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MEMORANDUM

May 24, 1982

TO: Chris DeMuth

Mike Horowitz

FROM: Mike McConnell

RE: Products Liability Conceptual Framework

This memo will outline my tentative thoughts on a conceptual framework for the products liability problem. It will not attempt to resolve technical problems with administration, propose statutory or regulatory language, or be politically realistic. The sole purpose of this memo is to explore a theoretically justifiable way to think about the problem. If the conceptual framework outlined in this memo seems fruitful, we can begin to work on the practical and political problems.

1. The question of the "best" products liability law is one of consumer preference, rather than of rational determination.

When a consumer purchases a product, he in effect purchases two products: the product itself, and an associated "insurance" package in the form of a potential lawsuit against the manufacturer in the event that use of the product causes injury. Provision of this "insurance" constitutes a cost of production, reflected in the price of the products. It follows, therefore, that the government is inherently incapable of determining the "best" products liability law -- any more than it could determine the "best" flavor of ice cream or the "best" price of cigars. */ The ideal solution, therefore, would be to permit manufacturers to offer their products with an array of "insurance" options, with different prices reflecting different

*/ At first blush, the prospect of third-party injuries (injuries inflicted by product defects on persons who are "strangers" to the purchase) could seem to contradict the view that the nature of products liability arrangements can justly be left to consumer choice. But in theory, the third-party plaintiff (C) is able to sue and recover against the second-party purchaser (B), who committed the tort by exposing C to the dangers of the defective product. The extent to which B has an action over against the manufacturer (A) will depend solely on the prior contractual arrangement between A and B -- as to which C is indifferent.

In practice, this answer may seem unsatisfactory because B may be judgment-proof. At the most, however, accommodation of the third-party injury problem would require that states be permitted to continue to allow a direct cause of action for C against A (and to adopt liability rules to govern the cause of action) to the extent that B is judgment-proof (and to no greater extent).

costs, and to permit consumers to choose their preferred option.

2. Neither courts nor legislatures are willing to permit

unfettered consumer choice in this area. For a variety of

reasons, courts and legislatures have strictly limited the

ability of manufacturers to offer, or consumers to choose, a mix

of products liability "insurance" options. For purposes of this

memo, I assume that a straightforward reliance upon pure

consumer choice (i.e., repeal of all binding products liability

law for those in privity of contract, and replacement with pure

contract law), while ideal, is not an available policy option.

However, to the extent that elements of consumer choice can be

permitted or even encouraged under available options, this

should be seen as a major plus.

3. Given certain conditions, state or local regulation is

generally preferable to federal regulation. There is a solid

basis in the economic literature for concluding that, in the

absence of significant externalities, state or local regulation

is preferable to federal regulation because:

° People are able, by selecting their community, to exercise a degree of choice about desirable regulatory regimes. Consumer welfare is therefore enhanced, though admittedly not optimized.

° The larger number of "experiments" produces more experience and information on "better" regulatory solutions.

° The movement of people and capital operates as a market-like mechanism -- however weak -- to induce governments to "improve" their regulations.

In my view, the advantage of state or local over federal regulation holds true even with respect to regulations governing products that have significant economies of scale in production, contrary to John Morrall's memo of May 8, 1981 (attached). The greater the economies of scale, the smaller will be the advantage to state or local regulation over federal regulation, and the greater the nationwide leverage of large states and strict states will be; nevertheless, short of the limiting case,

the state or local solution necessarily will remain superior in ⁷
terms of consumer welfare.

4. The Kasten bill is inconsistent with all of these

principles. The bill in no way increases consumer choice;

indeed, by federalizing large portions of products liability law

it makes a return to consumer choice even less likely. The bill

treats state and local rules as presumptively less efficient --

which is true only from the point of view of large-scale

manufacturers who stand to gain by the (artificial) creation of

homogeneous national markets. The bill adopts the view that an

optimal products liability law can be created by rational

political decision, without any market mechanism. But there is

absolutely no way to test whether the bill's provisions are

"best" from the consumers' point of view -- and they will by

definition be "worse" than a system of multiple consumer

options. Moreover, even if the current bill seems reasonable,

there is no reason to expect that over time the national

products liability code -- unchecked by any market mechanism --

will not become grossly out of kilter with consumer preferences.

It is ironic that the bill's proponents view its very uniformity and rigidity as advantages. But in my view, the rigidity -- the uniformity -- the national character -- the essential arbitrariness -- of the Kasten approach all militate against its adoption.

What is needed is a creative, consumer-choice-oriented framework for products liability, using the diversity of the states as a means for simulating a market mechanism, rather than attempting to stifle all non-uniformity.

5. The simple solution of leaving products liability law to the states will not work. In order for an optimal solution to be achieved, the costs and the benefits of regulatory decisions must be borne by the same consumers. Under the present system, however, the manufacturer is unable to charge a higher price for a product with a more costly "insurance" package attached, and therefore the costs and benefits of providing the more costly package are borne by different consumers. This result is a product of the conjunction of two causes: a purely physical cause (that a product with a costly "insurance" package is

physically indistinguishable from a product with a less costly "insurance" package) and a legal cause (that as a product moves from one state to another, the nature of its "insurance" element changes in accordance with the differing state laws). The manufacturer cannot calculate the "insurance"-related risk associated with an individual product. He must therefore calculate the price of each individual product to reflect the weighted average of the costs associated with the laws of all fifty states, rather than the costs associated with its particular use. As a consequence, each state gains the incentive to increase its products liability "insurance" package, since its citizens will reap the entire benefit while the cost is borne by consumers all over the country. This is an inherently unstable system, with no tendency to approach optimality over time.

6. Adoption of the conflicts principle of "the law of the state of manufacture" is one solution to the problem. If courts in all states were bound to apply the products liability law of the state of manufacturer, consumers would be able to choose between, say, a widget manufactured in Pennsylvania and a widget manufactured in New Jersey. The prices of these widgets would

reflect the different cost of the "insurance" package attached.

Consumer welfare would be enhanced by this choice, for the same reason consumer welfare is increased by additional choices of color, flavor, quality, or any other product feature.

Moreover, as the manufacturers in states with more "popular" products liability laws gained sales, other states would be induced to move toward the socially optimal products liability law. If a state proved unwilling to adjust its law to the optimum, manufacturers might well find it advisable to move to other states.

To the extent that different consumers have different preferences for products liability "insurance," the states could be expected to continue to provide a variation in products liability laws, to the degree consistent with economies of scale. Moreover, to the extent that consumer preferences for products liability "insurance" change over time, the states could be expected to change their laws in order to gain an advantage over other, less alert, states.

It should be emphasized that, theoretically speaking, there is no need for a "minimum" national level of products liability

"insurance." Consumers themselves can protect against inadequate laws by choosing to buy products made in other, more protective, states. The pressure will not be toward the least costly "insurance" package, but toward the socially optimal package, as defined by consumer preferences expressed in the market.

7. A second solution would be to permit manufacturers to designate on their products which state law of product liability would govern. The effect of this scheme would be much like that of the conflict of laws alternative, in that consumers would be able to select their preferred products liability "insurance" package at its appropriate price. The advantage of this solution over the former alternative is that the range of choices is likely to be larger, since each manufacturer could produce as many as 50 different product-insurance packages. The disadvantage of this over the former alternative is that it contains no incentive to the states to move toward the socially optimal products liability law. Each state will be neither better off nor worse off by virtue of a manufacturer "choosing" its law to govern sales.

MEMORANDUM

THE WHITE HOUSE
WASHINGTON

*file
products
liability*

May 27, 1982

MEMORANDUM FOR: JAMES BAKER III
FROM: WENDELL W. GUNN *W. W. Gunn*
SUBJECT: Briefing Points on Product Liability

It is my understanding that you will be meeting with representatives of the Product Liability Alliance, including a Mr. Victor Schwartz. Attached are briefing points prepared by Sherman Unger, General Counsel of the Department of Commerce. Included therein is an allusion to the business community's dissatisfaction with the Administration's lukewarm support, particularly OMB and the White House, who, they say, do not understand the issue. In fact, the real source of their dissatisfaction is that the Administration did not immediately salute and move into action.

Your guests have already met with a number of Administration and White House officials, apparently in search of a sympathetic ear. They have been told by several such officials, including OPD, that consideration of a major step like federal pre-emption requires that the problems be well defined and well documented. We have asked for quantitative information regarding the prospective impact on insurance, litigation expense, etc., to be used as the basis for cost/benefit analysis. Not only have they not supplied such information, but they seem to resent our asking for it.

This matter will probably come before the Cabinet Council on Commerce and Trade within the next 30 days. Meanwhile, if you need more details please call.

cc: Ed Harper
Sherman Unger

BRIEFING POINTS ON
PRODUCT LIABILITY

James A. Baker, III

PURPOSE OF YOUR MEETING

- ° The Business Community is seeking Administration support for Federal legislation to resolve problems being encountered in the law of product liability. They believe that the case has been made for a Federal solution after six years of deliberations in Congress as well as within the Executive Branch. (See Tab C, Chronology of Federal Involvement in Product Liability.)
- ° The Business Community is dismayed that the Administration has so far declined to support the concept of Federal product liability legislation. They were surprised that, in his testimony before the Senate Consumer Subcommittee on March 12, 1982, Secretary Baldrige -- who supports the need for a Federal approach -- offered only luke-warm support. They perceive that the problem lies with White house and OMB staff who do not fully understand the issue and who are concerned - unjustifiedly - that product liability legislation would be inconsistent with Administration concepts of New Federalism.
- ° Representatives of the Business Community have been meeting with OMB, CEA and White House policy staff in order to turn the Administration around on the product liability issue.

PRINCIPAL ISSUES TO BE DISCUSSED

The two specific concerns you will be asked to address are:

- ° Whether Federal Product Liability legislation is necessary to reduce the insurance, manufacturing and legal costs currently experienced by the business community.
- ° Whether Federal Product Liability legislation establishing uniform Federal standards is consistent with new Federalism and can be supported by the Administration.

STATUS OF ADMINISTRATION POSITION
ON PRODUCT LIABILITY

- ° The Product Liability issue is currently before the Cabinet Council on Commerce and Trade. The Cabinet Council first considered the issue on April 7, 1982. At that time, a Working Group was formed and directed to "identify and analyze the economic and intergovernmental policy arguments for and against a new federal statute on product liability." The Working Group is considering the following issues:
 - ° Whether Federal Product Liability legislation is necessary to reduce the insurance, manufacturing and legal costs currently experienced by the business community.
 - ° Whether Federal Product Liability legislation establishing uniform Federal standards is consistent with new Federalism and can be supported by the Administration.
- ° The Working Group held its first meeting on April 19, 1982, and anticipates presenting its recommendations to the Cabinet Council in mid-July.

BACKGROUND OF THE ISSUE

- ° During the 1960's, state courts began to develop new and divergent theories on which to base the liability of product manufacturers, moving away from theories based on negligence and developed theories intended to permit "compensation" to the consumer when injuries occurred.
- ° As product liability law began to become inconsistent from state to state, manufacturers began to find that the cost of obtaining adequate liability insurance was markedly rising. This resulted from the fact that unlike automobile, medical or worker compensation lines, product liability insurance is rated nationally, because most products are marketed nationwide. Insurance companies were therefore setting rates based upon increased exposure in a few states.
- ° In response to this problem, President Ford established a Federal interagency task force in 1976 and appointed the Department of Commerce as its lead agency. You were

instrumental in setting up this Task Force. See Tab D. The Task Force conducted a major survey of the product liability situation generally. It found that both liability of manufacturers and product liability insurance rates had increased dramatically. Among the principal causes identified by the task force for these increases were (1) overly subjective rate-making practices by major insurance carriers, and (2) uncertainties and imbalances in product liability law among the states.

- ° In response to the problem of overly subjective ratemaking practices, President Reagan approved the Product Liability Risk Retention Act of 1981 (Public Law 97-45, September 25, 1981). The Risk Retention Act ensures objective underwriting by permitting manufacturers to form risk retention groups and insure themselves. The Act provides for a limited preemption of inconsistent state laws in order to achieve this purpose.

The second outgrowth of the findings of the Task Force was the publication, by the Department of Commerce in 1979, of the Uniform Product Liability Act, a model law for adoption by the states which, if fully adopted, would have established nationwide uniform standards.

- ° The approach represented by the Uniform Product Liability Act has been unsuccessful. Only four states have adopted portions of the uniform law; twenty-seven other states have adopted various other statutes, none of which is alike. The result has been increased uncertainty among product sellers, insurers, and consumers. For this reason, all sectors of the business community are urging adoption of Federal uniform product liability standards.
- ° Congressional interest in product liability legislation has been growing in recent years. In the 97th Congress, Senator Kasten, Chairman of the Senate Consumer Subcommittee, developed a draft bill, and after extensive public comment, has come forth with a second draft. The Consumer Subcommittee held two days of hearings in March on the need for product liability legislation.
- ° In the House of Representatives, Congressmen Shumway and LaFalce have each introduced legislation, and it is anticipated that Congressman Waxman will do so in the near future.

OFFICE OF POLICY DEVELOPMENT

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product
liability*

STAFFING MEMORANDUM

DATE: 6/5/82 ACTION/CONCURRENCE/COMMENT DUE BY: FYTSUBJECT: Robert L. Robinson letter to Pres. re Federal product liability law

	ACTION	FYI		ACTION	FYI
HARPER	☐	☐	DRUG POLICY	☐	☐
PORTER	☐	☐	TURNER	☐	☐
BARR	☐	☐	D. LEONARD	☐	☐
BAUER	☐	☐	OFFICE OF POLICY INFORMATION		
BOGGS	☐	☐	GRAY	☐	☐
BRADLEY	☐	☐	HOPKINS	☐	☐
CARLESON	☐	☐	OTHER		
FAIRBANKS	☐	☐	_____	☐	☐
GUNN	☐	☒	_____	☐	☐
HEMEL	☐	☐	_____	☐	☐
B. LEONARD	☐	☐	_____	☐	☐
MALOLEY	☐	☐	_____	☐	☐
SMITH	☐	☐	_____	☐	☐
<u>UHELMANN</u>	☐	☒	_____	☐	☐
ADMINISTRATION	☐	☐	_____	☐	☐

Remarks:

Please return this tracking
sheet with your response.Edwin L. Harper
Assistant to the President
for Policy Development
(x6515)



WAYNE ENGINEERING CORPORATION

OFFICE OF
POLICY DEVELOPMENT

May 28, 1982

1982 JUN -5 A 11:44

President Ronald Reagan
The White House
1600 Pennsylvania Avenue N.W.
Washington, DC 20500

RE: Federal Product Liability Law

Dear Mr. President,

We are a small company out here in Iowa engaged in the manufacture of Mobile Refuse Collection Equipment (garbage trucks). The people who use our equipment are among the least educated, poorly motivated elements of American society. Thus, you will not be surprised to hear that they have one of the highest accident rates of any occupation.

The primary concerns of all manufacturers of this type of equipment are, first, protection of the man from the machine, and the machine from the man; and second, designing a machine that is both functional and safe. Product liability cases generally revolve around the success or failure of the manufacturer to meet this criteria.

At present there are fifty different jurisdictions, each building its own edifice of case law to guide our thinking in these matters. The only beneficiaries of this chaos are the lawyers; and they--of course--oppose a federal product liability law. I do not believe the organized bar, or any other organization having a purely predatory interest in the matter, should be permitted to lobby this issue.

Our company, and the entire waste equipment manufacturing community, ask only that uniformity be imposed on this area of litigation by establishing a single, federal jurisdiction. This is certainly well within the reach of the interstate commerce clause of the constitution. This request is for nothing more than equity and justice, and can hardly be regarded as a special pleading.

Your constituency in the business community strongly supports this legislation. Many of your more senior subordinates oppose it, probably because they are lawyers. Whatever the case, it is essential that this legislation pass so our industry can devote its resources to the problems of product quality and safety, not the enrichment of the organized bar.

Very respectfully,

WAYNE ENGINEERING CORPORATION

Robert L. Robinson
National Sales Manager
RLR/co

Copies: Edwin Meese, James A. Baker, Edwin L. Harper, Elizabeth Dole, David

Stockman
P.O. Box 648 2412 West 27th Street Cedar Falls, Iowa 50613 U.S.A.
Phone 319-266-1721 Cable: WAYNE ENG Telex: 465641

OFFICE OF POLICY DEVELOPMENT

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products
liability*

STAFFING MEMORANDUM

DATE: 6/7/82 ACTION/CONCURRENCE/COMMENT DUE BY: OPENSUBJECT: Product Liability

	ACTION	FYI		ACTION	FYI
HARPER	☐	☐	DRUG POLICY	☐	☐
PORTER	☐	☐	TURNER	☐	☐
<u>BARR</u>	☐	☒	D. LEONARD	☐	☐
BAUER	☐	☐	OFFICE OF POLICY INFORMATION		
BOGGS	☐	☐	GRAY	☐	☐
BRADLEY	☐	☐	HOPKINS	☐	☐
CARLESON	☐	☐	OTHER		
FAIRBANKS	☐	☐	James Baker III	☒	☐
GUNN	☐	☐		☐	☐
HEMEL	☐	☐		☐	☐
B. LEONARD	☐	☐		☐	☐
MALOLEY	☐	☐		☐	☐
SMITH	☐	☐		☐	☐
UHLMANN	☐	☐		☐	☐
ADMINISTRATION	☐	☐		☐	☐

Remarks:

Please return this tracking
sheet with your response.Edwin L. Harper
Assistant to the President
for Policy Development
(x6515)

THE WHITE HOUSE

WASHINGTON

June 4, 1982

MEMORANDUM FOR JAMES BAKER III

FROM: EDWIN L. HARPER

SUBJECT: Product Liability

Given your historic interest in the area of product liability, I would be interested if you have any comments on the attached memo by Mike Uhlmann on product liability and federal preemption. I think Mike's memo does a nice job of laying out the options and problems that are involved.

Thanks for your interest.

THE WHITE HOUSE

WASHINGTON

May 27, 1982

To: Ed Meese
From: Ed Harper
Subject: Product Liability and Federal Preemption

Attached is Mike Uhlmann's memorandum on Federal Preemption.

cc: Jim Jenkins
Ken Cribb
Craig Fuller

MEMORANDUM

OFFICE OF
POLICY DEVELOPMENT

THE WHITE HOUSE

1982 MAY 27 P 4:07

WASHINGTON
May 17, 1982

FOR: EDWIN L. HARPER
FROM: MICHAEL M. UHLIANN
SUBJECT: Product Liability and Federal Preemption

This memorandum provides: (1) an overview of the problems faced by industry; (2) a discussion of possible Federal responses, with emphasis on the preemptive statute favored by industry; and (3) an analysis of the "principles of Federalism" which should guide this Administration in addressing the products liability issue.

I. PROBLEMS FACED BY INDUSTRY

A. Diverse and hostile State laws have emerged.

Historically, State laws have governed the liability of manufacturers for injuries caused by their products.

Since 1960, State product liability laws have become unstable in two respects:

- o Judicial activism within the States has resulted in departure from common law principles and the judicial-creation of extreme pro-plaintiff rules which substantially increase industry's exposure. (Many States have, by judicial fiat, done away with "fault", radically expanded "strict liability", and eliminated defenses traditionally available to sellers and manufacturers.)
- o Sharp divergencies among the States have emerged as judges, severed from the anchor of common law, have embarked on a course of ad hoc judicial rule-making. (There is now wide variation among the States on such matters as duty of care, available defenses, and evidentiary and procedural rules.)

Over the past four years, there has been a countervailing trend as State legislatures have moved to remedy this imbalance. About 30 States have enacted product liability statutes; but,

these laws, no two of which are alike, provide only limited relief. The statutes focus on specific problems (e.g., statutes of repose) rather than comprehensively addressing the nature of a manufacturer's duty and the elements of a product liability claim.

B. Industry has been injured in three ways.

Sellers cannot predict where their products will end up and, hence, what legal standards will be applied in product liability suits. Manufacturers must assume, no matter where they are located, that they will be governed by the laws of the State with the most extreme pro-plaintiff rules.

This has injured manufacturers and distributors in essentially three ways:

1. Increased Insurance Costs: Insurance companies must build a high contingency factor into their rates to take into account the experience in those States with the strictest laws.
2. Disincentives Toward Product Innovation and Development: Some States have rules which penalize innovation and design changes. Because manufacturers cannot predict the standards by which new products will be judged, they are wary of innovation.
3. Increased Litigation Costs: Legal costs associated with determining 'what law applies', forum-shopping, and rebriefing of issues, appreciably increase the cost of product liability litigation.

These costs are passed on to consumers, either in the form of higher prices or obsolete products.

In short, a single State with extreme pro-plaintiff rules can inflict the costs of these rules on manufacturers and consumers located in the other 49 States.

C. The Costs of Diversity: Contract vs. Tort

The costs of non-uniform product liability laws are probably greater than the costs of non-uniform contract laws:

- o The costs of adhering to 50 different sets of contract law have been mitigated by: (1) adoption of U.C.C.; (2) general State adherence to common law principles; (3) ability of parties to choose applicable law and modify rights by

contract terms; and (4) clear-cut choice-of-law rules.

- o The costs of adhering to 50 different sets of product liability law have been exacerbated by: (1) judicial innovation away from common law principles; (2) limitations on ability to modify rights by contract; (3) development of State "long-arm statutes" which assert jurisdiction on out-of-state parties; (4) the move away from clear-cut choice-of-law rules in tort cases; and (5) increasing litigiousness of society.

II. POSSIBLE FEDERAL RESPONSES

A. Previous Federal Involvement

Responding to industry complaints, President Ford established a Federal Interagency Task Force in 1976 with the Commerce Department as its lead agency. The Task Force concluded that product liability insurance rates had increased dramatically due to (1) overly subjective ratemaking by major carriers, and (2) imbalances in product liability law among the States.

To deal with ratemaking, President Reagan approved the Product Liability Risk Retention Act of 1981 (P.L. 97-45, Sept. 25, 1981) which ensures objective underwriting by permitting manufacturers to form risk retention groups and insure themselves.

To address imbalances in State law, the Commerce Department published in 1979 the Uniform Product Liability Act. This model law for adoption by the States would, if fully adopted, establish uniform statutory standards of conduct (as well as certain procedural and evidentiary rules) nationwide.

B. Current Options

The Administration has essentially four options:

1. Do Nothing: Tort law has always been a matter for the States. The inconveniences that result from 50 different sets of rules arise in numerous other contexts and are part of the price we pay for our "Federal System". The Federal government should do nothing unless industry shows that: (1) the costs are exceptional; (2) the product liability problem is unique; and (3) a federal approach would be "better".

2. Encourage the Uniform Code Approach: Tort law should be handled in the same way the States have

handled sales and contract law under the U.C.C. In the past three years, UPLA has been adopted by four States. The going is slow, but State action is better than Federal intervention. The Federal government could help spur on the process.

3. Develop a Creative "Federalist" Approach: The Administration may be able to develop an approach which provides predictability but uses the diversity of the States as a means of stimulating a market mechanism, rather than attempting to stifle all non-uniformity. (E.g., a Federal statute which would require that the law of the place of manufacture governs product liability claims. This would foster competition among States to attract industry and would bring the market to bear, as consumers sought products from States that had come closest to the optimal mix of safety and price. Critics will say that some States may adopt lax standards and inflict unsafe products on the rest of the country. But this is far from clear.)

4. Adopt a Preemptive Federal Statute: Enact a single Federal product liability law that would supercede all such State laws. Federal jurisdiction would not be expanded. This would provide (1) uniformity and, hence, predictability; (2) a means for "rolling back" some extreme pro-plaintiff rules; and (3) a rigid system that will check judicial activism.

C. The Approach Favored by Industry -- Preemption

Industry feels that progress on UPLA has been too slow. It wants the Administration to endorse "the concept" of a preemptive Federal statute.

There are two principal groups pushing for a Federal statute:

- o The Product Liability Alliance (TPLA) with over 180 trade association and corporate members representing manufacturers, retailers, insurers, small businesses, etc. A "moderate" group that endorses a "fair and balanced approach" between consumer and industry interests.
- o Coalition for a Uniform Product Liability Law (CUPLL), a smaller group composed of large manufacturers and generally perceived as more "hard line" in pursuing distinctly pro-industry legislation.

The main opposition to a preemptive Federal statute comes from some lawyers' and consumers' groups:

- o ABA initially opposed Federal legislation, but two sections are reconsidering this position.
- o The National Trial Lawyers Association is opposed, as is the defense bar.
- o Nader's Public Citizens' group and other "consumer" organizations are actively resisting Federal legislation.
- o Other consumer groups say they will support a Federal statute if it is "balanced".

The picture in Congress is as follows:

Senate: Senator Kasten (R-WI), chairman of the Consumer Subcommittee of the Senate Commerce Committee, has drafted a comprehensive Federal product liability statute, and plans to introduce it at the end of this week. Drafts have been widely circulated. TPLA supports it. Consumer groups view it as tilting too much toward industry. (A synopsis of the Kasten Bill is attached.)

House: Rep. Shumway (R-CA) has introduced a bill, supported by CUPLL, that tilts decisively in favor of industry. Rep. Waxman (D-CA), chairman of the Health & Environment Subcommittee of the Energy & Commerce Committee, has drafted a bill which has not yet circulated. It is expected to be more "middle-of-the-road" than Shumway's, though it will be slanted toward "consumer" interests.

The arguments "for" and "against" a preemptive Federal statute are as follows:

Pro

1. Uniformity will result in predictability.
2. Predictability will:
 - stabilize insurance rates;
 - encourage research, innovation in product manufacture;
 - expedite reparations process and reduce legal costs for all parties.
3. Provides a way to roll-back extreme pro-plaintiff

Con

1. Premise that Federal law will bring uniformity and stability is erroneous:
 - 50 state judiciaries will interpret statute differently;
 - states will adopt different rules to "fill the gaps";
 - statute will encourage judicial activism by wiping the slate clean of prior precedents;
 - the statutory standards

rules.

are inherently malleable
(e.g., "reasonableness").

4. Puts a statutory check on
future judicial activism.

2. A single law is risky:
 - political process at national level may result in bad law;
 - a single prestigious court could sour the law by anti-industry constructions;
 - even if law is stable, this would prevent positive evolution.

3. Would set a bad precedent for "Federalizing" other areas of law traditionally left to the States. (Product liability problem is indistinguishable from problems in other areas of the law.)

III. GUIDING PRINCIPLES

This Administration should be guided by the following general principles in considering a possible Federal response to the product liability problem.

A. Free market action is preferable to government regulation.

Theoretically, selection of optimal product liability rules could be left to the market: Binding product liability laws would be repealed. The respective rights, duties and liabilities of consumer and manufacturer would be defined in individual sales contracts. Manufacturers could offer their products with a range of "insurance" options. Prices would vary according to the extent of "insurance" offered. Through the purchases, consumers would be permitted to choose their preferred option, and, in this way, select the optimal product liability rule. For a variety of reasons, the pure market approach is not a feasible means of setting product liability rules. Some government regulation is required.

B. Local regulation is preferable to State regulation; State regulation is preferable to Federal regulation.

The reason is competition. If local regulation is inefficient, people can easily escape. If there is a Federal monopoly on regulation, the cost of escape may be prohibitively high. Thus, the lower the level at which regulation is imposed, the more of a competitive check on oppressive regulations is

imposed by the ability of people to vote against it with their feet. Regulation at the lowest feasible level is thus preferable to Federal regulation because:

- o The movement of people and capital operates as a market-like mechanism to induce governments to improve their regulations.
- o Consumer welfare is enhanced because people are able to exercise a degree of choice about desirable regulatory regimes.
- o The larger number of "laboratories" produces more experience and information on better regulatory solutions.

The presumption in favor of local or state regulation is strongest where the burdens of the regulation are confined to the locality or state. Deference to the State political process is most appropriate where those directly affected by the regulation were represented in that process.

- C. The presumption in favor of State over Federal regulation is less where State regulation imposes excessive burdens on persons outside the State.

The lower the level of regulation, the greater the danger that the regulatory authority will impose costs on people to whom it is not answerable politically. Thus, while the competitive check is stronger at lower levels, the political check may be weaker.

If the costs of each State's regulation are spread throughout the nation, the advantage of diversity (i.e. the competitive check) is lost. Diversity is good where it serves as a basis for choice. When the burdens of each State's regulations are inflicted throughout the nation, people cannot "choose" to avoid them. There is no escape; they must live with whatever rules the legal system deals out in a particular case. Diversity thus results in capriciousness rather than competition.

- D. Even where State regulation inflicts external burdens, it is preferable to federal regulation unless (1) the external burdens are clearly excessive in relation to the putative benefits, and (2) the burdens of Federal regulation will be demonstrably lower.

Federalism has its price. It has always been recognized that the Federal system gives rise to inconveniences and inefficiencies.

However, the disadvantages of a single Federal law are clear.

It eliminates the check of a market mechanism on government regulation. There is no reason to suppose that a "better" products liability law can be created by a rational political decision at the national level, without any market mechanism.

- E. If Federal intervention is essential, an approach that preserves diversity and competition should be adopted over one which creates a preemptive uniform rule.

The disadvantages of a single Federal law are clear: (1) uniformity; (2) rigidity; and (3) arbitrariness. These sacrifices may not be necessary to obtain predictability.

It may be possible to develop an approach that achieves predictability but, at the same time, preserves diversity and competition. One possible approach is a Federal choice of law statute.

IV. RECOMMENDATION

It is too early to embrace the concept of Federal preemption in the products liability area.

Before we go down that road, we must make sure that:

- (1) the costs of the present system are excessive;
- (2) the Uniform Code approach is impractical;
- (3) short of preemption, there is no Federal measure that will establish predictability while preserving diversity and competition; and
- (4) the costs of a single Federal statute would be lower than present costs.

cc: Roger Porter
Wendell Gunn

SYNOPSIS OF "KASTEN BILL"

Sec. 3 -- Preemption:

Preempts state laws. Would not expand Federal jurisdiction.

Sec. 4 -- Manufacturers' Duties:

Preserves "strict liability" in cases involving negligent manufacture and express warranty.

Adopts traditional "negligence" standard in cases involving negligent design and failure-to-warn. Would "roll back" attempts by a minority of courts to extend "strict liability" to such cases.

Sec. 5 -- Non-Manufacturing Sellers' Duties:

Provides that non-manufacturing seller can only be held liable if he does something negligent. (Strict liability in express warranty cases.) Arrests efforts by a minority of courts to extend "strict liability" to non-manufacturing sellers.

Sec. 6 -- Government Standards:

Creates presumption that, if a manufacturer complies with Federal design or warning standards, the design or warning is not unreasonably unsafe.

Creates reverse presumption: the design or warning is presumed unsafe if manufacturer has failed to comply with Federal standards.

Both presumptions can be rebutted by clear and convincing evidence.

Sec. 7 -- Comparative Negligence:

Adopts "pure" comparative negligence standard. A plaintiff's recovery is reduced in direct proportion to the extent his own negligence had contributed to his injury.

Sec. 8 -- Plaintiff Misuse or Alteration:

Permits seller to raise plaintiffs' misuse or alteration of the product as a defense.

Sec. 9 -- Worker Compensation:

Reduces damages by the amount paid to claimant under worker compensation laws.

Sec. 10 -- Time Limit:

Provides that no claim alleging unsafe design or failure-to-warn may be brought for harm caused by a "capital good" more than 25 years after delivery.

Sec. 11 -- Punitive Damages:

Limits punitive damages to cases where there is clear and convincing evidence that the harm resulted from the reckless disregard of the product seller. Punitive damages can only be awarded by the judge.

Sec. 12 -- Subsequent Remedial Measures:

Provides that evidence of corrective measures taken by a product seller after the harm has occurred cannot be used as evidence against the seller to show unsafety of the original product.

OFFICE OF THE VICE PRESIDENT
WASHINGTON

June 11, 1982

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liability*

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MEMORANDUM TO CHRIS DEMUTH, MIKE HOROWITZ, MICHAEL UHLMANN

FROM: C. Boyden Gray

RE: Federal Product Liability Legislation

I think that the attached letter regarding the need for
Federal product liability legislation makes a number of good
points.

Bill Gray

1701

Eli Lilly and Company

307 East McCarty Street
Indianapolis, Indiana 46285

Walter C. Taylor, Jr.
Assistant General Counsel and Assistant Secretary

May 4, 1984

Boyden C. Gray, Esq.
Legal Counsel to the Vice President
Old Executive Office Building
17th & Pennsylvania Avenue, N.W.
Washington, D.C. 20501

Dear Mr. Gray:

I hope that as a result of the deliberations of the Cabinet Council on Commerce and Trade Working Group, the Administration will support Federal product liability legislation. It was with a great deal of reluctance that I came to the conclusion that federal legislation represented the only realistic hope of providing business with relief from the precarious position imposed by the fifty separate and often conflicting rules of tort law governing a manufacturer's liability for injuries allegedly caused by products sold in interstate commerce. Today, most products are sold in a national market. It is rare that a product is produced and consumed only in one state. Escalating verdicts, the cost of litigation, an increased willingness to file lawsuits, and the absence of clear and uniform rules governing product liability combine to place a tremendous burden on the interstate sale of goods.

The purposes of the New Federalism of the Administration, as I understand it, are to restore the efficiency of American business and to leave to the states those enterprises best handled locally. Federal product liability legislation that provides for predictability

MAY 6 REC'D

Boyden C. Gray, Esq.

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but does not create a Federal bureaucracy or expand the jurisdiction of Federal courts is consistent with those purposes and not inconsistent with the traditional purpose of tort law of providing an incentive for safer products by imposing liability for injuries caused by unsafe products where such injuries would have been preventable by the exercise of reasonable care by the manufacturer.

The Need

Product liability law is largely judge-made law in the fifty states. The California Supreme Court has held that an injured plaintiff who is unable to identify the manufacturer of the product unit that allegedly caused the injury may sue manufacturers who in the aggregate held a substantial share of the market for that type of product, even though it is quite possible that none of the manufacturers before the court produced the product charged with actually causing the plaintiff's injury.

Courts in another state (New York) have held that even if it is shown that the product unit that caused the injury was not produced by the defendant manufacturer, the defendant may be held liable where it sold an identical product.

Courts now routinely hold that a manufacturer may be sued for injuries allegedly caused by products produced and sold by the manufacturer decades before the occurrence of the injury which the suit is based upon.

Boyden C. Gray, Esq.
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Courts in many states have repudicated the long-standing rule that evidence of subsequent remedial measures may not be introduced on the issue of liability. Admission of this kind of evidence discourages product innovation which would improve the safety and performance of products.

In spite of pervasive regulation of the testing, manufacture and marketing of drugs by the Food and Drug Administration (FDA) to assure the efficacy and safety of such products, juries are permitted to determine in a product liability lawsuit that the drug manufacturer should have provided different warnings even though the warnings had been approved by FDA with full knowledge of all medical and scientific facts known to the manufacturer and to the medical community.

Attempts are made to justify these rules on the grounds that they place the cost of injury on the manufacturer who presumably is in a position to pass them on to consumers, so that small increments of the cost fall on many different persons. The difficulty is that in many instances the rules of liability are too unpredictable to permit passing on such costs. It is not possible to pass on costs attributable to conduct of twenty or thirty years from now may hold actionable under rules not envisioned today. Neither is it practicable to expect one manufacturer to be in a position to pass on the cost for injuries caused by the products of its competitor.

Even if it were possible to pass on such costs, the tort litigation system is a highly inefficient means of so doing. A million dollars in attorneys' fees for defending a product liability suit is fairly common. A manufacturer who prevails on the merits suffers a substantial monetary penalty merely as a result of defending itself. The unpredictability of the present rules of liability encourages the filing of many meritless suits in the hope of recovering a large judgment.

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State Action

It is not realistic to expect the states to solve this problem. Approximately twenty-eight states have enacted some form of product liability law in the last five years. These laws are not uniform. They vary from state to state. In fact, there is now less uniformity than before such enactments. This result is to be expected. The economies and interests of the several states are too diverse to expect the states to achieve reasonable uniformity. Some states have little manufacturing while others have substantial manufacturing. Among those with substantial manufacturing activity, the industrial mix often varies from one state to the other. While each manufacturer suffers the adverse effects of the present tort litigation rules, no two industries will suffer in precisely the same way. Therefore, it is unlikely, politically, that the kind of support needed to achieve reform can be developed at the state level. As a practical matter, federal action seems to offer the only viable prospect of accomplishing product liability reform in a manner that is fair to manufacturers and consumers.

Federal legislation need not create a Federal bureaucracy. In fact, there is no need for it to create any regulatory scheme whatsoever and it does not need to enlarge the jurisdiction of Federal courts. It can provide predictability and fairness by adopting fairly simple rules to be applied by state courts and Federal courts in exercising diversity jurisdiction.

I am writing this letter not only to express my views, but also those of Mr. C. H. Bradley, Jr., Lilly's General Counsel. Mr. Bradley underwent yesterday on short notice an appendectomy, and, of course, is still recuperating.

Sincerely yours,

Walter C. Gray Jr.

WCT:csr

COUNCIL OF ECONOMIC ADVISERS
WASHINGTON, D.C. 20500

MURRAY L. WEIDENBAUM, CHAIRMAN
JERRY L. JORDAN
WILLIAM A. NISKANEN

August 13, 1982

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liability*

MEMORANDUM FOR PRODUCT LIABILITY WORKING GROUP
CABINET COUNCIL ON COMMERCE AND TRADE

FROM: William A. Niskanen, Member
Council of Economic Advisers

WAN

SUBJECT: An Alternative Perspective on Federal
Product Liability Legislation

A. SUMMARY

This memorandum summarizes an alternative perspective on federal product liability legislation. My evaluation of the presently perceived problems of the existing body of common law and state statute law leads me to conclude that a federal law providing uniform standards for product liability may be sufficient to reduce these problems but is not necessary. This memorandum summarizes the primary characteristics of an alternative approach.

B. THE PROBLEMS

The two primary problems of the developments in product liability law over the last twenty years, as presently perceived by the manufacturers, are the following:

1. A manufacturer selling in several states cannot predict which state law will apply in a specific product liability suit. The rapid development and substantial divergence among states in this body of law also makes the cost of insurance against potential damages unusually high.
2. State legislatures and, maybe, state courts do not have a sufficient incentive to protect manufacturers because, although they can protect the consumers in each state, they cannot protect manufacturers who market in other states. As a result, product liability law may be increasingly biased against the manufacturers, in terms of the efficient distribution of risk between manufacturers and consumers.

C. EVALUATION

My evaluation of these problems leads me to the following conclusions:

1. Each manufacturing company would prefer that a known uniform body of product liability law apply to the sale of its products wherever these products are sold, in order to reduce the costs of insurance and, probably, litigation. For this purpose, it is necessary that the relevant law be uniform across states for each manufacturer, but it is not necessary that the law be uniform across manufacturers.

The state laws bearing on corporate charters are an example of this point. A legal case bearing on the corporate charter is subject to the law of the state in which the corporation is chartered, regardless of the states in which the plaintiffs reside or the states in which the corporation operates. Most of us appropriately opposed a uniform federal law on corporate charters, such as proposed by Nader in the 1970s, in part, because a federal law was not necessary to assure that uniform body of law applied to each corporation and that there was no merit to a uniform federal charter across all corporations. Similarly, a federal law providing for uniform product liability standards is sufficient but not necessary to resolve this issue.

2. Each state would have a better incentive to balance the interests of consumers and manufacturers in that state if the state product liability law applied to the manufacturers in that state wherever their products are sold. Each state is likely to choose a somewhat different balance of these interests, but each manufacturer would be subject to only one body of law. The Federal Government also has a better incentive to balance these average interests across states, but any uniform federal standards would be "tighter" (in terms of the liabilities on the manufacturer) than preferred in some states and looser than preferred in other states. Again, a federal law imposing uniform product liability standards is sufficient but not necessary to resolve any present bias in the decisions in each state. Moreover, uniform federal standards cannot reflect the legitimate differences in the balancing of these interests among the states.

3. A third consideration arises whenever one is considering any proposal to substitute statute law for common law. Statute law is subject to greater certainty, after a shakedown period, but it can be more certainly wrong as well as right. On the other hand, common law has better "evolutionary" properties in adapting to changing perceptions about the efficient or just balancing of interests. The decision to codify a body of law should depend on how confident one is that the proposed standards are correct, now and over time. A relevant fact is that no state now has a comprehensive product liability statute and that the major manufacturing states now have no product liability statute. My own judgement is that it is presumptuous to believe that we are ready to codify product liability law in the form of uniform federal standards.

The only other case for a federal law imposing uniform product liability standards is that it would be preferable to apply the same standard to all manufacturers. As far as I know, no one has submitted any argument or evidence in support of this case.

D. AN ALTERNATIVE APPROACH

Some federal product liability legislation may be valuable. My view, however, is that a structural law, rather than a substantive law, is both sufficient and superior. A federal law with the following general characteristics would be sufficient to resolve the two primary perceived problems without replacing the evolutionary development of the common law or the legitimate diversity of state statute law:

1. The Liable Party

In general, the liable party would be the company that places its brand name on the product, whether or not that company is the dominant manufacturer of the product. This would make Sears, for example, liable for any products marketed with a Sears brand, whether or not Sears manufactured any component of the product. Several exceptions would require different treatment: For a product marketed without a brand, the liable party would be a manufacturer that contributed the highest proportion of value added to the product. For a product for which the specific manufacturer cannot be identified (e.g., the Sindell case), the liable parties would be all the manufacturers, with a proportionate liability based on the market share at the time of the tort.

2. Jurisdiction

In general, the body of law that would apply would be the law of the state in which the highest proportion of value added is manufactured. Again, several exceptions would require special treatment: If the specific place of manufacture cannot be identified, jurisdiction would be in the state in which the highest proportion of value added for that brand is manufactured. If the specific manufacturer cannot be identified, jurisdiction would be in the state in which the highest proportion of value added for that general product is manufactured. For imported products, jurisdiction should probably be in the state of entry.

3. Conclusion

The above paragraphs describe the rough general characteristics of a federal law that would be sufficient to address the two primary perceived problems of the present body of products liability law. A bill based on these characteristics could be written in a few pages, would not change the substantive standards of the present common law or any state statute law and, in my view, is superior to any federal law imposing uniform product liability standards. I recommend that this alternative perspective be considered seriously before the Administration endorse the specifics of any federal product liability law.