

# Products Liability Reform in Congress: An Issue of Federalism

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The focus of this Commentary is on products liability reform at the federal level. This reform occurs against a backdrop of several unsuccessful attempts to impose on state courts a federal solution to what is perceived to be a problem of "crisis" proportions.<sup>1</sup> I will express some modest skepticism of the arguments advanced in favor of these proposals. I then will raise a more fundamental set of questions, evolving out of concerns for federalism, that should make us cautious about federal proposals, even if we believe that reform of some type is warranted. These latter questions may become increasingly important because of the recent report from the Reagan Administration calling for general tort reform<sup>2</sup> and the introduction late in the 99th Congress of several bills that would substantially preempt general state tort law.<sup>3</sup>

There are many different levels at which one can define the problem of our current handling of product-caused harm. There are those, like Professor Jeffrey O'Connell, who find all of the tort system of third-party liability inherently flawed. I suspect if Professor O'Connell and others like him had their way, no-fault plans or other first-party insurance schemes that purport to efficiently provide quick, but not full, compensation to injured persons would replace the current tort system.

Although earlier federal proposals called for a study by the judicial conference of the potential for no-fault compensation to victims of dangerous products,<sup>4</sup> the provision was dropped from the most recent bill reported to the Senate.<sup>5</sup> With the exception of a new expedited settlement procedure, few provisions of the most current bill are directed at the heart of a third-party liability system. Congressional efforts, instead, appear to assume a continuation of the tort liability system for product-caused harm. Many of the proposed changes seek to narrow the substantive standards of defectiveness<sup>6</sup> or to reduce the potential size of judgments by, for

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1. The federal government's interest in products liability reform was heightened by publication of the report of an interagency task force in 1977. INTERAGENCY TASK FORCE ON PRODUCT LIABILITY, FINAL REPORT, U.S. DEPT. OF COMMERCE (May 1977). Since then a number of products liability reform bills have been considered by Congress. The most recent include: S.2631, 97th Cong., 2d Sess. (1982); S.44, 98th Cong., 2d Sess. (1984); S.100, 99th Cong., 1st Sess. (1985); S.2760, 99th Cong., 2d Sess. (1986). Three of these four have been reported to the full Senate. See S.REP. No. 97-670, 97th Cong., 2d Sess. (1982) (S.2631); S.REP. No. 98-476, 98th Cong., 2d Sess. (1984) (S.44); S.REP. No. 99-422, 99th Cong., 2d Sess. (1986) (S.2760).

2. REPORT OF THE TORT POLICY WORKING GROUP ON THE CAUSES, EXTENT AND POLICY IMPLICATIONS OF THE CURRENT CRISIS IN INSURANCE AVAILABILITY AND AFFORDABILITY (1986).

3. E.g., H.R. 4460, 99th Cong., 2d Sess. (1986).

4. S.44, *supra* note 1, at §17.

5. S.2760, *supra* note 1.

6. For example, in S.2631, *supra* note 1, extensive provisions established standards for imposing liability on manufacturers of products. Section 4 imposed liability for construction flaws, design flaws, failure to warn, and express warranty. Liability for construction flaws remained one of strict liability but to be defective the product must represent a material deviation from a formula, specifications, or identical units. *Id.* at §5(a). Liability for design defects required the manufacturer to adopt an unreasonable design given the information available to that manufacturer at the time of the manufacture of the particular product. *Id.* at §5(b). The proposal establishes negligence as the standard for liability for

example, narrowing joint and several liability.<sup>7</sup> These provisions purport to address the concerns of the insurance industry that a lack of predictability and uniformity of legal doctrine have prevented insurance companies from adequately assessing their liability.

Producers of goods did experience substantial premium increases in the mid 1970s and again in the 1980s. Whether these increases were a result of flaws in the liability system, flaws in the insurance pricing system, or flaws in the product manufacturing system has not been determined definitively. I am not sufficiently versed in the practices of the insurance industry to make my own assessment. But, as background to a consideration of the accusations against the tort system, some things are apparent. First, the Task Force on Products Liability found several flaws in the way insurance companies calculated their premiums, including the fact that for many product classes premiums are set not by actuarial information but by intuitive guesses from recent risk experience.<sup>8</sup> Second, insurance premiums tend to cycle in relationship to the interest rate because much of the income of insurance companies comes from the investment returns on premium dollars paid in advance of claims. This cycle seems to be at least congruent with, if it does not explain, the most recent history of premium levels. Third, the insurance industry does not appear to have the full discipline in price setting of a competitive industry. Companies remain regulated and protected by state regulators, and the industry continues to enjoy an exemption from the federal antitrust laws.

At the same time, the pricing of insurance premiums does require some stability of risk. Insurance companies must have a large number of similar and predictable exposures over which to spread the costs of those risks that materialize. To the extent the tort system fails to provide a reasonable degree of stability, it will have a disruptive effect on insurance pricing.

Those who advocate federal reform seem to advance two major justifications for congressional intervention. First, tort law does not provide enough predictability to permit insurance carriers (or manufacturers who self-insure) to adequately assess potential risk and establish their premiums (or reserves). Second, tort law is not uniform—that is, national manufacturers of products must comply with the tort liability law of fifty different jurisdictions and thus can not make unified design and marketing decisions.

### Predictability

Products liability rules vary within single jurisdictions and among the states. Some decisions are difficult to defend. This must cause some uncertainty.

In response, several federal legislative proposals seek to address the two core issues in any products liability case: (1) the definition of defect, and (2) the definition of consumer misbehavior sufficient to create a defense to liability. For these two

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failure to warn. *Id.* at §6. Express warranties are limited to material facts. *Id.* at §7. These provisions carried through the various proposals but were omitted from S.2760.

7. S.2760, *supra* note 1, at §308.

8. INTERAGENCY TASK FORCE ON PRODUCTS LIABILITY, *supra* note 1, at V-9—13.

fact-sensitive questions, I am skeptical that legislation can provide a more predictable or more uniform standard unless the standard is either so restrictive as to deny recovery in most cases or so liberal as to permit recovery in most cases.

Those promoting legislative codifications of these issues are displaying extraordinary impatience with the courts. I am reminded of my own children who criticize the limits of technology they were borne to, while I am still amazed at its accomplishments. For me, *Greenman v. Yuba Power*<sup>9</sup> was a case handed out in first year torts class in 1963 in mimeographed form (I mean mimeographed not photocopied).

Given the superficial analysis provided by Judge Traynor as to both the holding and the justifications for the decision in *Greenman*, I think the courts have made remarkable progress in the twenty years they have worked at fashioning a system of liability for product injuries. The process, I suspect, is not complete, as variations in fact patterns continue to emerge. But the incidents of uncertainty have been substantially reduced as the courts have used the traditional trial and error method of the common law to fashion a cohesive body of doctrine. The most a legislature could do now is to codify our current understanding in its incomplete form and thus prevent further fine tuning.

There are, however, procedural issues at the margin for which legislation is likely to be more effective. These issues are less fact-sensitive and often represent a relatively focused issue such as the scope of joint and several liability or the application of the collateral source doctrine. They are suitable for legislative resolution. However, most have little effect on the predictability of the law—indeed the issues are clear but found by some to be resolved improperly. They are not new issues, and the insurance industry has accounted for their operation in other areas of tort law for many years.

The Senate seems recently to have recognized the limits of legislation as an art form. The intricate provisions redefining defectiveness in the context of manufacturing flaws, design flaws, and warnings cases have been dropped from the latest bill to be reported out of Committee. For the most part, the bill concerns itself with more focused procedural matters.<sup>10</sup> I will consider later in this commentary whether these narrower questions require a federal response.

### Uniformity

Those who advocate federal reform argue vigorously that product manufacturers who sell their goods in fifty states should be subject to a uniform law rather than fifty different definitions of defectiveness or fifty different rules on joint and several liability. Again, I am skeptical of many of the arguments that support the need for federal intervention in order to achieve uniformity.

I doubt there is as great a diversity in outcomes of product cases between jurisdictions as is claimed to exist. I recognize that competing rules defining defective

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9. 59 Cal. 2d 21, 377 P.2d 897, 27 Cal. Rptr. 697 (1963).

10. See *supra* note 6.

products either articulate different standards or establish different perspectives or provide for different burdens of proof.<sup>11</sup> There is variation in defining what misbehavior on the part of consumers or third parties should constitute a defense to liability. Some cases apply broad principles of contributory or comparative negligence;<sup>12</sup> others apply the *Restatement* formulation of assumption of risk and misuse.<sup>13</sup> Within the universe of products liability cases, these shadings of definition or switches in the burden of proof can only alter outcomes in a very narrow range.

Nowhere has the common law method been better illustrated than in resolving the initial confusion associated with the rejection of contributory negligence in favor of assumption of risk and misuse as a defense to strict liability. In short order a number of courts came to recognize that a contributory negligence defense, properly understood, created the proper incentive structure in the market place for products. Notwithstanding remaining differences between jurisdictions on this and other issues, there may be few differences in outcome and what difference there is appears to me to be narrowing.

Some procedural rules do make a difference in the magnitude of the potential liability. Abandonment of joint and several liability, ceilings on damage recovery, and the limitations on punitive damages could impact on the size of verdicts or their enforcement. The culture of varying jurisdictions also affects the risks faced by manufacturers. Casual empiricism suggests that juries in California provide more liberal recovery than those in Nebraska. The fifty state supreme courts also appear to be more or less adventuresome and creative in incorporating or excluding marginal cases.

These premises lead me to several conclusions about the uniformity argument. I doubt that manufacturers adjust their designs, warnings, or manufacturing techniques to comply with the differences among jurisdictions in the common law of products liability. Even if there is greater diversity in the outcome of cases than I believe there is, there does not appear to be enough diversity to outweigh the economies of scale faced by product manufacturers. And as the producers themselves argue, the mobility of products prevents producers from knowing which state law will govern a risk that ultimately materializes.

In short I doubt if the *probability* of risk associated with the production of goods is dependent on which state law is applicable. Federal definitions of substantive doctrine, under each of the bills introduced to date, have relied on the state courts for implementation. This undercuts much of any residual potential for uniform law application. Juries and state courts would continue to apply federally imposed standards in a conservative or creative way free of any substantial review and synthesis by the federal appellate courts.

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11. Many jurisdictions follow the language of *Restatement (Second) Torts* §402A, which requires a showing of "unreasonably dangerous" in addition to "defectiveness." See generally Wade, *On the Nature of Strict Tort Liability for Products*, 44 Miss. L.J. 825 (1973). This analysis has been rejected in other jurisdictions. See, e.g., *Barker v. Lull Engineering Co.*, 20 Cal. 2d 413, 573 P.2d 443, 143 Cal. Rptr. 225 (1978). My impression is that in most products liability cases the distinction will not be determinative; it is only at the margin that the approach may make a difference.

12. *Codling v. Paglia*, 32 N.Y.2d 330, 298 N.E.2d 622 (1973).

13. *Henderson v. Ford Motor Co.*, 519 S.W.2d 87 (Tex. 1975).

The *magnitude* of the risks faced in different jurisdictions does vary. To the extent this variation in the sizes of potential verdicts creates uncertainty for the insurance industry in pricing their products, some federal intervention may be justified. Some uniformity may be achieved by a federal law on punitive damages, joint and several liability, and ceilings on damage recoveries.

### Federalism

Proposals for federal legislation that preempt an area of traditional state concern should bear a heavy burden of justification for overriding state autonomy. However creative or useful federal reform proposals may be, the choice between federal or state action should not be ignored.

Under current interpretations of the commerce clause, Congress presumably has the authority to enact a preemptive product liability reform act. However, deference to state authority may be justified on several policy grounds. These policies may justify restraint in the exercise of the full limits of federal power.<sup>14</sup>

Justice Brandeis, among many others, has observed that states offer us competing laboratories in which real life experimental solutions to problems can be attempted.<sup>15</sup> Notwithstanding our advances in social sciences, prediction of the consequences of social reform remains imperfect. Social problems tend not to have right or wrong solutions but require trade-offs among a variety of competing interests. State experimentation permits the simultaneous implementation of different solutions.

The adverse consequences of misconceived solutions at the state level are confined to that state. More importantly, one can achieve some comparative measurement of the consequences produced by a variety of plausible reforms. Each state provides a yardstick against which to measure the costs and benefits of another state's reform. The experience with no-fault automobile plans may be illustrative. After failure of a federally required no-fault bill, the states enacted diversely tailored plans that balanced the claims for quick compensation against the incentive features of the tort system.

State action also permits the law to account for a wider diversity of tastes than federal action. Citizens of different states may have different tastes relative to a variety of matters, including the tort system. Whether private parties should be encouraged to sue because of the prospect of punitive damages, whether the exclusivity of the workers compensation system should be breached by products liability claims, whether retailers should act as surrogate defendants for their suppliers, all seem to be issues on which reasonable societies might differ.

The choice between state authority and federal authority is the choice between competition and monopoly. States may be viewed as competitors with each other and

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14. See generally *Federalism*, 89 *YALE L.J.* 1018-1296 (1977); *Symposium on Federalism*, 6 *HARV. J.L. & PUB. POL'Y* 1-147 (1982).

15. *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting) ("It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.").

restrained in their policy choices by competition from other states. Some advocate federal action because of the alleged relative ease with which special interest groups such as trial lawyers might prevent meaningful reform. It is plausible that the risk that state legislatures will be influenced by special interest groups may be greater at the state level. However, the consequences of the risk of special interest power at the federal level are considerably higher. Beyond that, the competitive pressure from other states may restrain the influence of special interests and the willingness of state legislators to depart from a moderate course.

State autonomy is more difficult to defend where there are spillover effects—where the citizens of one state are forced to bear the costs of the policy decisions in another state.<sup>16</sup> Advocates for federal legislation seem to me to have their strongest case here. Under current law, liberal liability states impose the costs of their taste for ample recovery on citizens of conservative liability states through nationally rated insurance premiums. Three plausible causes account for nationally rated premiums: (1) the inability of a manufacturer to limit the state law that will be applied to any particular product since the mobility of products creates a national risk; (2) the scale of large numbers needed to make the insurance mechanism work may require pricing premiums on the basis of national risks; or (3) there is insufficient competition in the insurance industry to produce state-rated premiums.

What this analysis suggests is that federal legislation should be directed at providing methods to reduce the spillover effects of state product liability laws. Such legislation could come in many forms.

For example, manufacturers could be permitted to designate the state law applicable to their liability just as corporations are permitted to incorporate in their state of choice. If Californians wanted liberal liability recovery, they could purchase “California” products which would be priced accordingly. If they preferred “Nebraska” products with reduced liability protection, they might be permitted to buy them.<sup>17</sup> This suggestion is not unlike the power of parties to a contract, within limits, to designate the law governing their contract.

Alternatively, Congress might enact conflict of laws rules to require that a product be subject to the laws of the state in which it was originally sold. Problems of proof would not be unlike those confronted in the “original package” cases under the commerce clause. And for some classes of products—such as machines—proof would be relatively easy. In fact, manufacturers of machine tools should be able to predict today the law applicable to particular machines sold.

Federal legislation might facilitate competition in the insurance industry to provide a better test as to whether there are, in fact, inherent reasons why state based premiums could not be charged. The recent Risk Retention Acts,<sup>18</sup> which permit

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16. For a good discussion of the spillovers in the context of environmental protection, see Stewart, *Pyramids of Sacrifice? Problems of Federalism in Mandating State Implementation of National Environmental Policy*, 86 *YALE L.J.* 1196 (1977).

17. There would remain the problem of injured bystanders who might be given a claim against the purchaser for the difference between the liability in the state of the accident and the designated state.

18. 95 Stat. 949 (15 U.S.C. §3901), as amended by 100 Stat. 3170 (October 17, 1986).

producers of goods to combine to self-insure and thus create more competition in the insurance industry, may be at least a step in that direction.

Attention to issues of federalism may reveal a few areas where federal action is both required and appropriate. The potential application of punitive damages to a national manufacturer by multiple jurisdictions for a single act may be the type of problem only resolvable by national legislation. Similarly, there may be some classes of products or market conditions that require federal legislation because of the inherent spillover effects. One might argue that vaccines against disease or risks arising from nuclear power plants are examples of risks that have such uncontrollable spillover effects that federal action is required.<sup>19</sup>

There appears to be real concern that products liability laws place American producers at a competitive disadvantage with foreign producers who can insulate themselves from the collection of judgments. Some federal attention might properly be directed toward assuring that the manufacturers of imported goods are financially responsible for their products liability exposure. And the federal government may have the resources required to collect data to evaluate the "experiments" of the states.

These principles of federalism underline my objection to the expedited settlement procedure for product liability claims contained in S.2760.<sup>20</sup> Under this procedure, either the plaintiff or the defendant may make an offer of settlement agreeing to accept or to pay "net economic loss" and "dignitary loss." Net economic loss is economic loss reduced by collateral source payments; dignitary loss applies in four narrowly defined situations and is capped at \$100,000. If a defendant refuses to accept such an offer made by the plaintiff and the ultimate judgment is equal to or greater than the value of the offer, the defendant is forced to pay up to \$100,000 in reasonable attorney's fees. If a plaintiff refuses to accept such an offer made by the defendant and the defendant is held liable, the plaintiff can only recover net economic loss and up to \$250,000 of noneconomic loss.

However innovative the procedure might be, imposing it nationwide without the slightest understanding of the incentives it is likely to create seems to be extraordinarily risky. The limitation for noneconomic loss recovery to \$250,000 and the ceiling on attorney's fees of \$100,000 if the defendant refuses a settlement offer will have greater impact on liberal recovery states than on conservative recovery states. The slant in favor of wage earners as opposed to nonmarket workers may not satisfy the tastes of some state electorates. As the no-fault experience illustrates, there is more than one way to define a threshold for recovery of "dignitary loss" and at least I am not aware that one has been proven significantly more satisfactory or effective than another.

It is unlikely that pressure for a products liability bill and perhaps a more general tort reform measure will abate in the next session of Congress. The substantive issues in tort reform are both important and sensitive; however, the preemption of state

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19. See Anderson-Price Atomic Energy Damages Act, 42 U.S.C. §2210 (1986); National Childhood Vaccine Injury Act of 1986, Pub. L. No. 99-660, 99th Cong., 2d Sess. (1986).

20. Tit. II of S.2760, 99th Cong., 2d Sess. (1986).

diversity by federally imposed tort law runs very substantial risks of its own. For cases of product caused harm, the need for uniformity and predictability may be overstated. Some attention by Congress to ways to reduce the spillover consequences of each state's law might be not only a compromise but also a sensible solution.