

1987

Products Liability in the Small Capital Goods Manufacturing Firm: Problems, Proposals and Pitfalls

William G. Rood

Follow this and additional works at: <https://scholarlycommons.law.cwsl.edu/cwlr>

Recommended Citation

Rood, William G. (1987) "Products Liability in the Small Capital Goods Manufacturing Firm: Problems, Proposals and Pitfalls," *California Western Law Review*: Vol. 23 : No. 2 , Article 6.
Available at: <https://scholarlycommons.law.cwsl.edu/cwlr/vol23/iss2/6>

This Comment is brought to you for free and open access by CWSL Scholarly Commons. It has been accepted for inclusion in California Western Law Review by an authorized editor of CWSL Scholarly Commons. For more information, please contact alm@cwsl.edu.

Products Liability in the Small Capital Goods Manufacturing Firm: Problems, Proposals and Pitfalls

Wall Street Journal, June 3, 1976:

Not much remains of Havar Manufacturing Co. of St. Paul, Minn. The small punch-press maker has halted production, auctioned off much of its machinery and idled most of its 80 employees. . . .

. . . [T]he company was hit by a wave of lawsuits filed by press operators around the country who had lost fingers or hands in Havar presses.^[1] . . .

Havar's product liability insurance premiums soared from \$2,000 in 1970 to \$4,000 in 1974 and \$10,000 in 1975. Last September [1975], the company's insurer canceled Havar's policy. Replacement insurance would have cost \$200,000, or 10% of the company's \$2 million in annual sales. . . .

. . . .
Havar's case is extreme, of course, but far from unique. Thousands of American manufacturers, large and small, are finding that the cost of insurance covering the products they sell is significantly hurting their business. . . . Among the hardest-hit industries are drugs, general aircraft, *tools and various kinds of capital equipment.*²

Los Angeles Times, September 14, 1985:

Acmat Corp. had a good safety record and a booming business removing cancer-causing asbestos from schools, hospitals and homes. Then last spring disaster hit . . . : [Its insurer] canceled all policies connected with asbestos, including Acmat's. After a search of 30 other insurers, the company [found coverage at] an astonishing \$4 million in annual premiums.

Acmat grabbed it, even though premiums were twice what it paid last year for coverage that was 10 times as great. It at least keeps the company in business.³

When products liability insurance becomes unavailable or unaffordable, a small capital goods manufacturing firm may be faced with bankruptcy or liquidation if an accident occurs and a large personal injury judgment is awarded. Consequently, the injured

1. See, e.g., *Finnegan v. Havar Mfg. Corp.*, 60 N.J. 413, 290 A.2d 286 (1972); *Bexiga v. Havar Mfg. Corp.*, 60 N.J. 402, 290 A.2d 281 (1972).

2. Wysocki, *Litigation Load: Manufacturers Are Hit with More Lawsuits, Rising Insurance Costs*, Wall St. J., June 3, 1976, at 1, col. 6 (emphasis added).

3. Day, *Insurance for Liability Skyrockets*, L.A. Times, Sept. 14, 1985, Part I, at 1, col. 1.

plaintiff may have to look to the perhaps inadequate assets of the firm for compensation. The insurance industry blames strict products liability law, increased litigiousness of the public and increased levels of personal injury awards for the increasing cost and scarcity of products liability insurance.⁴ Others blame the insurance industry.⁵ Still others blame the tort litigation system, the legal profession, unsafe manufacturing practices, inflation, increased consumer and worker awareness of products liability, the complexity of products and product misuse.⁶

This Comment examines strict products liability from the perspective of the small capital goods manufacturing firm.⁷ First, a brief introduction to the basic doctrine of strict products liability, its genesis, goals, rationales and trends is included.⁸ Second, the problems of the small capital goods manufacturing firm are delineated and the goals and rationales of strict products liability as applied to such a firm are explained.⁹ Third is a discussion of pro-

4. *Id.*

5. *Id.* at 28, col. 1 (quoting Ralph Nader, consumer activist; James P. Corcoran, New York's Superintendent of Insurance; and Bruce Bunner, California Insurance Commissioner).

6. Interagency Task Force on Product Liability Final Report, Nov. 1, 1977, at I-20-31 [hereinafter Task Force Report]. The Task Force, which acted under the direction of the United States Department of Commerce, also noted that there are other causes of the products liability problem including "inflation and the increase in number and complexity of products." *Id.* at I-21.

The Task Force's reports are available from the National Information Service, Springfield, Virginia 22161 (Attention: Sales Desk). Reference should be made to the appropriate accession number and a check made payable to NTIS in the proper amount should be enclosed:

Final Report—PB 273-220, \$20.00 (1 vol.) (1977) [hereinafter Task Force Final Report].
Selected Papers—PB 278-625, \$17.50 (1 vol.) (1978) [hereinafter Task Force Selected Papers].

Legal Study—PB 263-601, \$31.25 (7 vol.) (1977) (The Research Group, Inc.) [hereinafter Task Force Legal Study].

Legal Study: Executive Summary—PB 265-450, \$6.00 (first of 7 vol.) (1977).

Industry Study—PB 265-542, \$21.25 (2 vol.) (1977) (Gordon Associates, Inc.) [hereinafter Task Force Industry Study].

Insurance Study—PB 263-600, \$9.00 (1 vol.) (1977) (McKinsey, Inc.) [hereinafter Task Force Insurance Study].

7. The Task Force defined a small firm as one with less than \$2,500,000 in sales. Task Force Industry Study, *supra* note 6, vol. 1, at IV-4. S. 100, 99th Cong., 1st. Sess. (1985), defines "capital good" as

any product, other than a motor vehicle, or a vessel, aircraft, or railroad used primarily to transport passengers, or any component of any such product, if it is also of a character subject to allowance for depreciation under the Internal Revenue code of 1954, as amended, and was—

(A) used in a trade business;

(B) held for the production of income; or

(C) sold, leased, or donated to a governmental or private entity for the production of goods, for training, for demonstration, or other similar purposes.

8. See *infra* notes 12-44 and accompanying text.

9. See *infra* notes 45-113 and accompanying text.

posed legislative actions to address the problems caused by the strict products liability doctrine and the laws' possible effect on the small capital goods manufacturer.¹⁰ Finally, the pitfalls of the current legislative attempts at correcting the problems are examined and suggestions for a possible solution are offered.¹¹

INTRODUCTION

The first year law student marks them well—the signposts along the road toward strict products liability. The evolution, some say revolution,¹² began with the concepts of *caveat emptor* and privity of contract in *Winterbottom v. Wright*.¹³ The movement continued through the fall of privity in negligence cases, as in *MacPherson v. Buick Motor Co.*,¹⁴ and the imposition of implied warranty without fault in *Henningsen v. Bloomfield Motors, Inc.*¹⁵ The stage was thus set for the strict liability theory espoused by Justice Traynor¹⁶ to become the law in California.¹⁷

In *Greenman v. Yuba Power Products, Inc.*, Justice Traynor wrote: "A manufacturer is strictly liable in tort when an article he places on the market, knowing that it is to be used without inspection for defects, proves to have a defect that injures a human being."¹⁸ With the support of Dean Prosser as Reporter for the Restatement of Torts and the *Greenman* decision, the rule of strict products liability as embodied in section 402A¹⁹ of the Restate-

10. See *infra* notes 115-90 and accompanying text.

11. See *infra* notes 191-234 and accompanying text.

12. Wade, *Strict Tort Liability for Products: Past, Present and Future*, 13 *CALIF. L. REV.* 335, 343 (1984).

13. 10 M. & W. 109, 152 Eng. Rep. 402 (Ex. 1842).

14. 217 N.Y. 382, 111 N.E. 1050 (1916).

15. 32 N.J. 358, 161 A.2d 69 (1960).

16. This theory first appeared in 1944 in his concurring opinion in *Escola v. Coca-Cola Bottling Co.*, 24 Cal. 2d 453, 461-68, 150 P.2d 436, 440-44 (1944).

17. *Greenman v. Yuba Power Products, Inc.*, 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1963).

18. *Id.* at 62, 377 P.2d at 900, 27 Cal. Rptr. at 700.

19. RESTATEMENT (SECOND) OF TORTS § 402A (1965) [hereinafter RESTATEMENT § 402A].

§ 402A Special Liability of Seller of Product for Physical Harm to User or Consumer

(1) One who sells any product in a defective condition unreasonably dangerous to the user or consumer or to his property is subject to liability for physical harm thereby caused to the ultimate user or consumer, or to his property, if

(a) the seller is engaged in the business of selling such a product, and

(b) it is expected to and does reach the user or consumer without substantial change in the condition in which it is sold.

(2) The rule stated in Subsection (1) applies although

(a) the seller has exercised all possible care in the preparation and sale of his product, and

(b) the user or consumer has not bought the product from or entered into any

ment quickly swept the country.²⁰ Despite little legislative action, but with overwhelming judicial support,²¹ the doctrine of strict products liability took on enormous importance to sellers of products.

The trend has been toward the elimination or severe curtailment of the traditional defenses to an action in strict products liability such as privity of contract, intervening cause, modification of the product by others, contributory negligence and due care by the manufacturer.²² Privity of contract is never a defense to strict products liability²³ and the exercise by the manufacturer of "all possible care in the preparation and sale of his product" is irrelevant under section 402A.²⁴ Since strict liability is imposed on the seller *without fault or negligence*, the user's contributory negligence is not a complete bar to recovery in most jurisdictions.²⁵ However, a growing number of states apply comparative fault principles to proportionally reduce the plaintiff's recovery because of his negligence despite doctrinal problems of mixing strict liability and negligence.²⁶

Most states, under section 402A, require that a plaintiff prove that (1) the product was in a defective condition unreasonably dangerous for its intended or reasonably foreseeable use; (2) such defect existed when the product left the seller's control; and (3) the defect was the proximate cause of the injury.²⁷ But two states, California and Alaska, merely require that the plaintiff prove that the design of the product caused the injury; the difficult burden of proof then shifts to the defendant manufacturer or seller to show

contractual relation with the seller.

20. Wade, *supra* note 12, at 343. Dean Prosser described the strict liability movement as "the most rapid and altogether spectacular overturn of an established rule in the entire history of the law of torts." Prosser, *The Fall of the Citadel (Strict Liability to the Consumer)*, 50 MINN. L. REV. 791, 793-94 (1966) (footnote omitted) [hereinafter Prosser, *The Fall of the Citadel*]. Just six years after the *Henningsen* decision, twenty-three states and the District of Columbia had adopted strict liability either judicially or by statute. *Id.* at 794. For a detailed treatment of the history and development of strict tort liability, see Prosser, *The Assault upon the Citadel (Strict Liability to the Consumer)*, 69 YALE L.J. 1099 (1960) [hereinafter Prosser, *The Assault upon the Citadel*], and Wade, *Strict Tort Liability of Manufacturers*, 19 SW. L.J. 5 (1965).

21. Wade, *supra* note 12, at 343.

22. Birnbaum, *Legislative Reform or Retreat? A Response to the Product Liability Crisis*, 14 FORUM 251, 256-57 (1978).

23. RESTATEMENT § 402A, *supra* note 19.

24. *Id.*

25. Dworkin, *Product Liability Reform and the Model Uniform Product Liability Act*, 60 NEB. L. REV. 50, 63 (1981); RESTATEMENT § 402A, *supra* note 19.

26. See, e.g., *Daly v. General Motors Corp.*, 20 Cal. 3d 725, 575 P.2d 1162, 144 Cal. Rptr. 380 (1978).

27. RESTATEMENT § 402A, *supra*, note 19. See, e.g., *Lee v. Crookston Coca-Cola Bottling Co.*, 290 Minn. 321, 329, 188 N.W. 2d 426, 432 (1971).

by a risk-benefit analysis that the design was not defective.²⁸

Some jurisdictions impute to the manufacturer knowledge of technology that is available at time of trial rather than at time of manufacture.²⁹ In New Jersey, a defendant asbestos manufacturer was held strictly liable for failure to warn of the dangers of asbestos even though the danger may not have been knowable at the time that the asbestos was processed.³⁰

A few courts have come very close to absolute liability by "holding that the tort-litigation system should provide a recovery for persons who prove they were injured by a product."³¹ Additionally, the liability of the defendant manufacturer is increased by the well-known propensity for juries to compensate the severely injured plaintiff knowing tacitly that the defendant is insured or "can afford it."³²

The small capital goods manufacturer, however, cannot always "afford it" nor is it always insured. One survey indicated that twenty-nine percent of small manufacturing firms carry no products liability insurance.³³ Whether the small manufacturer can "afford it" depends on its competitive position in its industry, its financial condition and the size of the judgment.³⁴ The goals and rationales of strict products liability are commendable:

(1) to provide compensation to persons injured by defective products;³⁵

28. "[A] product may . . . be found defective . . . if the plaintiff demonstrates that the product's design proximately caused his injury and the defendant fails to establish . . . that, on balance, the benefits of the challenged design outweigh the risk of danger inherent in such design." *Barker v. Lull Engineering Co., Inc.*, 20 Cal. 3d 413, 432, 573 P.2d 443, 456, 143 Cal. Rptr. 225, 238 (1978). See also *Caterpillar Tractor Co. v. Beck*, 593 P.2d 871, 884 (Alaska 1979).

29. *Birnbaum*, *supra* note 22, at 256-57. See also *Hamilton v. Hardy*, 37 Colo. App. 375, 385, 549 P.2d 1099, 1108 (1976) (adequacy of drug manufacturer's warning determined from dangers of product as subsequently manifested rather than at time of manufacture or sale).

30. *Beshada v. Johns-Manville Products Corp.*, 90 N.J. 191, 447 A.2d 539 (1982).

31. Task Force Report, *supra* note 6, at 1-27. See also *Report of the Tort Policy Working Group on the Causes, Extent and Policy Implications of the Current Crisis in Insurance Availability and Affordability* 61 (Feb. 1986) (available from the Superintendent of Documents, U.S. Government Printing Office, Washington D.C., 20402) [hereinafter *Working Group Report*].

32. Task Force Legal Study, *supra* note 6, vol. III, at 121 (citing Prosser, *The Assault upon The Citadel*, *supra* note 20, at 1115, and Prosser, *The Fall of the Citadel*, *supra* note 20, at 842).

33. Task Force Industry Study, *supra* note 6, vol. I, at IV-9. See *Working Group Report*, *supra* note 31, at 6-15, for a discussion of increases in the costs of various types of insurance coverages.

34. Prosser, *The Assault upon the Citadel*, *supra* note 20, at 1121-22 & n.147 (quoting Plant, *Strict Liability of Manufacturers for Injuries Caused by Defects in Products—An Opposing View*, 24 TENN. L. REV. 938, 947 (1957)).

35. *Escola v. Coca-Cola Bottling Co.*, 24 Cal. 2d 453, 462, 150 P.2d 436, 441 (1944) (Traynor, J., concurring).

(2) to shift the loss for defective products as an incentive for manufacturers and sellers to produce safer products by placing the cost of defective products on those who can most effectively reduce the hazards of these products;³⁶

(3) to spread the risk of the injury through insurance or the broad customer base of the manufacturer or seller;³⁷

(4) to internalize the risk of defective products so that they will fully "pay their way" in the marketplace;³⁸ and

(5) to reduce the injured person's difficult burden of proving the negligence of the manufacturer or seller.³⁹

These goals and rationales are acceptable, even desirable, in the case of truly defective products, and especially in the case of manufacturing defects.⁴⁰ However, these rationales weaken when applied to design defects⁴¹ warning defects⁴² and unsafe use or un-

36. *Id.*

37. *Id.*

38. See *infra* notes 86-92 and accompanying text. The costs of products should not be externalized (that is, spread to other products) because defective products would then be "subsidized" by not being priced at their full cost to society. These defective products thus would not fully "pay their own way" in the marketplace. Montgomery & Owen, *Reflections on the Theory and Administration of Strict Tort Liability for Defective Products*, 27 S.C.L. REV. 803, 809-10 (1976).

39. *Id.* at 809.

40. Manufacturing defects occur when a product fails to meet the manufacturer's own specifications. W. KEETON, D. OWEN & J. MONTGOMERY, *PRODUCTS LIABILITY AND SAFETY* 269 (1980). Generally, these are due to physical flaws in materials or components or faulty assembly into the final product.

41. Defective design is most troublesome. How can the court or a jury in a relatively short time be expected to evaluate all the considerations that took technical design engineers years of study? Furthermore, there are always trade-offs and balancing required in design engineering (for example, cost or weight v. utility and reasonable safety). The court or jury is evaluating the design based on a specific accident that has occurred rather than the probability of accidents that may occur. For example, a gas tank placed in the front of the vehicle will reduce dangers in rear-end collisions but will increase danger in head-on collisions. A court or a jury in a rear-end collision case may determine that the vehicle is defective because the tank is placed in the rear; but another court or jury in a head-on collision could determine that it was defective because it was placed in front. For a court troubled by this difficult problem, see *Dawson v. Chrysler Corp.*, 630 F.2d 950, 962 (3d Cir. 1981), *cert. denied*, 450 U.S. 959 (1981). Examples of design defects are (1) the lack of some safety device (for example, a guard, an electrical safety switch, a mechanical cut-off device or a "safety" on a gun), (2) flammable fabrics used in clothes, (3) chemicals (for example, drain cleaners, household cleaners and products) and (4) products made of unsuitable materials (for example, too soft or hard or brittle for their intended use). W. KEETON, D. OWEN & J. MONTGOMERY, *supra* note 40, at 364-65.

42. Warning defects present other problems. When is a warning required? How specific must it be? Must it delineate every possibility? Must a warning be given if the danger is obvious (for example, a permanent warning that a knife may cut)? Under a traditional risk-benefit analysis, a warning would almost always be required because the low cost of warning (a few words printed on the product) would be outweighed by the cost of the accident. Twerski, Weinstein, Donaher & Piehler, *The Use and Abuse of Warnings in Products Liability—Design Defect Litigation Comes of Age*, 61 CORNELL L. REV. 495, 514-16 (1976). This is especially true when determined by a jury with an injured plaintiff present. *Working Group Report*, *supra* note 31, at 32 n.25.

voidable accidents because these concepts are extremely difficult to define. When strict products liability has been applied to these latter problems, the doctrine has been extensively abused and "often has had the effect of transforming [strict liability] in practice into absolute liability."⁴³ These latter problems plague the small capital goods manufacturer in particular; therefore, the goals and rationales of strict products liability tend to break down when applied to such a manufacturer.⁴⁴

I. PROBLEMS OF THE SMALL CAPITAL GOODS MANUFACTURING FIRM

In the rush toward strict products liability and the accomplishment of its goals, some problems have developed, especially for the small manufacturer of capital goods. The Task Force Report⁴⁵ states:

For small firms that manufacture nothing but long-life products such as industrial machinery, the problem [of unavailability or unaffordability of insurance] is especially acute. Many of these firms have [liability] exposures that may amount to 10 to 20 times the current year's production—i.e., machines now in use that were sold over many years' time. Thus, in developing [an insurance rate] to be applied to the current year's sales, the insurer must multiply the loss potential per machine 10 to 20 times.⁴⁶

Former Senator James Pearson (R-Kansas) began one of the earliest attempts to solve this problem. He introduced federal legislation⁴⁷ in 1977 after receiving some three hundred letters from small manufacturers having trouble obtaining products liability insurance.⁴⁸ The following is a typical case from Missouri:

"In . . . 1976 . . . and for five years prior to that we carried . . . a rate . . . of approximately \$3,000 for our product liability coverage. [Our insurance company] notified us of cancellation of that product liability coverage, and we attempted to seek a carrier. . .

43. *Working Group Report*, *supra* note 31, at 61.

44. Prosser, *The Assault upon the Citadel*, *supra* note 20, at 1121-22 n.147.

45. Due to the potential problems of strict products liability and its possible effect on the manufacturing capability of the United States, the U.S. Department of Commerce sponsored an exhaustive study of the products liability area. The Final Report of this Federal Interagency Task Force on Product Liability, though published on November 1, 1977, remains as a landmark analysis of products liability. This report, including the supporting Legal Study, Industry Study and Insurance Study, has been the source of almost all of the proposed products liability legislation, both federal and state.

46. Task Force Insurance Study, *supra* note 6, at ES-5.

47. S. 403, 95th Cong., 1st Sess. (1977). Parallel legislation was introduced in the House of Representatives. H.R. 6300, 95th Cong., 1st Sess. (1977).

48. Smith, *Uniform Product Liability Law, but on Whose Terms?*, 5 CAL. LAW. 34, 36 (Jan. 1985).

. We could not find a standard carrier that would even quote us and had to go to what I believe they call the excess market.^[49].
. . . We finally received about six or seven quotes from this marketplace and accepted the lowest quote, which was . . . \$39,000.”⁵⁰

No doubt there are instances where the large recoveries based on the theory of strict products liability in general or the unavailability or unaffordability of insurance in particular has forced a small manufacturing firm into bankruptcy or liquidation.⁵¹ But specific information and data are lacking because there are many reasons for the failure of small firms including mismanagement, insufficient capital, loss of market and costs exceeding receipts.⁵² To illustrate the problems encountered by the small capital goods manufacturer, a hypothetical situation based on actual experience will be examined.⁵³

A small manufacturer of farm equipment has been in business for over twenty-five years producing a cotton harvesting machine needed by farmers as evidenced by average sales of \$1 million per year and pretax profits of \$75,000.00. Prior to 1982, there had been no products liability claims filed against the firm.

In 1982, a personal injury action of arguable merit was filed. One of the safety features of the machine was that it was ground driven, that is, when the machine stopped, all rotation of the equipment stopped. Therefore, when the operator stopped and got off the machine, there was no danger of being caught in any rotating equipment. Furthermore, there were numerous warnings, both in the operator's manual and on the machine, to stay clear of the machine and any moving parts and to avoid riding on the machine. The machine was normally not run at night and no lights were furnished by the manufacturer, but some operators "rigged" lights to extend operating time.

One night while driving the machine, the operator heard an unusual noise. The operator climbed off the machine and had another person drive while the operator listened for the noise. The operator then climbed under a safety bar and reached his right hand across a three foot safety space and was injured. The operator alleged a design defect and an inadequacy of warnings in strict

49. The excess market refers to insurance firms that will insure risks that are refused by standard carriers but normally only at much higher premiums.

50. Task Force Report Selected Papers, *supra* note 6, at 554 (quoting Howard Bobroff, owner of Lawnmower Parts Manufacturing Co., Aug. 11, 1977, Kansas City, Mo.).

51. See, e.g., the case of Havar Manufacturing Co. Wysocki, *supra* note 2.

52. Task Force Report, *supra* note 6, at VI-34.

53. The author personally experienced the events described in the ensuing text.

products liability.⁵⁴

In 1983, an unrelated action of equally questionable merit was filed. There, the operator raised the basket of the machine into a high voltage power line and was killed despite the warnings on the machine and warnings made by his employer to watch overhead clearance. The operator's parents alleged a design defect and an inadequacy of warning in a wrongful death action in strict products liability.⁵⁵

Both claims were the result of on the job accidents to other firms' employees using the small manufacturer's product. Further, both employees were covered by workers' compensation. In twenty-five years, the firm has sold over four thousand machines and most of them are still operating.

Based on these two lawsuits, and without regard to their validity, the firm's products liability insurance premiums increased from \$4,000 per year for \$10.5 million in coverage to over \$40,000 per year for \$2.5 million in coverage. In addition, very few insurance companies were willing to even quote on the coverage.⁵⁶ The old line insurance company that had insured the company for six years now declined to renew the policy, thereby forcing the manufacturer to obtain insurance from second or third rate firms. Moreover, there was the very real possibility in the future of further reduction in coverage limits or unavailability of liability insurance at any price since only three insurance companies would even submit a quotation on the coverage. On the facts of this hypothetical paradigm, the goals and rationales of strict products liability are reexamined.

A. Compensation to Plaintiff

On its surface, the goal of compensating an injured plaintiff seems a worthy one. Severely injured persons are generally unprepared for such consequences and loss of time or health may be an overwhelming misfortune to them.⁵⁷

Some commentators, however, question whether compensation to the plaintiff should be a legitimate goal of products liability

54. The claim was settled by the insurance company for \$100,000.00.

55. The claim was settled by the insurance company for \$35,000.00

56. When a lawsuit is filed against a firm, details of the lawsuit along with other underwriting information (sales, number of employees, type of products, etc.) is given to all prospective insurers before they will agree to furnish a price quotation on the desired coverage.

57. *Escola v. Coca-Cola Bottling Co.*, 24 Cal. 2d 453, 462, 150 P.2d 436, 441 (1944) (Traynor, J., concurring).

law.⁵⁸ The goal of compensation to the plaintiff is based essentially on compassion, but allocating scarce resources based on compassion may be a serious error.⁵⁹ Perhaps, considering the economic realities of the 1980's, "what is really needed in times of increasing scarcity are principles that give stimulus rather than disincentive to those who are in a position to make new discoveries and to increase productivity."⁶⁰

The goal of compensation to a plaintiff from the manufacturer without its fault or wrongdoing is contrary to the very concept of the tort as the civil wrong.⁶¹ The plaintiff should not have an almost automatic *right* to compensation; rather, the defendant should be liable *in tort* only on a clear showing that the manufacturer has done something *wrong*, that is, has breached a duty of care or has been negligent.⁶² Compensation to the injured plaintiff under the strict liability theory of many jurisdictions has become merely a "deep pocket" rationale. There is no inherent justice in compensating the injured plaintiff at the expense of the manufacturer without a showing of fault or negligence.⁶³

Even assuming that compensation to an injured plaintiff is a legitimate goal of society. This goal is, however, frustrated in the paradigm when either the unavailability or unaffordability of insurance forces the manufacturer to go without insurance.⁶⁴ The injured plaintiff is thus forced to rely on the perhaps inadequate assets of the firm for compensation. Therefore, in order to accomplish this goal of strict products liability, insurance at affordable rates should be made available to all reasonably insurable product manufacturers.⁶⁵

B. Incentive For Safer Products

Certainly, a goal of producing safer products is laudable. But there is some question whether a strict liability standard has accomplished or will accomplish that goal more effectively than a negligence standard.⁶⁶ Further, there is considerable question

58. Owen, *Rethinking the Policies of Strict Products Liability*, 33 VAND. L. REV. 681, 703-07 (1980); Epstein, *Products Liability: The Gathering Storm*, 1 REG. AEI J. ON Gov. & Soc. 15, 20 (Sept./Oct. 1977).

59. Owen, *supra* note 58, at 705.

60. *Id.*

61. Epstein, *supra* note 58, at 16.

62. *Id.*; *Working Group Report*, *supra* note 31, at 61.

63. Plant, *supra* note 34, at 946. *Working Group Report*, *supra* note 31, at 61-62.

64. Coccia, *Uniform Product Liability Legislation: A Proposed Federal Solution*, 1983 TRIAL LAW. GUIDE 236, 262.

65. Task Force Final Report, *supra* note 6, at V-2.

66. Posner, *Strict Liability: A Comment*, 2 J. LEGAL STUD. 205, 209 (1973).

about the resulting safety of products under the rule of strict liability versus that of negligence.⁶⁷ Under strict liability, the manufacturer has an incentive to produce safer products to avoid liability since it must pay for all accident costs caused by its product.⁶⁸ Similarly, under the negligence rule, since the cost of unavoidable accidents is borne by the injured persons, consumers will tend to purchase safer products thus increasing the manufacturer's incentive to build safer products through the market mechanism.⁶⁹ Which theory results in safer products is far from certain.⁷⁰ Some commentators contend that because, in most cases, insurance is available at a reasonable price, it is considered merely a cost of doing business and has little effect on the safety of the product.⁷¹

When a product, especially a capital goods product, has been made as safe as reasonably possible, the manufacturer should not continue to be held responsible for what is simply an accident.⁷² Although there are truly defective products and unreasonably dangerous products, there is also some residual level of "unavoidable" accidents that simply cannot be controlled by the manufacturer without affecting the utility of the product or discontinuing its manufacture.⁷³

For example, in the case of the paradigm, a twenty-three year history of no products liability claims is at least evidentiary of a reasonably safe machine. Additionally, the nature of the claims do not show that the machine is defective. Perhaps these claims were merely the result of the statistical residual accident rate. Yet because of them, the small manufacturing firm may be unable to obtain or afford products liability insurance for a reasonably safe and socially useful product.

Furthermore, the manufacturer is not always in the best position to control safety. Over thirty-seven percent of all products liability actions,⁷⁴ and a much larger percentage of capital goods

67. *Id.*

68. *Id.*

69. *Id.*

70. *Id.*

71. J. O'CONNELL, ENDING INSULT TO INJURY: NO FAULT INSURANCE FOR PRODUCTS AND SERVICES (1975); Posner, *supra* note 66; Prosser, *The Assault upon the Citadel*, *supra* note 20, at 1119.

72. J. O'CONNELL, *supra* note 71, at 98-99.

73. Wilson, *Products Liability Part II: The Protection of the Producing Enterprise*, 43 CAL. L. REV. 809, 811 (1955):

A harvester of x degrees safety will not normally injure the user. But since a certain number of people are known to be "non mechanical," bad with their hands, butterfingers, perhaps there is a statistical risk of injury to one person per thousand users quite apart from any contributory negligence considerations.

74. O'Connell, *An Immediate Solution to Some Products Liability Problems: Workers' Compensation as a Sole Remedy for Employees, with an Employer's Remedy against*

liability actions, are based on workplace accidents where the employer, not the manufacturer, has the primary responsibility and control of the environment.⁷⁵ The reason for this is that capital goods, by definition, are those used in the workplace.⁷⁶ Thus, virtually all of the actions involving capital goods manufacturers will be based on workplace accidents.⁷⁷

Workers' compensation laws which immunize employers and the limited recoveries permitted by these laws⁷⁸ result in actions against the manufacturer in strict tort liability for accidents that it cannot and should not control.⁷⁹ As Justice Traynor wrote in *Greenman*, "[t]he purpose of such [strict] liability is to insure that the costs of injuries resulting from defective products are borne by the manufacturers that put such products on the market rather than by the injured persons who are powerless to protect themselves."⁸⁰ Contrary to Justice Traynor's position, however, the manufacturer, rather than the injured person, may well be the party who is powerless to protect itself both from the negligent and unsafe practices of an employer protected by workers' compensation laws and from a negligent and unsafe employee.⁸¹

Imposing an almost prohibitive risk of bankruptcy or liquidation on the small manufacturing firm based on liability without fault cannot provide incentive for a safer product. Rather, it will encourage voluntary or involuntary bankruptcy and the attendant societal loss of productive capacity and employment. Again, what is needed is affordable and available insurance.

C. Spreading The Risk

The rationale of spreading the risk of injury through insurance or through the manufacturer's broad customer base works well when insurance is available and affordable or when the manufacturer is large enough to effectively accomplish the risk spreading.⁸² But the rationale fails when insurance becomes unavailable

Third Parties, 1976 INS. L.J. 683-85. O'Connell estimates that from 37% to 85% of products liability actions involve "products employed in work related situations".

75. *Id.* at 685; Epstein, *supra* note 58, at 19.

76. *See supra* note 7.

77. O'Connell, *supra* note 74, at 685.

78. *Rosales v. Verson Allsteel Press Co.*, 41 Ill. App. 2d 787, 354 N.E.2d 553 (1976). *See also* Mitchell, *Products Liability, Workmen's Compensation and the Industrial Accident*, 14 DUQ. L. REV. 349, 354-56 (1976).

79. Epstein, *supra* note 58, at 19.

80. *Greenman v. Yuba Power Products, Inc.*, 59 Cal. 2d 57, 63, 377 P.2d 897, 901, 27 Cal. Rptr. 697, 701 (1963).

81. Epstein, *supra* note 58, at 19.

82. The Task Force found that the larger manufacturers rarely had problems obtaining products liability insurance. Task Force Insurance Study, *supra* note 6, at ES-5.

or unaffordable to the small manufacturer. Furthermore, the small manufacturer's customer base is not broad enough to spread this risk to a significant degree:

It is a common failing to overlook the problem of the small manufacturer. When social reformers speak of "manufacturers" they generally assume that all manufacturers are in the position of U.S. Steel Corporation or General Motors or Standard Oil Company of New Jersey. It may very well be (leaving out considerations of justice) that large organizations of this character can absorb or distribute an item of increased cost such as that which would result from the imposition of strict liability. But many manufacturers are in a totally different situation. Their position in the industry is vulnerable and their competitive situation delicate. It is these comparatively small manufacturers who suffer when additional costs are added without regard to their situation.⁸³

Thus, strict products liability has the detrimental effect of concentrating productive capacity in larger firms because they are able to obtain products liability insurance or spread the risk of loss over their broad customer base. Over the long term, as more small manufacturers drop out, competition is reduced and prices may rise.

In the paradigm, a firm making \$75,000 pretax profit cannot afford an increase in products liability insurance of \$36,000 unless this rise in costs could be passed along to its customers by higher prices. There is a further distinct probability that the insurance could become even more expensive or completely unavailable.⁸⁴ The small manufacturer then may go without products liability insurance and risk bankruptcy or liquidation if an accident occurs.⁸⁵

D. Cost Internalization

The rationale that accident costs of products should be internalized rather than externalized because all products should be made to "pay their own way" in the market place is persuasive.⁸⁶ Accident costs are internalized when the product price fully reflects *all* of the accident costs; externalization occurs when these costs are

Moreover, because of their size, large manufacturers may be able to self-insure, spreading the risk of loss over their broad customer base.

83. Plant, *supra* note 34, at 1121 n.147.

84. Only three second and third rate insurance companies would even bid on the insurance in 1985.

85. Coccia, *supra* note 64, at 262. *Working Group Report, supra* note 31, at 57 n.4. Doing business without products liability insurance is known as "going bare."

86. G. CALABRESI, *THE COSTS OF ACCIDENTS* 24-29, 68-75, 144-49 (1970). Owen, *supra* note 58, at 713-14.

spread to *other* products or customers.⁸⁷ For example, if products liability insurance rates were the same for all manufacturers without regard to the safety or loss history of the product, some of the accident costs of more dangerous products would be borne by the safer products and thus externalized from the more dangerous products.

Accident costs should be internalized because, theoretically, this encourages production of products in relation to their full societal cost.⁸⁸ If all products bore their own accident costs by basing insurance rates on their own loss history, then the more dangerous products would become more expensive. That is, the more dangerous product would logically be involved in more injuries. In turn, the cost of insurance would be greater for such products than for safer products. If internalized, this higher cost would be reflected in the product being more expensive to consumers. Consumers then would decide in the market place whether the more dangerous products are socially useful enough to justify their higher prices.⁸⁹

A distinction should be made, however, between defective product costs and residual accident costs. Defective product costs are those costs directly related to the safety and design of the product considering its utility and purpose; residual accident costs are those costs associated with an unavoidable statistical risk of injury despite the product being as safe as reasonably possible.⁹⁰ Defective product costs should not be allowed to be externalized because such externalization causes production of goods that would not be produced if the consumer had to pay the full cost of the goods including the defective product costs.⁹¹

There is a certain level of residual accidents⁹² that occur in even reasonably safe products, however, especially capital goods products. The manufacturer has no control over these accidents because, generally, they are the result of employers' and employees' conduct. The manufacturer clearly should pay defective product costs as an incentive to produce a reasonably safe product. But the residual accident costs of capital goods should properly be paid either by the employee whose unsafe conduct caused the accident or the employer whose working conditions were at fault. Yet with the trend toward "stricter" liability, expanded plaintiffs' recov-

87. G. CALABRESI, *supra* note 86.

88. *Id.*

89. *Id.*

90. Wilson, *supra* note 73, at 811. The writer uses "residual accident costs" to describe the costs associated with Wilson's "statistical risk of injury."

91. G. CALABRESI, *supra* note 86.

92. Wilson, *supra* note 73, at 811.

eries and the historical immunity of employers under the workers' compensation laws, the small capital goods manufacturer is forced to pay *both the residual accident cost and the defective product cost*. A mechanism must be found to spread the residual accident cost to the employee and to the employer within the present legal framework. That mechanism is insurance reform.

Additionally, the small capital goods manufacturer, by definition, produces a long life product.⁹³ Each year more and more of his products are in use. This so called "long tail" of exposure causes additional problems because the statute of limitations in tort cases typically begins to run when the injury occurs, not when the product is sold.⁹⁴ The manufacturer thus can be held liable for products for ten to twenty years of use.⁹⁵ When insuring such manufacturers, the insurance companies must take this "long tail" of risk into account in computing the products liability insurance rates and assessing the risk exposure. Assuming that the manufacturer's sales are relatively stable, this "long tail" of risk can be ten or twenty times the yearly production of the small manufacturer. This means that in computing an insurance rate, the insurance company must consider this exposure and each machine sold each year must bear the risk of ten or twenty times its own exposure. Due to the products' long lives, this problem is especially acute in industrial machinery manufacturing⁹⁶ and the aircraft industry.⁹⁷

In the paradigm, the yearly average sales of 160 machines must bear the risk exposure of the entire 4,000 machines that remain in service. Furthermore, if sales are reduced below the average because of unfavorable business conditions, each machine must bear an even greater burden. For example, if the product liability insurance premium is \$40,000.00 and sales are 160 machines, the premium is \$250.00 per machine. Regardless of the number of sales, the insurance premium would at least stay at the same level (or could rise because of inflation, increased injuries or to protect

93. See *supra* notes 7 & 46 and accompanying text.

94. Some states have enacted statutes of repose limiting the time in which products liability actions may be brought. These laws are generally disfavored by plaintiffs and face serious constitutional challenges. For a detailed analysis of state enacted statutes of repose and constitutional issues, see McGovern, *The Variety, Policy and Constitutionality of Product Liability Statutes of Repose*, 30 AM. U.L. REV. 579 (1980).

95. Task Force Insurance Study, *supra* note 6, at ES-5.

96. *Id.*

97. *Id.*

The General Aviation Manufacturers Association reports that the cost of liability insurance per aircraft was \$51 for the 6,778 business, commuter and private aircraft delivered in 1962, and increased to \$211 for the 9,774 delivered in 1972. Currently, for the 2,000 planes delivered in 1985, the liability insurance cost has increased to \$70,000 per plane.

Working Group Report, *supra* note 31, at 13.

against the "long tail" of liability). So, assuming that the liability insurance premium remains constant at \$40,000.00 but that sales decrease to forty machines because of unfavorable business conditions, each machine must now bear \$1,000.00 of the insurance premium.

Thus, merely to break even with no increase in insurance premium, the paradigm manufacturer must increase the price per machine by \$750.00 just because of the reduced level of sales. The competitive market conditions simply may not allow such an increase when the manufacturer is hit by both increasing liability insurance costs and reduction of the number of machines sold.⁹⁸

E. The Insurance Problem

As discussed above,⁹⁹ the traditional goals and rationales of strict products liability have serious shortcomings when applied to the small capital goods manufacturer. However, given the strong consumer sentiment in the United States today and absent a more compelling crisis, any major legislative action reducing either the number of claims or the amount of damages per claim will be politically difficult.¹⁰⁰ Moreover, the judicially developed law of strict products liability is becoming more and more skewed toward compensating the injured person without regard to the manufacturer's plight.¹⁰¹

Therefore, any solution to the products liability problem must provide both for reasonable compensation to the injured person and for the continued existence of the small capital goods manufacturer by making products liability insurance "more widely available and affordable"¹⁰² The primary problem of the small capital goods manufacturer is his inability to spread the cost of injury when he becomes a poor risk to the insurance company.¹⁰³ In the paradigm, when the two lawsuits were filed, details of the lawsuits along with other underwriting information (sales, number of employees, type of products, etc.) were given to each prospective insurer before they agreed to furnish a price quotation

98. The general aviation industry figures cited *supra* note 97 serve as an extreme example of this problem.

99. See *supra* notes 57-97 and accompanying text.

100. Hollings, *Product Liability Law: Let's Keep the Federal Government out of It*, 7 AM. J. TRIAL ADVOC. 347 (1984).

101. Hoenig, *Products Liability Problems and Proposed Reforms*, INS. LAW J., Apr. 1977, at 213.

102. Model Uniform Product Liability Act, reprinted at 44 Fed. Reg. 62,714, 62,716 (1979) [hereinafter UPLA].

103. Based on a personal interview with Bruce Moore, partner at Barney & Barney Insurance Agency, San Diego, Cal. (Nov. 25, 1985).

on the desired coverage. Some insurance companies would accept this "poor risk" only with a substantial increase in the premium.¹⁰⁴ Others declined to accept the risk at all and refused to quote a price for the coverage. Thus, the paradigm manufacturer may be unable to spread the risk either because it cannot afford the increased premium or, in some cases, cannot secure coverage at all.¹⁰⁵

Yet, why would a rational insurance company whose very existence is based on spreading risks over large numbers of insurers refuse to insure a reasonably insurable risk? The answer lies in the statutory capital reserve system. To assure the financial stability of insurance companies and to further assure that funds will be available to pay any claims that may arise, insurance statutes provide that certain capital reserve funds be maintained by insurance companies.¹⁰⁶ The insurer may not transact business in the state if these reserve funds fall below a certain specified amount, usually based on a percentage of total premiums collected.¹⁰⁷

In practice, the capital reserve requirements force the insurance companies to reduce the total amount of policies written. Thus, insurance companies must reduce their insurance in force when their capital reserves are depleted. Generally, this reserve fund must be maintained at one-third of the earned premiums of an insurance company. In other words, the insurance company must maintain in capital reserves an amount equal to one-third of the total premiums it receives each year or face sanctions from the commissioner of insurance.¹⁰⁸

For example, an insurance company that receives earned premiums of \$100 million in 1986 is required to have \$33 million in capital reserves. If underwriting or investment losses¹⁰⁹ reduce these capital reserves by \$5 million to \$28 million, then in 1987 the company can provide insurance based on only \$84 million in premiums. (One-third of \$84 million is \$28 million.) Thus, a \$5

104. This increase was from \$4,000.00 to \$40,000.00 per year.

105. See *supra* notes 84 & 85.

106. See, e.g., CAL. INS. CODE § 923.5 (Deering Supp. 1987).

107. See, e.g., *id.* §§ 11556-11558. CAL. INS. CODE § 11558 requires reserves of sixty percent of earned premiums during each year less the amount already paid for losses and expenses. In practice, this amounts to approximately one-third of the earned premiums. *Supra* note 103.

108. See, e.g., CAL. ADMIN. CODE tit. 10, R. 2319-2319.4 (1976).

109. Capital reserves may be depleted by underwriting losses (that is, losses due to errors in estimating the magnitude of risk) or investment losses (that is, losses on investments or loss of income because of lower interest rates). In the early 1970's, insurance companies suffered both types of losses, depleting their reserves and reducing their premium collecting capacity severely. See generally Page & Stephens, *The Product Liability Insurance "Crisis: Causes, Nostrums and Cures*, 13 CAP. U.L. REV. 387 (1984), and Working Group Report, *supra* note 31, at 16-52 for a discussion of the causes of the crisis.

million reduction in capital reserves forces an immediate \$16 million reduction in the amount of premiums that can be collected and a corresponding reduction in the amount of policies that can be provided.

Furthermore, since the insurance company is losing money, it must increase the price of the premiums to restore its reserves. If the insurance company decides to increase premium income by fifty percent this year to cover these losses, it must charge \$84 million for coverage that would have cost \$56 million in 1986. (One hundred fifty percent of \$56 million is \$84 million.) This would require not only a substantial increase in the amount of premium charged to insureds that are able to obtain insurance (an increase from \$56 million to 84 million) but also a severe reduction in the amount of insurance that can be provided.¹¹⁰

This capital reserve requirement system means that a relatively small underwriting or investment loss which reduces capital reserves can substantially reduce the amount of insurance that the company is allowed to write. The Task Force, and more recently the Working Group, alluded to this "capacity" problem as a cause of unavailability or unaffordability of products liability insurance.¹¹¹ When facing such a mandatory reduction in premiums, the companies are very selective in their renewals "and cancel or fail to renew those [companies] with poor loss records—and obviously the greatest need."¹¹²

Unfortunately, the paradigm manufacturer falls precisely into this category. Two products liability actions and a "long tail" of potential liability make it a relatively poor risk to the insurance company faced with a mandatory cutback of insurance business. The small capital goods manufacturer may have the greatest need because its very existence may be threatened if it must "go bare" and another products liability action is filed with potentially confiscatory damages.¹¹³

The critical problem of the small capital goods manufacturer, therefore, is its inability to spread the risk of accident costs because of the unavailability or unaffordability of products liability insurance. Moreover, the goals and rationales of strict products

110. Actually, the insurance company will be charging \$84 million in 1987 for coverage that would have cost \$56 million in 1986. These figures were developed from a personal interview with Bruce Moore, *supra* note 103, and from Riggs, *Insurance Industry Retrenching after Heavy Claims*, San Diego Union, Oct. 13, 1985, at I-1, col. 1 (quoting Mr. Moore, partner at Barney & Barney, insurance agency, San Diego, Cal.).

111. Task Force Legal Study, *supra* note 6, Vol. III, at 132; *Working Group Report*, *supra* note 31, at 16-17 n.1.

112. Riggs, *supra* note 110.

113. Task Force Selected Papers, *supra* note 6, at 555-56.

liability are not being accomplished as applied to the small capital goods manufacturer in this situation because an injured plaintiff may not be adequately compensated by an uninsured or underinsured manufacturer.

Recognizing the potential problems of strict products liability and its possible effect on the manufacturing capability of the United States, the U.S. Department of Commerce sponsored an exhaustive study of products liability culminating in the Final Report of the Interagency Task Force on Product Liability.¹¹⁴ This Task Force Report has been the basis for almost all of the proposed federal and state products liability legislation. A brief analysis of some of these proposals as they affect the small capital goods manufacturer follows.

II. PROPOSALS AND THEIR EFFECT ON THE SMALL CAPITAL GOODS MANUFACTURER

The Interagency Task Force on Product Liability found three major causes of the products liability problem:¹¹⁵

- (1) the insurance industry's rating practices;
- (2) manufacturing practices; and
- (3) uncertainties in the tort litigation system. The primary administrative, legislative and academic proposals affecting the small capital goods manufacturer include:
 - (1) the Model Uniform Product Liability Act;
 - (2) federal bills introduced by Senator Kasten¹¹⁶ and Representative Shumway;¹¹⁷
 - (3) the Product Liability Risk Retention Act of 1981;¹¹⁸
 - (4) the proposal that workers' compensation be an injured worker's sole remedy;¹¹⁹ and
 - (5) the potential adoption of the New Zealand Accident Compen-

114. See *supra* notes 6 & 45.

115. Task Force Final Report, *supra* note 6, at I-20-I-29.

116. Senator Robert Kasten, Jr., (R-Wis.) introduced Senate Bill 100 in the first session of the 99th Congress on January 3, 1985. It was rejected by the Senate Committee on Commerce, Science and Transportation on May 16, 1985.

117. Representative Norman Shumway (R-Cal.) introduced a similar proposal in the House of Representatives, Bill 2568, in the first session of the 99th Congress on May 21, 1985. For a detailed history and analysis of prior congressional response to the products liability problem through 1982, see Coccia, *supra* note 64, at 243-44.

118. 15 U.S.C. §§ 3901-3904 (1982 & Supp. III 1985). For more detailed information, see Maxfield, *Risk Retention Act: An Alternative Form of Product Liability Insurance for Small Business*, 32 FED'N INS COUNS. Q. 273 (1982); Shea, *The Product Liability Risk Retention Act of 1981*, 28 PRACT. LAW., Mar. 1, 1982, at 9.

119. Professor Jeffrey O'Connell of the University of Illinois has written extensively on no-fault insurance systems. See, e.g., O'Connell, *supra* notes 71 & 74.

sation Plan.¹²⁰

With the exception of the Product Liability Risk Retention Act of 1981 which involves insurance industry practices, the proposals largely address the third cause—the uncertainties in the tort litigation system brought about by the inconsistencies of the various state common and statutory laws of products liability.

A plaintiff injured by a product can bring suit on at least three distinct theories of recovery: negligence, breach of warranty and strict liability in tort under Section 402A of the Restatement.¹²¹ Each of the fifty states applies somewhat different rules of common law regarding the *prima facie* case for each theory, the allowable defenses and the relative burdens of proof.¹²² Additionally, state legislative enactments have been inconsistent and largely ineffective as a solution for the small capital goods manufacturer because they have created “51 sets of differing state laws, cases and enactments.”¹²³

The various proposals and statutes were initiated as a response to these disparities, especially in light of the burdens placed on the small capital goods manufacturer. As a direct result of the Task Force study, the first attempt at resolving the uncertainties of the tort litigation system was the Model Uniform Product Liability Act.

A. *The Model Uniform Product Liability Act*

To try to unify state law on products liability, the U.S. Department of Commerce drafted the Model Uniform Product Liability Act and recommended its passage to the states.¹²⁴ Its goals were “first, to assure that persons injured by unreasonably unsafe products will be adequately compensated for their injuries and, second, to make product liability insurance more widely available and affordable”¹²⁵

The UPLA was published in its final form on October 31,

120. In 1972, New Zealand enacted a comprehensive no-fault system of accident compensation for all accident victims. The plan was briefly discussed in the Task Force Legal Study but was discarded because of political “realities.” See *infra* 180-89 and accompanying text.

121. RESTATEMENT § 402A, *supra* note 19; Prosser, *The Assault upon the Citadel*, *supra* note 20; and Prosser, *The Fall of the Citadel*, *supra* note 20.

122. L. FRUMER & M. FRIEDMAN, PRODUCTS LIABILITY vol. 2A, ch. 3D and vol. 5, app. (individual state statutes).

123. Smith, *supra* note 48, at 36. For a detailed analysis, see L. FRUMER & M. FRIEDMAN, *supra* note 122.

124. UPLA, *supra* note 102, 44 Fed. Reg. at 62,714.

125. *Id.* at 62,716.

1979¹²⁶ and was offered as a model state law.¹²⁷ It has not been adopted in full by any state, although over thirty states have adopted some form of products liability legislation.¹²⁸ However, these statutes are inconsistent, are not comprehensive and have failed to resolve the uncertainties in the products liability tort litigation system.¹²⁹ To illustrate the inconsistencies and uncertainties of the state statutes compared to the UPLA, each of the relevant provisions affecting the small capital goods manufacturer will be briefly discussed.¹³⁰

(1) The UPLA consolidates the three theories of a manufacturer's liability, that is, negligence, breach of warranty and strict tort liability, into one products liability claim and specifically preempts the Uniform Commercial Code. The state laws generally do not consolidate the three theories, instead retaining negligence and the UCC provisions.

(2) The UPLA specifically defines defectiveness with respect to manufacturing defects, design defects, inadequate warnings or instructions and breach of warranty. The state laws do not; instead, they retain the common law concepts of negligence, implied warranty, strict liability in tort based on *Restatement* section 402A and the U.C.C. formulation of express and implied warranty.

(3) State laws vary greatly as to when and whether subsequent remedial measures (that is, changes in the product's design, warnings or instructions, "state of the art" or custom in the industry *after* the product was manufactured) are admissible. Under the UPLA, these measures will not be admitted as evidence of defectiveness.

(4) Generally, the state laws do not consider meeting administrative regulatory standards as probative of safety and non-defectiveness of the product. The UPLA makes compliance with these standards a rebuttable presumption that must be overcome by the plaintiff.

(5) The UPLA adopts a two year statute of limitations from the time of injury but allows the manufacturer to prove that the harm was caused after the product's "useful safe life" to avoid liability. Many states have adopted "statutes of repose" that absolutely bar products liability actions after a certain period of time (for example, six to twelve years after a product is sold or manufactured). Some statutes of limitations also vary.

126. *Id.* at 62,714.

127. S. REP. NO. 476, 98th Cong., 2d Sess. 6 (1984).

128. *Id.*

129. *Id.*

130. For a more thorough examination of each of these elements, see generally L. FRUMER & M. FRIEDMAN, *supra* note 122, and UPLA, *supra* note 102, at 62,720-37.

(6) The UPLA adopts comparative responsibility and apportionment of damages based on the actions of all parties including the plaintiff. The state laws range from full comparative responsibility of all parties (similar to the UPLA) to contributory negligence of the plaintiff being a complete bar to recovery.

The UPLA, *if adopted by all states*, would provide needed uniformity and reform. But, since it has not been adopted in full by any state fully six years after its publication, it is virtually certain that it will not be generally accepted.¹³¹ This improbability of adoption has prompted attempts at direct federal legislation.

B. Federal Proposals

Federal efforts to pass products liability legislation began with the 95th Congress in 1977.¹³² A recent proposal of Senator Robert Kasten, Jr., Senate Bill 100, was introduced on January 3, 1985, in the 99th Congress. Although it has been rejected by the Committee on Commerce, Science and Transportation, it is representative of the general approach of the federal proposals. The provisions of Senator Kasten's bill that most concern the small capital goods manufacturer are:

(1) It preempts all state law on products liability and consolidates actions that formerly would have been based on (a) strict liability in tort; (b) negligence; (c) breach of express or implied warranty; and (d) failure to warn or instruct.¹³³

(2) It defines the responsibility of manufacturers with regard to (a) manufacturing defects; (b) design defects; (c) failure or inadequacy of warnings or instructions; and (d) express warranty.¹³⁴ Strict liability is essentially retained for manufacturing defects and breach of express warranty, but negligence and its risk-benefit analysis¹³⁵ are applied to design and warning defects.¹³⁶

(3) It applies principles of comparative responsibility which reduce, but do not bar completely, a claimant's recovery when some responsibility for the harm is attributed to the claimant.¹³⁷ Evidence of contributory negligence, assumption of the risk, product

131. Coccia, *supra* note 64, at 243; S. REP. No. 476, *supra* note 126, at 6.

132. See Coccia, *supra* note 64, at 243-44 nn.1 & 2 for a detailed list of bills introduced in Congress from 1977 through 1980. Since that time, Senator Kasten introduced S. 100, 99th Cong., 1st Sess. (1985) and Representative Shumway introduced H.R. 2729, 98th Cong., 1st Sess. (1983) and H.R. 2568, 99th Cong., 1st Sess. (1985).

133. S. 100, *supra* note 132, § 3(b)(4).

134. *Id.* § 4.

135. That is, the balancing of the challenged design against the risk of danger inherent in such design. See *supra* note 28 and accompanying text.

136. S. 100, *supra* note 132, § 5. See also *supra* notes 41-42.

137. S. 100, *supra* note 132, § 9(a).

misuse or modification and acts of third parties (for example, an employer or other employees) will be considered in determining comparative responsibility.

(4) It provides employees an action against a manufacturer for workplace injuries, but reduces recoveries by amounts paid under workers' compensation.¹³⁸

(5) It requires that a claim be made against any capital goods manufacturer within twenty-five years of first delivery of the product.¹³⁹ This provision is much more to claimants' interest than state statutes of repose which are typically six to twelve years.¹⁴⁰

(6) It provides that subsequent remedial measures are generally not admissible.¹⁴¹

(7) It includes a two year statute of limitation which begins to run when the claimant discovers or should have discovered the harm and its cause.¹⁴²

Since many manufacturers sell in more than one state, they are unable to determine to which standard they will be held because of the present patchwork of state and common law and inconsistent jury decisions. Thus, the primary advantage of the federal proposals and the UPLA, if passed by all states, is the uniformity and consistency not found in the existing common law. Although a detailed analysis of these proposals is beyond the scope of this Comment,¹⁴³ with respect to the small capital goods manufacturer, neither the proposals nor the state legislative enactments appear to be the solution to the problem.

The UPLA has been ineffective because it has not been enacted by the states.¹⁴⁴ The federal proposals which have been introduced in five sessions of Congress¹⁴⁵ do not appear close to passage. They are attempts to balance the conflicting interests of consumers, manufacturers, sellers, insurance companies and the legal profes-

138. *Id.* § 10(a).

139. *Id.* § 11(a)(1).

140. *See supra* note 94.

141. S. 100, *supra* note 132, § 13(a).

142. *Id.* § 14.

143. For detailed analyses of the proposal, *see* Symposium on Product Liability, 13 CAP U.L. REV. 335 (1984); Coccia, *supra* note 64; Cohen, *Analysis of the Products Liability Act (S.44 98th Congress) as Reported*, 3 J. PROD. L. 1 (Mar./June 1984); Cooke, *The Federal Product Liability Bill: The Judge's View*, 15 TRIAL LAW. Q. 5 (Spr. 1983); Davis, *Product Liability under Section 402A of the Restatement (Second) of Torts and the Model Uniform Product Liability Act*, 16 WAKE FOREST L. REV. 513 (1980); Dworkin, *supra* note 25; Murphy, *Federal Product Liability Legislation*, 38 J. MO. B. 371 (1982); The Special Committee on Product Liability, *The Model Uniform Product Liability Act*, 37 REC. A.B. CITY N.Y. 222 (1982); Specter, *The Federal Product Liability Bill: The Lawyer's View*, 15 TRIAL LAW Q. 9 (Spr. 1983); Twerski, *The Federal Product Liability Bill: The Professor's View*, 15 TRIAL LAW. Q. 19 (Spr. 1983).

144. Coccia, *supra* note 64, at 243.

145. *Id.* at 243-44.

sion. By and large, these proposals are a move backward on the *caveat emptor*—absolute liability continuum and have drawn severe criticism from consumer advocates.¹⁴⁶ Furthermore, these federal proposals are riddled with special interest sections¹⁴⁷ and consequently would not be tolerated in an age of consumerism and expanded plaintiffs' recoveries.

C. *The Product Liability Risk Retention Act of 1981*

The Product Liability Risk Retention Act of 1981¹⁴⁸ attempts to solve the critical problem of unaffordability or unavailability of products liability insurance which faces the small capital goods manufacturer. This act allows the establishment of "risk retention groups" or "captive insurance companies" to assume, spread or purchase products liability insurance.¹⁴⁹ The act exempts these entities from the stringent state regulation of insurance companies¹⁵⁰ although it does provide for strict financial monitoring to assure sufficient reserves for plaintiffs' judgments.¹⁵¹

The theory of the act is to reduce regulatory barriers to the formation of these entities, thus allowing small firms to band together to self insure or reinsure, that is, purchase insurance at wholesale rates. The theory is plausible, but in practice the small capital goods manufacturer does not have the assets to retain the risk of self insurance nor the expertise to form groups to do so or to reinsure.¹⁵² The so-called "insurance crisis" of the early 1970's¹⁵³ eased shortly after the act was passed and products liability insurance again became affordable and available.¹⁵⁴ This did not occur because of provisions of the act; rather, the easing of the crisis was due primarily to investment gains made by insurance companies in the bull markets of the late 1970's.¹⁵⁵ As investment

146. See, e.g., Hollings, *supra* note 100.

147. See Smith, *supra* note 48.

148. 15 U.S.C. §§ 3901-3904 (1982 & Supp. III 1985).

149. Comment, *Solving the Products Liability Insurance Crisis: A Study of the Role of Economic Theory in the Legislative Reform Process*, 31 MERCER L. REV. 755, 767-68 (1980). Risk retention groups are groups of small manufacturers or sellers that band together to assume, spread or reinsure (purchase at wholesale) products liability insurance. A captive insurance company is a company formed by the manufacturer or seller for the purpose of handling the insurance requirements of the parent manufacturer or seller only. Premiums are paid to the captive insurance company by the parent manufacturer or seller and the captive either assumes or reinsures the risk.

150. *Id.* at 768.

151. *Id.* at 768-69.

152. Page & Stephens, *supra* note 109, at 398-99.

153. *Id.* at 387. See also *infra* notes 213-22 and accompanying text.

154. Page & Stephens, *supra* note 109, at 388, 396-97.

155. See *supra* note 109 and accompanying text.

gains increased capital reserves, insurance capacity (the dollar amount of policies that can be written) increased, forcing insurance companies to become very competitive to maintain or increase their market share.¹⁵⁶

Thus, with products liability insurance both available and affordable, manufacturers had little incentive to form risk retention groups or captive insurance companies. In fact, few risk retention groups have been formed and "to date it would be safe to assume . . . the Risk Retention Act has had no effect whatsoever on products liability insurance costs."¹⁵⁷ A scheme whose viability depends on the investment results of the insurance companies can hardly be a permanent, rational solution to the problem. This act does not address the real problem in products liability insurance—the reduction in insurance capacity forced by the statutory reserve requirements when underwriting or investment losses deplete insurance company reserves.¹⁵⁸ As a further indication that the act had virtually no effect on products liability insurance costs, yet another insurance "crisis" is approaching.¹⁵⁹

D. Workers' Compensation As Workers' Sole Remedy

The Task Force recommended that consideration be given to making workers' compensation the sole remedy for workplace injuries and to increasing such benefits to a more equitable level.¹⁶⁰ The limited recovery schedules of workers' compensation were developed historically as *quid pro quo* for its no-fault principles and have never included amounts that would be payable for pain and suffering or impairment of earning capacity.¹⁶¹

Workers' compensation as the sole remedy for workplace injuries would eliminate the injured worker's right to bring a tort claim against the manufacturer of a product if the worker were injured while using the product in the course of employment.¹⁶² If adopted, this recommendation would provide an immediate solution to the problem of the small capital goods manufacturer.¹⁶³

156. See discussion of the insurance reserve system, *supra* notes 106-12.

157. *Product Liability Act: Hearings on S. 44 Before the Subcomm. on the Consumer of the Senate Comm. on Commerce, Science and Transportation*, 98th Cong., 1st Sess. 139 (1983) (testimony of William Ford, Chairman of the Coalition for a Uniform Product Liability Law). See also *Working Group Report*, *supra* note 31, at 58-59.

158. See *supra* notes 106-12 and accompanying text.

159. See *supra* notes 3 and 110 and accompanying text.

160. Task Force Final Report, *supra* note 6, at VII-251.

161. Mitchell, *supra* note 78, at 354.

162. Task Force Final Report, *supra* note 6, at VII-103.

163. This proposal, however, would do little for the consumer goods manufacturer because consumer goods are not generally used in the workplace.

Well over thirty percent (and perhaps as many as eighty-five percent) of the products liability suits are based on injuries caused by products in work related situations.¹⁶⁴ Since capital goods are by definition products used in the workplace,¹⁶⁵ if workers' compensation were made the sole remedy for these accidents, then products liability suits against all capital goods manufacturers would be virtually eliminated.¹⁶⁶

Much has been written on this proposal and its advantages of quick and fair compensation to victims as well as its reduction of transaction costs.¹⁶⁷ For every dollar paid by insurance companies in a products liability suit, twenty-six cents is paid to the plaintiff's attorneys and an additional thirty-seven cents is paid to the defendant's lawyers.¹⁶⁸ Therefore, only thirty-seven cents of each dollar paid by insurers reaches the plaintiff; this could be nearly doubled to sixty-five to seventy cents under a workers' compensation system because "the huge amounts now spent on legal fees . . . would be saved."¹⁶⁹ "The only clear beneficiaries of [the present] system appear to be lawyers."¹⁷⁰

The disadvantages of the proposal are (1) limiting recovery exclusively to workers' compensation, (2) reducing manufacturers' incentive to produce safer products and (3) increasing the cost of workers' compensation insurance to employers.¹⁷¹ To overcome these disadvantages and implement the proposal, workers' compensation awards must be increased. Under an exclusive no-fault system, however, the injured worker still would not be allowed substantial damages for pain and suffering.¹⁷² This is the most serious drawback of the exclusive no-fault system as injured workers could not maintain actions against manufacturers which are pres-

164. O'Connell, *supra* note 74, at 685 (citing Insurance Company of North America, *Products Liability: Some Professional Considerations*, Booklet H H-8306, 3 (1976) (available from INA Corp., Philadelphia, PA.)).

165. *See supra* note 7.

166. O'Connell, *supra* note 74, at 684.

167. *See, e.g.*, O'Connell, *supra* notes 71 and 74.

168. A study by The Rand Corporation involving 24,000 claims, *reprinted in* Schwartz & Bares, *Federal Reform of Product Liability Law: A Solution That Will Work*, 13 CAP. U.L. REV. 351, 354 n.10 (1984), revealed that "for every dollar received by plaintiff in a product liability suit, 41 cents is paid immediately to the plaintiff's attorney. The defendant spends an additional 58 cents in legal costs." Thus, of a total cost to the insurance company of \$1.58, 59 cents goes to the plaintiff, 41 cents goes to plaintiff's attorneys and 58 cents to the defendant's attorneys. Converting these figures, for every dollar paid by insurance companies in a products liability suit, 37 cents is paid to the plaintiff, 26 cents to the plaintiff's attorney and 37 cents to the defense lawyers. *See also Working Group Report, supra* note 31, at 42-45.

169. O'Connell, *supra* note 71, at 98 (footnote omitted).

170. *Working Group Report, supra* note 31, at 45.

171. Task Force Insurance Study, *supra* note 6, at 4-76.

172. Task Force Industry Study, *supra* note 6, at VII-104.

ently allowed by tort law.

To retain the manufacturer's incentive to produce safe products, the manufacturer could be required to pay into the workers' compensation system based on the number and types of machines sold.¹⁷³ Another possibility is that employers could be allowed an arbitration or contribution procedure against manufacturers based on comparative responsibility for the injury.¹⁷⁴ The disadvantage of this latter mechanism is the added transaction costs that would be required because an allocation of fault must be made in every product-related injury case.¹⁷⁵ "Presumably, these transaction costs would be less than those that arise under the present tort-litigation system [because] the arbitration system would be less expensive than a jury trial, and there would be no plaintiff's attorney contingent fee involved."¹⁷⁶

Since the employer would have some incentive to reduce its workers' compensation claims, it would tend to purchase safer products. The manufacturer in response to this market incentive would thus be encouraged to produce safe products.¹⁷⁷ But this may not be as effective as direct liability for injury because there is more incentive to produce safer products when a manufacturer is faced with a potentially devastating personal injury suit. Finally, the increased cost of workers' compensation insurance to employers could be offset with equitable contributions from manufacturers as discussed above and a significant reduction in transaction costs when compared to the present tort litigation system.¹⁷⁸

E. The New Zealand Accident Compensation Plan

If spreading the loss is a viable rationale for compensating the plaintiff, then should it not be carried to its logical conclusion by truly spreading the loss to all possible accident victims in a social insurance scheme along the lines of the New Zealand Accident Compensation Plan?¹⁷⁹ Why should compensation be limited to those who are "lucky" enough to be injured by a defective product? "[V]ictims of crime, illness, [and] earthquakes . . . should be entitled to the same level of protection because they have precisely the same needs."¹⁸⁰

173. *Id.* at VII-110.

174. *Id.* at VII-111.

175. *Id.*

176. *Id.*

177. *See supra* notes 66-71 and accompanying text.

178. *See supra* notes 174-75 and accompanying text.

179. New Zealand Accident Compensation Act 1972, 2 N.Z. Stat. §§ 1-184 (1975).

180. Epstein, *supra* note 58, at 20.

In 1974, New Zealand abandoned both workers' compensation and the tort litigation system and instituted a comprehensive, government operated no-fault system of accident compensation of *all* accident victims.¹⁸¹ An injured person is paid all medical and rehabilitation expenses, eighty percent of lost earnings for the duration of the disability and limited lump sum payments for loss of body parts or functions and pain and suffering.¹⁸² The plan is financed by an employers' tax, a motorists' tax and general tax revenues.¹⁸³

Proponents feel the plan has been an outstanding success. For example, New Zealand employers only pay 1.07% of their total payrolls into the system, while in New South Wales, Australia, the average rate is three times this.¹⁸⁴ Furthermore, the drivers' rate is \$14.20 per year per licensed driver compared to the compulsory third party coverage paid by New South Wales automobile owners of \$124.00 per year.¹⁸⁵ "The burdens of the New Zealand scheme are the lowest of their kind anywhere in the developed world. And they provide better benefits as well as wider coverage."¹⁸⁶ The plan has been criticized because no tort action is available to an injured person, illness or disease is not covered, payment limits are arbitrarily set, manufacturers have no incentive to build safer products and interests of the individual are sacrificed to the perceived good of society.¹⁸⁷ Implementation of such a plan in the United States is not feasible at present.¹⁸⁸ First, at the time New Zealand implemented the plan, it had in place a national health plan that paid full hospital and drug costs and a significant portion of office visits to physicians.¹⁸⁹ Second, New

181. The New Zealand Accident Compensation Act was adopted in 1972 and amended in 1973 before it became effective in April 1974. 2 N.Z. Stat. 1413 (1975); Dahl, *Injury Compensation for Everyone?—The New Zealand Experience*, 53 J. URB. L. 925, 929 (1976). For a detailed explanation and historical review, see Franklin, *Personal Injury Accidents in New Zealand and the United States: Some Striking Similarities*, 27 STAN L. REV. 653 (1975); Henderson, *The New Zealand Accident Compensation Reform*, 48 U. CHI. REV. 781 (1981); Palmer, *Accident Compensation in New Zealand: The First Two Years*, 25 AM. J. COMP. L. 1 (1977); Sanford, *Challenges Past, Present Future*, NEW ZEALAND ACCIDENT COMPENSATION COMMISSION REPORT (July 1978). The act was adopted in New Zealand in 1974 following the recommendation of the Royal Commission on Inquiry which examined compensation for personal injury. Dahl, *supra*, at 927-28.

182. 2 N.Z. Stat. §§ 107-38 (1975); Henderson, *supra* note 181, at 783; Dahl, *supra* note 181, at 936-37.

183. 2 N.Z. Stat. §§ 30-42 (1975). Franklin, *supra* note 181, at 635.

184. Palmer, *What Happened To The Woodhouse Report?*, NEW ZEALAND L.J. 561, 562 (1981).

185. *Id.* at 563.

186. *Id.*

187. Henderson, *supra* note 181, at 794, 797.

188. Task Force Legal Study, *supra* note 6, at VI-III.

189. Franklin, *supra* note 181, at 656-57.

Zealand is a small agricultural nation compared to the diverse industrialized society of the United States. Finally, the political "realities" of the powerful insurance industry, consumer groups, legal profession and medical profession as well as the general American disinclination toward "socialism" preclude the adoption of such a plan in the United States today.¹⁹⁰

Despite an abundance of study, little substantive action has been taken to address the products liability problem faced by the small capital goods manufacturer. No state has adopted the UPLA; no federal products liability act has been passed except for the Risk Retention Act of 1981 which has been ineffective. The academic no-fault proposals, the modification of the workers' compensation program and the New Zealand Plan have attracted almost no support because of political and economic realities.

III. REFORM AND EQUITABLE RISK SPREADING

To date, no reform has been adopted to aid the small capital goods manufacturer. This is not to say, however, that such changes are not attainable while at the same time satisfying the purposes of products liability.

A. Normative Goals of Products Liability

Products liability legislation should accomplish the following:

- (1) Persons injured by an unreasonably dangerous product should receive reasonable compensation for their injuries including both economic loss and pain and suffering.¹⁹¹
- (2) There should remain a strong incentive for manufacturers to produce safe products.¹⁹²
- (3) The cost of accidents should be spread over a large enough base so as not to impose too great a burden on any particular group.¹⁹³
- (4) The true cost of defective products accidents, not including residual or unavoidable accidents, should be borne by the products themselves.¹⁹⁴

To accomplish these goals, at least as they relate to the small capital goods manufacturer, little needs to be done to the present system. Despite the hue and cry about "reform" of the tort litiga-

190. Task Force Legal Study, *supra* note 6, at VI-III.

191. UPLA, *supra* note 101, at 62,714-15.

192. *Id.* at 62,715.

193. *Escola v. Coca-Cola Bottling Co.*, 24 Cal. 2d 453, 462, 150 P.2d 436, 441 (1944) (Traynor, J., concurring).

194. *See supra* notes 86-92 and accompanying text.

tion system, the legislative proposals are merely a uniform codification of the most reasonable provisions of present common and statutory law. They do not severely limit plaintiffs' recovery, nor do they eliminate manufacturers' liability.

The Report of the Tort Policy Working Group¹⁹⁵ recently recommended certain tort law reforms "that would bring a greater degree of rationality and predictability to tort law, and thereby significantly assist in resolving the [insurance] availability/affordability crisis."¹⁹⁶ Although the Working Group Report is somewhat biased toward the insurance industry's view of the problem, it does contain some reasonable recommendations for tort law reform.¹⁹⁷ These recommendations include:

- (1) Retaining fault as a basis for liability including a *reasonable* application of strict liability for defective products.¹⁹⁸
- (2) Requiring that a plaintiff prove by credible scientific and medical evidence that an injury was caused by a defect in the product.¹⁹⁹
- (3) Eliminating joint and several liability and its "deep pocket" results.²⁰⁰
- (4) Limiting non-economic damages, including punitive damages, to \$100,000.00.²⁰¹
- (5) Allowing periodic payments of future economic damages.²⁰²
- (6) Reducing awards by amounts received from collateral sources for the same injury.²⁰³
- (7) Limiting contingency fees to lawyers per a schedule based on amount of recovery.²⁰⁴
- (8) Developing alternative dispute resolution mechanisms to reduce transaction costs.²⁰⁵

195. *Working Group Report*, *supra* note 31. In October, 1985, the U.S. Attorney General established an Inter-agency Tort Policy Working Group consisting of ten agencies and the White House. Its report outlined the magnitude of the crisis on insurance availability and affordability and included recommendations for tort reform.

196. *Id.* at 60.

197. *Id.* at 60-75.

198. *Id.* at 61-62.

199. *Id.* at 62-64.

200. *Id.* at 64-65. An initiative measure (Proposition 51) approved by the people of California on June 3, 1986, addressed this issue. CAL. CIV. CODE §§ 1431-1431.5 (West Supp. 1987). This law provides that liability shall be several and not joint for *non-economic* damages. *Id.* § 1431.2. This measure is an effort to reduce the "deep pocket" abuses of joint and several liability that hold a solvent tortfeasor "with only a small or even *de minimis* percentage of fault liable for 100% of plaintiff's damage." *Working Group Report*, *supra* note 31, at 64.

201. *Working Group Report*, *supra* note 31, at 66-69.

202. *Id.* at 67-70.

203. *Id.* at 70-72.

204. *Id.* at 72-74.

205. *Id.* at 74-75.

Although these proposals could serve to reduce the abuses of the tort litigation system,²⁰⁶ they are far from being implemented. Again, the political and economic realities must be considered.

Even if implemented, these proposals would not solve the problem confronting the small capital goods manufacturer. The problem is not so much the tort litigation system as it is the insurance system.²⁰⁷ Even under the new reform proposals or legislation, products liability insurance may become unavailable or unaffordable to the small capital goods manufacturer because of the insurance reserve system and the manufacturer's relatively high risk exposure. Such a manufacturer would still be faced with the same catastrophic prospect of bankruptcy or liquidation when assessed a judgment. A judgment being *slightly* more difficult to win is little consolation.

B. Insurance Capacity Problem

The insurance industry touts the new reform proposals as a panacea for what ails the system,²⁰⁸ but there is evidence that the cyclical insurance "crises" have more to do with interest rates, investment income or reserve requirements than they do with substantive tort law.²⁰⁹ The substantive tort law of products liability which has been evolving since the early 1960's²¹⁰ has seen no major change during the last few years to account for this so-called insurance "crisis." There have been, of course, increases in both the number of products liability suits filed and the size of the judgments awarded, but these neither justify nor cause an insurance "crisis" because the function of insurance companies is to equitably spread the risk of loss over their large customer bases, whatever that loss may be.²¹¹ Indeed, the Tort Policy Working

206. See *id.* at 29-52 for a description of many of the problems and abuses in the present tort law system.

207. For a description of the problems facing the insurance industry, see *supra* notes 106-12 and accompanying text.

208. Based on a personal interview with Bruce Moore, partner at Barney & Barney Insurance Agency, San Diego, Cal. (Nov. 25, 1985).

209. Page & Stephens, *supra* note 109, at 401 (quoting a conversation that those authors had on July 19, 1983, with James H. Mack of the National Machine Tool Builders Association).

210. For a brief history of the evolution of products liability law, see Wade, *supra* note 20.

211. The Tort Policy Working Group found that both the number of products liability suits filed and the amount of damages awarded have increased dramatically. *Working Group Report*, *supra* note 31, at 35-52. "For example, the number of product liability cases filed in federal district courts has increased from 1,579 in 1974 to 13,554 in 1985, a 758% increase . . ." *Id.* at 45. Average products liability jury verdicts increased from \$393,580 in 1975 to \$1,850,452 in 1985, a 370% increase. *Id.* at 36.

Group stated that

the crisis in insurance availability and affordability does not appear to be a crisis for the insurance industry. . . . Rather, it is a crisis for the insureds who cannot obtain or afford the insurance they believe necessary for their on-going activities. And, to the extent that entities are forced to operate without insurance or with inadequate insurance, it is a crisis for victims of tortious conduct who may find that liable defendants cannot pay them their damages.²¹²

During the last insurance "crisis" in the early 1970's, products liability rates increased drastically and insurance companies cancelled policies of higher risk insureds.²¹³ This "crisis" was largely responsible for the formation of the Task Force as manufacturers complained of high rates and unavailability of insurance and insurance companies blamed the tort litigation system.²¹⁴ By the late 1970's, with no change in the substantive tort law or the increasing trends in products liability lawsuits, the crisis eased, insurance reserves were plentiful, insurance companies scrambled for business and products liability rates declined.²¹⁵ Now the reserves are down again,²¹⁶ insurance capacity is reduced, insurance rates have increased and cancellations of policies of higher risk companies logically follow. The problem is more the instability of the insurance companies' insurance writing capacity than it is the inconsistency in the tort law.

Furthermore, there is no logical reason for insurance companies to lose money over the long term. They exist merely to spread the risk. Their function is to collect enough premiums to pay all the claims plus a little more to cover expenses and profits. However, when they miscalculate and suffer losses to their capital reserves, it causes a *disproportionate* reduction in insurance writing capacity and a so-called insurance "crisis."²¹⁷ What is needed is stability in the amount of insurance that can be written and equitable spreading of the risk. The Task Force devoted an entire section of

212. *Id.* at 15.

213. *See supra* note 109. This was brought about primarily by large investment losses to insurance companies' portfolios and the resulting contraction of premium collecting capacity. *See supra* notes 106-12 and accompanying text.

214. *See, e.g., Day, supra* note 3.

215. This was caused by large investment gains during the bull markets and inflation of the late 1970's which increased reserves and insurance capacity industry-wide and forced severe competition to maintain market share. *See supra* note 109.

216. This has been caused by (1) loss of income from insurance companies' portfolios because of the lowering interest rates and (2) underwriting losses because of the unrealistically low prices quoted during the last "boom" cycle (1980-82) in an effort to maintain or increase market share. Page & Stephens, *supra* note 109, at 390-95. *See also supra* notes 106-12 and accompanying text for an explanation of how premium writing capacity is affected by reductions in capital reserves.

217. *See supra* notes 99-114 and accompanying text.

its report entitled "The Availability of Insurance to All Reasonably Insurable Product Manufacturers and Suppliers at a Cost Reasonably Commensurate with Product Risk" to explain precisely this situation. The Task Force noted that "[t]he basic issues here are whether premiums actually reflect costs related to the product risk and whether premiums charged different policyholders are equitable."²¹⁸

C. *Equitable Spreading of the Risk Insurance Plan*

There were a number of proposals made to the Task Force to affect availability and affordability of insurance. These included:²¹⁹

- (1) assigned risk plans;
- (2) government operated funds; and
- (3) pooling mechanisms (joint underwriting and reinsurance).

The Task Force Insurance Contractor felt that justifying any of these government programs would require hard evidence that (1) a substantial number of businesses were threatened with extinction; (2) these businesses produce products needed in the economy; (3) these businesses follow safe manufacturing practices; and (4) no government action would result in substantial unemployment, less new product development, transfer of these products overseas, reduction of competition or substantial inflation.²²⁰ Although the Contractor felt that such evidence was lacking, one of the limitations of the Insurance Study was its reliance on the insurance industry and its industry "perspectives."²²¹

With very little modification, the present private insurance mechanism together with the present tort litigation system could accomplish the goals that strict liability was meant to achieve and at the same time solve small capital goods manufacturers' problems. As discussed above, the existing problem results from a substantial reduction in insurance writing capacity when reserves are depleted due to underwriting and/or investment losses.²²² When both types of losses occur simultaneously, as in the early 1970's,²²³ a severe "crunch" occurs. Faced with substantially less capacity to write insurance policies, the rational insurance com-

218. Task Force Final Report, *supra* note 6, at V-2.

219. Task Force Insurance Study, *supra* note 6, at 4-8.

220. *Id.* at 4-9. The contractor who performed the Insurance Study for the Task Force was McKinsey, Inc.

221. Task Force Final Report, *supra* note 6, at I-15.

222. See *supra* notes 99-114 and accompanying text.

223. See *supra* note 109.

pany will reduce its exposure to higher risk accounts.²²⁴ One category of higher risk accounts is the small capital goods manufacturer, especially those with a recent loss history.

Based on an underwriting file analysis, the Task Force found that although products liability rates varied from .06% of sales for household TV manufacturers to 3.12% of sales for metal working machinery and equipment manufacturers, rates were less than one percent of sales in all but a few manufacturing industries.²²⁵ The question is whether the burgeoning tort liability system will impose too great a burden on the small capital goods manufacturer. The Tort Policy Working Group felt that at the present time, "[t]he private sector is being asked to carry a compensation burden which in some instances it simply cannot afford to carry without substantial economic dislocations. Thus, even where insurance is available, in order to carry this compensation burden, it often is priced at unacceptable levels."²²⁶ But at less than one percent of overall sales, products liability insurance rates are acceptable and the solution lies in equitably spreading the risk without unduly burdening the small capital goods manufacturer because of *short-term problems*—either reserve reductions and loss of capacity in the insurance industry or recent loss history.

The private insurance industry is uniquely qualified to equitably spread this risk with relatively minor modifications to the present system. First, insurance companies must be allowed to continue writing approximately the same amount of insurance each year, with proper allowance for growth, but without the tremendous swings caused by the present reserve requirement system. The purpose of the reserve system is to assure that insurance companies are financially secure and that funds will be available for claims payment. But, requiring the insurance writing capacity to expand or contract drastically when capital reserves are depleted by underwriting or investment losses is unreasonable and to a large extent transforms an inconvenience into a crisis.

Under the present system, insurance companies are virtually forced to (1) eliminate their relatively higher risk accounts or (2) drastically increase premiums or (3) do both. These are precisely the problems faced by the small capital goods manufacturer. State regulators must develop a more flexible approach, balancing the capacity requirements of the industry with the financial security concerns.

Additionally, some state regulatory mechanism should be devel-

224. Riggs, *supra* note 110, at I-1, col. 1.

225. Task Force Insurance Study, *supra* note 6, at 2-25-2-27.

226. Working Group Report, *supra* note 31, at 52.

oped to require insurance companies to continue insuring manufacturers that desire coverage with premium increases limited to some maximum percentage of sales.²²⁷ If, after some period of time, the loss history continued to be poor, then the premium could be raised.²²⁸ Such a plan would serve a dual purpose. First, it would force the product to carry a larger share of the accident costs in the marketplace and thus reduce externalization.²²⁹ This is equitable because if the poor loss history continues, the product should be required to carry a larger part of the accident costs corresponding to the defective product costs. Second, the mechanism would provide incentive for the manufacturer to improve the safety of its products because liability insurance rates could climb to ten percent of sales in five years.

There is a problem with this approach, however: What should be done about products that are or turn out to be extremely dangerous? Insurance companies must be allowed some way to decline coverage for products that cause almost certain liability far in excess of premiums that can be charged because of these proposed limitations.²³⁰ Perhaps the answers to this relatively small problem²³¹ lie in some of the mechanisms suggested to the Task Force—assigned risk plans, government operated funds or pooling mechanisms (joint underwriting and reinsurance).²³² Serious public policy concerns prompted a solution to the similar, but more difficult, problem of toxic waste contamination. Congress established a “superfund” financed by “general [tax] revenues and [excise] taxes on petroleum and certain chemicals.”²³³ If, as in the case of toxic waste contamination, the situation requires compen-

227. Since present products liability rates average less than one percent of sales, this maximum might reasonably be put at five percent of sales for the first five years. A longer term approach must be taken; perhaps a five year moratorium on increases would be appropriate.

228. This increase might be ten percent of sales for the next five years.

229. See *supra* notes 86-97 and accompanying text for a discussion of the benefits of internalizing costs of products.

230. As an extreme example, the 1985 Jalisco Cheese fiasco in California (where a number of people died after eating the product) would have resulted in tremendous liability for any insurance company insuring Jalisco. Almost confiscatory regulation of the insurance industry would have resulted if an insurance company were required to continue insuring Jalisco at a maximum rate of five percent of sales (now zero because of the problems) for five years, with an increase to ten percent of sales for the next five years.

231. The problem is relatively small only because there are not that many instances of the extremely dangerous product. To the manufacturer involved or the injured plaintiff, however, it is an overwhelmingly large problem.

232. Task Force Insurance Study, *supra* note 6, at 4-8.

233. Comprehensive Environmental Response, Compensation, and Liability Act of 1980, 42 U.S.C. §§ 9601-9657 (1982 & Supp. III 1985). See also Note, *Superfund and California's Implementation Potential Conflict*, 19 CAL. W.L. REV. 373 (1983) (footnote omitted).

sation of the victims as an overriding public policy, then funds could be made available from general tax revenues and industry excise taxes.²³⁴

The equitable spreading of the risk approach to products liability insurance would accomplish the desired goals of the system:

(1) The approach would provide adequate compensation for injured plaintiffs.

(2) With the prospect of products liability rates increasing over a period of time to ten percent of sales, manufacturers would have strong incentive to produce safe products.

(3) Any additional costs of accidents would be spread over the insurance companies' broad base of customers, but rates to these customers still would be maintained at a reasonable level, presently less than one percent of annual sales.

(4) An approximation of the true cost of defective products would fall on product manufacturers while an approximation of the residual unavoidable accidents would fall on the large customer base of the insurer.

CONCLUSION

The trend in strict products liability has been toward eliminating traditional defenses and imposing increasing liability on manufacturers. In an effort to compensate injured plaintiffs, to shift the accident costs to manufacturers, to spread the risk of accident costs and to internalize the risk of defective products, strict products liability has caused serious problems for small capital goods manufacturers.²³⁵

At the same time, the insurance reserve system forces a severe reduction in the amount of insurance that can be written when insurance companies' capital reserves are depleted due to underwriting and/or investment losses. An insurance company is thus faced with a severe mandatory reduction in the amount of insurance that it can underwrite.²³⁶

When a products liability action is filed against a small capital goods manufacturer, the manufacturer becomes a relatively poor risk to an insurance company regardless of the actual merits of the action. A rational insurance company faced with mandatory cutbacks either declines to insure the manufacturer or drastically increases the premiums charged. Both alternatives are unacceptable to the manufacturer as either may force operation without

234. Note, *supra* note 233, at 375-82.

235. See *supra* notes 45-97 and accompanying text.

236. See *supra* notes 99-114 and accompanying text.

products liability insurance.²³⁷

Specifically, when unavailability or unaffordability of products liability insurance causes a small manufacturer to operate without insurance, there is a strong possibility of bankruptcy or liquidation if an accident occurs and a judgment is awarded. Moreover, the injured plaintiff then is forced to rely on the perhaps inadequate assets of the firm for compensation.²³⁸

There are three major causes of the products liability problem—insurance rating practices, manufacturing practices and uncertainties in the tort litigation system.²³⁹ Administrative, legislative and academic proposals have largely addressed the latter cause—the inconsistencies and inequities of the various state common and statutory laws of products liability. The state and federal proposals, however, do not solve the problem of unavailability or unaffordability of products liability insurance to the small manufacturer. These plans do not and should not severely limit plaintiffs' recoveries nor eliminate manufacturers' liability.²⁴⁰

Overall, manufacturing products liability insurance rates average less than one percent of sales. At this rate, there is little evidence of a major problem in the tort litigation system. What is needed is some common sense legislation to equitably spread the risk partially to the small manufacturers and partially to the broader customer base of the insurance industry.²⁴¹

First, reform is required in the insurance reserve system to allow insurance companies to maintain a relatively stable capacity to insure without the tremendous swings caused by the present system.²⁴² Second, some mechanism should be developed to require insurance companies to continue insuring reasonably insurable manufacturers with premium increases limited to some maximum percent of sales for a certain period of time.²⁴³ Finally, insurance companies must be allowed to decline coverage for products that cause almost certain liability far in excess of premiums that can be charged due to these limitations.

If, as some commentators predict, the tort liability system is faulty and costs become too burdensome, then perhaps the time will come when a social insurance plan will be necessary.

[But] [u]ntil Americans have a comprehensive scheme of social insurance, courts must resolve by a balancing process the head-

237. See *supra* notes 111-13 and accompanying text.

238. *Id.*

239. See *supra* note 115 and accompanying text.

240. See *supra* notes 116-78 and accompanying text.

241. See *supra* notes 223-34 and accompanying text.

242. See *id.* for an explanation of some possible reforms.

243. See *supra* notes 227-29 and accompanying text.

on collision between the *need for adequate recovery and viable enterprises* This balancing task should be approached with a realization that the basic consideration involves a determination of the most just *allocation of the risk of loss*²⁴⁴

The solution proposed here will accomplish the major goals of strict products liability while preserving the present tort litigation system, private insurance mechanisms and the small capital goods manufacturer.

William G. Rood

244. *Helene Curtis Indus. Inc. v. Pruitt*, 385 F.2d. 841, 862 (5th Cir. 1967) *cert. denied* 391 U.S. 913 (1968) (citing Wilson, *Products Liability*, 43 CALIF. L. REV. 809 (1955)) (emphasis added).