFORNIA TRIAL LAWYERS ASSN.

Conservatively estimated, each year ordinary consumer products produce 20 million injuries, 30,000 deaths, 110,000 disabilities and disfigurements and the 5.5 billion economic losses. That is the "crisis" in products liability to the extent there is a "crisis," not the artificial one promoted by the liability insurance industry.

There are not a million or a half million lawsuits on file in products liability; the only authoritative study I have seen indicates 50,000. I can tell you that statistically in the State of California that the products liability cases are less than one percent of the civil filings that we have here in California.

The Federal Interagency Task Force appointed by the Commerce Department -- to find and seek out the products liability crisis -- reported that there, in fact, was no crisis. What they did discover though was the reason we have products liability cases is because people are making unsafe products and people are getting injured by unsafe products. And they further told us that the cost of products liability insurance accounts for less than one percent of the percentage of sales of the companies involved. We submit, is that too much of a price to pay for safe products; too much of a price to pay to see that people who are injured by unsafe products are compensated?

I think we've seen and heard enough in California about stories about the little farmer who is going to lose his farm unless you vote a certain way on a proposition or the doctors that are going to leave

in droaves out of our society unless we give them complete immunity. The last study I saw is that the medical profession is doing quite well -- they are increasing their membership and they are coming into California at every opportunity. That was the phony medical malpractic crisis we heard about two years ago. Now we have the products liability crisis as the public relations agencies of the insurance industry keep putting out their information and their message.

Let's not overlook the value of the existing system. The existing system says if you put out a defective product, you should be held responsible and accountable for the injuries that come from that unsafe product. But the system we now have really is twofold, not just a system of compensation to an injured person; but a system which prevents future injury by shifting the cost of that injury to the individual who had the opportunity to prevent the injury in the first instance thereby encouraging "loss prevention." The law is full of examples where successful (and sometimes unsuccessful lawsuits) were responsible for alteration or removal of dangerous products.

How about the cases involving the turntable where everybody knew that the children would go out and play on that turntable at the railroad station. If they had put a one dollar lock on that turntable, the child would not have lost his leg. Or how about the rotary lawmowers? Rotary lawnmowers caused more deaths in this country than the Viet Nam war. With a slight change in the angle of the deflection of the blade (a $1.10 part) we could have saved those lives. Or how about the railroad crossing in Arizona where the Southern Pacific Railroad knew and had their own reports that said if they merely put in the barrier and the signals they could reduce death

at a well known dangerous intersection by 90 percent. They knew it and when did they get around to changing the railroad crossing? After they got sued. And after 12 people picked at random from the community heard the evidence, found out that they knew long before the deaths that they were going to occur, had their own studies and for want of putting in a safety crossing, they could have prevented 90 percent of the deaths. The jury awarded damages and the jury awarded punitive damages for the reckless, absolute disregard for human life and now there is a railroad crossing in Arizona and lives are being saved.

What about the washing machine case that we had in California. For want of a $2.00 switch that would turn off the washing machine when the door was opened automatically, a customer got his arm caught in the door and lost his arm. Or the earthmoving machine with a total blind spot behind the operator of that earthmoving machine that for want of putting a simple device we have in our cars called a rearview mirror, he could have seen the workman behind him and could have saved his life. Instead, the workman behind him was buried under all that earth, leaving a widow and three children. Or the Drano cans we hear so much about. For want of putting a little plastic top. We didn't need a screw top cap on Drano cans -- after all, we are a society who put men on the moon, do you think we could have devised a cap that couldn't come off, that a child couldn't unscrew. Of course we could. But when did we get around to doing it? After somebody got sued and after Drano had to pay damages. Now we hear that when you look at a Drano can and you see that antidote on the can that there is no antidote. That's pure deadly poison and pure and simple, there is no antidote. But they tried in effect to control their

liability, control their responsibility by putting on a warning that is ineffective. How many times do we recall before the advent of consumerism, how often was there such a thing as recall of automobiles in this society. Now one gets a letter in the mail that says that a particular car which happens to have a cruise control on it -- that has a little slight problem. We have discovered through tests that if you put the cruise control on sometimes it does not disengage when you hit the brake, and sometimes it is known to increase in speed! Now can you imagine going down the Santa Ana Freeway on Friday afternoon at 55 miles per hour just to find out that when you hit the gas pedal that the cruise control does not disengage, but your speed increases and how many of those warnings would have gone out before we became concerned with product safety and before we became concerned with preserving individual's rights to damages for their injuries.

What we have not done is provide sufficient forums to allow the loss prevention and compensation function of the tort system to work smoothly. We are a society which spends more money on advertising products that insure than we do on the judicial system which is responsible for handling the aftermath. For example, the Federal Judicial System is only .07 of 1% of the federal budget.

The product liability situation is part of an overall claimed "tort explosion" which has led to demands that all such cases be taken out of the court system, the rights to trial by jury be abolished and benefits to the injured severely restricted, yet none of the available statistics support such a claim.

In California, for example, all civil filings between the years 1973 - 1974 to 1974 - 1975 increased but 7 percent, yet for the same period, automobile personal injury filings increased only 2 percent. All other personal injury filings, the so-called "tort" cases, encompassed 4.1 percent of the total civil filings and now only encompass 4.3 percent. Included in that category would be all of your medical malpractice cases, government tort liability cases, products liability cases, slip and fall cases, etc., statistics which hardly reach crisis proportions.

Singling out the product liability cases, it would be surprising if there had been a decline. There has been a substantial growth in our population, therefore, in the number of consumers and a great increase in the number and complexity of products which are sold. It is an important indicator of economic health that there be a steady annual increase in the gross national product. The more goods that are sold, the greater chance of defect and injury. At the same time, the cost of medical care and the level of hourly and annual wages has risen year by year so that the same injury and the same lost time of a decade ago costs far more to compensate at today's prices. Yet there has been no increase in the percentage of the sales price which goes to pay claims by the average manufacturer. I.e., the federal interagency task force recently concluded that the cost to see that injured victims of defective products are compensated is less than 1 percent of the gross sales of the industries effected.

We continually ignore the value of the open courtroom. If litigants knew they were going to trial they would realistically evaluate their cases because, in the final analysis, no one feels

comfortable with a third party deciding "their" case, especially when that third party is as "unpredictable" as a jury. The fact that juries follow a statistical pattern does not eliminate this feeling in the individual case. The jury thus serves its dynamic role of inducing parties to settle their cases without burdening the judicial system, plus like E. F. Hutton, when a jury speaks, manufacturers of bad products and the insurance industry listens.

What has been the response of the manufacturing associations and the insurance industry? Their response is to take out full page ads and tell you that if you don't do something about the products liability crisis by taking away the rights of injured people, it is going to cost the public money. They withhold coverage to small manufacturers at any price in order to bolster this artificial crisis. That's what was reported in the Business Insurance Journal. And what should the response of the insurance industry be? It really should be on be one of loss prevention, not one of taking away the rights of the injured individuals. It really should be a construction gang and not the role they have been playing -- that of a wrecking crew.

The insurance industry and manufacturers have put together a legislative program and their intellectual justification for it is the artificial crisis and this is a national conspiracy and a national program and they are attempting to stampede every State Legislature. And what do they want to do? For one, they want to decrease the statute of limitations. They say there should be a life on a product and after ten years or after eight years no suit can be brought against any entity based on a unsafe product. Now what, for example, would that do to the DES cases, that drug that was put out that's causing

cancer in the female children of the women who used it? And when was that discovered -- 18 years after the product was sold! Under their program, the manufacturer of that product (that's causing cancer in all those young women) should be held not responsible because it's more than ten years after the date of the manufacture of the product. What about elevators that they know are going to be used for 30 or 40 years and they know when they put it out that it only has an eight year life expectancy and they don't tell any body. Should they be excused because it happened over more than eight years? They are further advocating a State of the Art defense. It says that if the product that's built in conformance with the standards of the very industry that's being sued, it's an absolute defense! You set your own standard, nobody else has anything to say about it. You and Richard Nixon set your own standards, we can't pass on it, we can't judge it.

What effect would such law have on loss prevention? There is a case documented where they knew that steam vaporizers that you put in your room for your children when they got a cold, that if that child gets up and pulls on that steam vaporizer, he can pull a lot of hot scalding water on top of him or her. And they knew a long time ago that you could put a safety cap on the top of that vaporizer that would prevent spillage onto the young child. And when did they change it? They changed it, not only when they got a lawsuit against them and they had to pay $150,000 to a burned and scalded child, burned and scalded for the rest of his life, but when the insurance company came to them and said you keep making that product unsafely, you keep putting out that vaporizer without that safety cap and we are not going to insure

your product. Now if that company went out of business, or could not afford liability insurance, would it be a tragedy? Either they accept their social responsibility to all of us, or they belong out of the business. It's not good business if you only think in terms of profit and not of safe products, not to have quality control and not to care for the safety of the people who you know are going to be using your product or are going to be in the area where your product is being used.

The Vice-Chairman of the National Commission for Consumer Safety was talking to a manufacturer and this manufacturer wanted to put out a 50 cc. bike for seven year olds. Now, that's a brilliant idea, isn't it? A 50 cc. bike for seven year olds. He pointed out, quite appropriately, "Can you imagine how many children are going to be injured when they take that 50 cc. bike out onto the streets and how many will be killed and maimed?" And the manufacturer looked at him and said, "Yes, but can you imagine what a market I would have for a product like that?" That was the reaction of one manufacturer, and that's not the reaction of all manufacturers, and it should not be the reaction of the industry, but individuals such as the one quoted should either meet their responsibility or they should be out of business. We should not radically change the law and radically change the compensation of injured victims because somebody may have gone out of business in Minnesota because they made an unsafe punch press.

In closing, we would like to just remind you that what this is really all about in the final analysis is prevention, product safety. It has been said ably this way "A fence at the top of the hill is far better than the ambulance in the valley below." The existing tort system has contributed substantially to see that those fences are constructed.

APPENDIX IX

August 10, 1977

California Legislature
Joint Committee on
Tort Liability

Committee Members:

I'm Gerald Cashion, President of Meyer Machinery Company of Los Angeles and Redwood City, and representing the California Product Liability Task Force, which is an unincorporated organized association. We are a group of wholesalers and distributors in the State of California working together for a common purpose; that of the enactment of legislation at the State level to provide equitable product liability laws.

How many businesses and employers are directly affected here in California? In the 1972 census there were approximately 24,000 wholesalers and distributors in California that generated 28.9 billion dollars worth of sales per year and employed approximately 269,000 employees.

In our opinion, product liability has reached a crisis in this state for small business. The proliferation of product liability suits poses to the industry, and especially the small businessman, a threat unequal to that faced by the medical profession. It is driving insurance rates out of range for many small businesses. It is forcing some companies to operate without insurance. It is eroding the foundation of the industrial system and the common market place. It is, as a result, pumping millions of dollars worth of inflation into the economy annually in the form of higher prices for goods manufactured that must be paid by the consumer.

This task force conducted a sample survey and as of July 8, 1977, 149 companies have responded, with more answering every day. From this survey it was determined that the ever increasing product liability insurance rate in the last two years is driving some businesses to the brink of closing their doors. Of the 149 survey answers, 30% of the companies have had an increase of their insurance for liability by 50%; 19% have had an increase of 100%; the next 19% had a 300% increase; 8% of this group received a 400% increase, and 24% reported a 500% or better increase.

We feel a three-year survey would have increased these percentages dramatically. Those reporting, almost 50% were companies with 25 or less employees. We feel this is a good cross-section of the small businessmen in our state. We, as wholesalers and distributors, have no means to pass this increase on.

The need to change our laws in our state is now. Companies that have been in business for 40 to 50 years or more are liable for items sold before some of us were born that have changed hands many times as well

as having been modified. We as wholesaler-distributors have no control over the product after it is sold, and in many cases never see the item after it is ordered and is shipped direct to customers from the manufacturer. What the user ultimately does with the product cannot be controlled by us.

We should act now with:

Doctrine of Strict Liability in Tort

State of the Art

Statue of Limitation

Contingent Fees

Product Alteration

Punitive Damages

Product Liability Review Panel

Third Party Actions

To protect not only the wholesaler distributors, but the consumer from the spiraling increase for costs in products used.

Gerald R. Gaskin

cc: Fred Naglestad
Clarence Bush
Jim Hamilton

APPENDIX X

Testimony at Products Liability hearing in San Diego 7/18/77
by Dick Romney

CHAIRMAN KNOX JULY 19, 1977

I have been asked to reply to your letter of June 6th.

I am Dick Romney - President of Pac-Power, a Walnut Creek-Woodland California utility equipment firm.

We sell, service, and overhaul hydraulic aerial manlifts and mobile derrick cranes; perform dielectric, stability, structural testing; and certify. We are licensed by the State Industrial Commission as a mobile crane test and certification agency - No. A-97. Our customers are public utility companines, municipal governments, State of California, Federal agencies, and some export accounts.

We currently employ 27 people. Since inception - one liablity action - $900 loss.

We represent two of the leading midwestern lift and crane manufacturers.

Our company was founded in 1973 - I've been in the utility equipment field thirty-three years - my partner seventeen years.

Assemblyman Knox asked that I answer three specific questions. The first is:

1 - How much have your premiums increased since 1974?

In July of 1973, with a major carrier we paid about $3,200 for $500,000 primary and $1,000,000 umbrella policy-products and completed operations.

In 1974 the carrier declined to renew coverage. We again obtained $500,000 prime coverage with a south-eastern firm for $3,220, with an eastern firm providing the $1,000,000 umbrella for $3,112.

This was a 100% increase.

One policy was cancelled before expiring in 1975. The other expired.

None of the major carriers would insure us. We finally obtained coverage with a Michigan firm - at $21,250 - a 335% increase for $1,200,000 less coverage. Shortly before Christmas 1976 - the Michigan Insurance Commissioner ordered the Michigan carrier out of California.

We had an audit in our agent's hands the night of the 10th day. It took almost two months to obtain the refund on our unused premium, and the refund was based on a short-rate cancellation.

Incidently, I was informed last week that this Michigan carrier is still selling coverage in California, although firms that were insured and cancelled by this carrier have been unable to obtain premium refunds.

Second question I've been asked to answer is:

2 - Have you been refused coverage by any insurance company?

Yes, we have to date approached vigorously 42 carriers; received coverage from none. We have utilized a small-town agent, a broker specializing in construction and industrial liability coverage, and three of the largest brokerage houses in San Francisco. We have been repeatedly commended by insurance comapanies for our well run and documented business. Some three weeks ago, after detailed plant inspection, documentation, and testing review with the carrier and brokers group, we received this quote:

> $100,000 primary coverage only - with $10,000 deductible - per occurance - written on a claims-made basis for $63,000 in premium. This is 37 times manual rate.

One occurance - and we would be out $73,000. This means we would be spending 73 cents to protect 27 cents - this makes no sense to me.

We have been repeatedly turned down by major carriers who write firms in other states doing the same job, representing the same lines we do - and with realistic premiums costs. Salt Lake City, Denver, Portland, San Antonio are all examples.

The Colorado company in June saved some $19,000 in premium costs due to legislative change; Texas, $11,000 with insurance commission help.

Twelve western utility equipment dealers, we are one of them, are so concerned a captive insurance company is being

investigated. We won't save premium dollars, but won't receive a 10-day cancellation.

The dollars required up front and reserves required make this venture almost overwhelming - it's a long-haul program.

It seems unrealistic to me that I must go into the insurance business to survive.

The third question:

3. Do you know any companies that were unable to obtain coverage due to the cost of premiums?

Yes, three here in California.

Product liability is the most serious problem we face today.

Premuim costs put a new "Partner" in your business.

Lack of product coverage is now spilling into general liability market.

We must have legislative relief in California or legitimate equipment distributors will be no more.

APPENDIX XI

Statement of Berry L. Griffin, Jr.

before the Joint Committee on Tort Liability.

San Diego, California

July 18, 1977

Mister Chairman and Members of the Joint Committee on Tort Liability, I am Berry L. Griffin, Jr., Risk and Benefits Manager of Baker International Corporation located in Orange, California. I appear here today as a practicing Risk Manager, as a member of the Orange Empire Chapter of the Risk and Insurance Management Society, Inc. or RIMS, and also as the National Vice President of RIMS in charge of Government and Industry Relations.

RIMS is a non-profit corporation with over 2500 members and consisting of 54 chapters, of which 48 are located in the U.S.A. Four of these chapters are located in California. They are the Northern California, Los Anglees, Orange Empire and San Diego chapters. These four chapters are composed of approximately 250 practicing risk managers. The members of our four California chapters are the largest consumer or buyer of insurance in the state of California.

We risk managers are charged with the responsibility of protecting our employers' assets against the risk of loss as the result of static losses such as fire, earthquake, automobile liability, products liability, etc., generally considered as insurable risks either through self-insurance or the more traditional purchase of insurance. In other words, the professional risk manager spends 40 hours or more a week dealing with nothing but the management of the risks of his firm. I can assure you that we risk managers are very aware of the products liability problem facing not only the business community but the entire citizenry of the state of California and the nation as a whole. We face this problem daily.

Much has been written about why we have a products liability problem today. Because so much has been written on the subject and in the interest

of brevity I will not rehash the many reasons why we find ourselves in this position. What I will do is propose solutions to the products liability insurance problem so that manufacturers can find adequate insurance at an affordable price.

Firstly, manufacturers should be producing products free from defect. Industry is spending many millions of dollars to make sure their products are safe. Industry must continue these efforts. Several governmental agencies are carefully watching industry's efforts.

Secondly, much more must be done to educate the public concerning the tort system--to let the public know what happens to their insurance premium and to the price of any product purchased when tort liability is abused.

Thirdly, the insurance industry must get a handle on products liability. They must develop meaningful statistics which substantiate the enormous premiums they now demand.

Lastly, the American Tort System, encompassing the judicial mechanism, is a viable concept which should be retained. The erosion of the fault concept of liability, the increased use of the courts to redress wrongs, the costliness and inefficiency of the system evidence serious problems within the system.

We support responsible, meaningful legislation and action which will correct the basic causes of our tort system problem. Among these reforms we recommend:

1. Enact a statute of limitations, a law confining the time period during which a suit may be filed. We recommend a 6-10 year statute from the time a particular product enters the stream of commerce.

2. Limit court awards to economic loss, including attorney and court fees, thus:

a. limiting pain and suffering awards.

b. eliminating punitive damage awards.

c. permitting disclosure of collateral source of recovery.

This, we feel, would reduce the size of court awards and encourage more reasonable settlement negotiations of claims before trial.

3. We recommend that all state worker's compensation laws should be improved to an adequate level, and recoveries of the worker or his dependents be limited to statutory worker's compensation for job-related injuries. Suits against fellow employees and third party suits against suppliers and manufacturers should be discouraged.

4. Comparative Negligence--RIMS supports this as a form of contribution among negligent parties, under which awards to injured parties would be reduced proportionately by their negligence in causing their own damage or injuries.

5. State of Art Defenses--A law prohibiting the introduction of evidence of negligence any improvements in products resulting from advances in technology.

6. Enact a statute which would regulate plaintiff attorney's contingent fees. We recommend a graduated scale or possibly, in the alternate, court awarded fees.

7. Compliance with Federal or State standards--such a compliance should be at least a rebuttal presumption that a product was not defective.

8. Contribution among tortfeasors. We support meaningful contribution among joint tortfeasors.

9. Advance Payments--RIMS supports evidence rulings which will exclude such payments from being disclosed or imply admission of liability, and permit such payments to be offset against subsequest awards.

10. Bifurcated Trials--We support the use of bifurcated trials, or separate trials, where the issues of liability or negligence are tried first, and if liability is found a second trial may be held on the issue of damages. This will separate the emotional issue of damages from the more objective issue of negligence.

11. Advance Notice of Claim. We will support a requirement that prior to any liability suit being filed, a notice of claim must be filed with the other party and a reasonable opportunity given to remedy the defect and compensate for economic loss to the claimant.

12. Arbitration--We will support a requirement for binding arbitration both as to liability and damages in certain types of cases so as to lighten the caseload of the courts.

13. Contingency Fee System--We recommend the contingency fee system be modified so as to reimburse the attorney on a graduated basis only on that portion of the award or settlement which exceeds the highest settlement offer made by defendants before an attorney was engaged by the claimant.

14. Payment of Winner's Costs--We recommend the loser in court should pay all the court costs and attorneys' fees, to discourage the filing of spurious law suits and to encourage more reasonable settlement negotiations before trial and before suit is filed.

15. Ad Damnum--We support the elimination of the Ad Damnum in pleading because of its inflammatory nature.

16. Installment Payment of Awards--We can support the concept of commutation of awards to periodic payments to the claimants as an alternative to large lump sum payments and possible reduction of the award in the event of the early demise of the claimant.

I wish to thank the committee for the opportunity of appearing before you today. Should you have any questions, I will be pleased to attempt to answer them.