IV. LIABILITY FOR DAMAGE CAUSED BY PRODUCTS INTENDED FOR OR INVOLVED IN INTERNATIONAL TRADE

A. Report of the Secretary-General: liability for damage caused by products intended for or involved in international trade (A/CN.9/133)*

CONTENTS

INTRODUCTION

1. The United Nations Commission on International Trade Law considered at its eighth session (1-17 April 1975) a report of the Secretary-General on "Liability for damage caused by products intended for or involved in international trade".** The Commission decided to continue work in respect of this subject and requested the Secretary-General "to prepare a further report for consideration by the Commission, if possible at its tenth session, that would examine, *inter alia,* the following issues:

(*a*) The extent to which the absence of unified rules on products liability affects international trade;

(*b*) The practicability and advantages of unification at a global level, as opposed to unification at a regional level;

(*c*) The relationship between this subject and schemes of insurance which have been or may be developed in relation thereto;

(*d*) The extent to which and the manner in which liability may be limited, and the possible effects of different techniques of limitation;

(*e*) The types of product in regard to which liability should be imposed;

(*f*) The classes of persons on whom liability may be imposed and the classes of persons in whose favour liability may be imposed, with particular reference to the protection of consumers;

* 12 April, 1977.

** A/CN.9/103. Yearbook . . . , 1975, part two, V.

(*g*) The kinds of damage for which compensation may be recoverable;

(*h*) The kinds of transaction falling within the scope of the proposed uniform rules;

(*i*) The relationship between any proposed uniform rules and standards of safety in relation to products which are mandatorily imposed in many States by national law".[1]

2. In addition, the Commission "was of the view that the Secretariat should also consider the advisability of circulating, at an appropriate time, a questionnaire designed to elicit information on relevant legal rules and case law, and also on governmental attitudes to the issues involved".[2] Following this suggestion, the Secretary-General circulated a questionnaire to Governments under cover of a note verbale of 26 March 1976. The 35 replies which were received until 31 March 1977 are examined in the analysis reproduced in document A/CN.9/139.*

3. This report has been prepared in pursuance of the above decision, taking into account the information provided by Governments in their replies to the questionnaire and the views expressed by representatives to the Commission at its eighth session.

4. The consumption or the use of a product sometimes leads to injury or damage. Then, questions arise as to whether, from whom, under what circumstances, and to what extent the victim can get compensation. The report deals with these questions.

5. Civil liability for damage caused by products can be considered as a conventional subject of the law and as a new legal development. Traditionally, the liability for damage caused by goods with harmful qualities has primarily been viewed in the context of the contractual relationship between the seller and the buyer. Only in exceptional cases has liability for such injury been imposed under the general law of torts.

6. The new development is characterized by an awareness of the unique features of product hazards and by particular policy considerations that suggest the treatment of "products liability" as an independent subject of the law. Reflecting a growing concern for consumer protection, the new approach tends to be more embracing in that it extends to persons other than the immediate contractual parties and somehow eases the victim's burden of proving fault.

7. This evolution of products liability law is stimulated by such factors as: the considerable increase in production and consumption; the appearance on the market of new and complex goods which are often made in large-scale manufacture and complicated machine processes; the handing down of ready-made consumer goods to the ultimate buyers via long distribution chains; the use of containers and packages which minimize the possibility of exercising intermediate control; and the use of advertisements inducing consumer reliance. These and other contributing factors are primarily found in industrialized countries. But they are not without relevance to other States, firstly, because of increasing imports of industrial goods into such other regions, and, secondly, because similar economic developments are in these States under way and to some degree already existent.

8. It is in the context of world trade that the diversity in the law pertaining to products liability is most troublesome and gives rise to certain problems that could be mitigated by the adoption of a uniform liability scheme.

9. The following approach has been chosen for the present report. Part I examines the special features of products liability and evaluates general policy considerations. Part II discusses various concepts of liability with a view to determining an appropriate basis of uniform products liability. Part III sets out and evaluates the arguments pertaining to certain additional requirements and elements which relate to the scope and extent of liability. Part IV examines the insurance implications of such proposals pertaining to basis or extent of liability and considers further relevant issues of products liability coverage. Finally, suggestions as to a possible future course of action are submitted to the Commission for its consideration.

PART I. THE EVOLUTION OF PRODUCTS LIABILITY LAW: GENERAL POLICY CONSIDERATIONS

1. This part of the report will be devoted to an examination of the major policies which have influenced, if not determined, the development of products liability law as a unique régime of liability for product-caused damage. These policy considerations, which will be discussed under the three broad groupings of: (*a*) consumer reliance; (*b*) risk creation and control; and (*c*) cost allocation and loss spreading, are relevant not only to the determination of the basis and extent of a uniform liability scheme, but also to such issues as who should be made liable and for whose benefit.

2. However, useful as these policy considerations are, they cannot by themselves provide an easy solution to all the problems of product liability: their persuasiveness varies from one case to another and has to be assessed in the context of particular economic facts and social demands.

A. *Consumer reliance on producer*

3. The first policy consideration to be examined is "consumer reliance". The fact that consumers and users do not expect products to be dangerous is, of course, nothing new. Nevertheless, reliance on the safety of goods used or consumed has gained significant new dimensions. This reliance is shaped and accentuated by various factual changes in production and distribution patterns: large-scale manufacture, production of complex and highly sophisticated goods and modern distribution methods, at the apex of all of which stands a producer who is less and less likely to be a party to the final sales transaction with the ultimate consumer or user.

Evolution of consumer reliance rationale

4. Historically, the consumer reliance argument was first stressed in respect of packed or canned goods, particularly food. It was, for example, recognized in the famous British landmark decision of *Donoghue v. Stevenson* [1932] A.C. 562 which has been followed in many Common Law jurisdictions. In that case, the plaintiff had

[1] *Official Records of the General Assembly, Thirtieth Session, Supplement No. 17* (A/10017), para. 103; Yearbook . . . , 1975, part one, II, A.

* Reproduced in this volume, section B, below.

[2] *Official Records of the General Assembly, Thirtieth Session, Supplement No. 17* (A/10017), para. 102; Yearbook . . . , 1975, part one. II, A.

alleged injury as the result of consuming ginger beer from an opaque bottle which contained the decomposed remains of a snail. The guiding reason for liability, as expressed by one of the judges, was that the manufacturer had sold his products "in such a form as to show that he intends them to reach the ultimate consumer in the form in which they left him with no reasonable possibility of intermediate examination" (*ibid.*, at 599).

5. This idea helped to pave the way for the protection of consumers other than ultimate purchasers by imposing liability on producers who previously had been shielded by what has been called the "fallacious conclusion that the manufacturer of a defective article owed a duty to those alone who were in contractual privity with him".[1]

6. Such a shift in emphasis from the contractual party (usually the retailer) to the party on whom reliance was placed (often the producer) has not, however, been limited to situations involving packaged products, for there were concurrently other developments which came to be recognized as prompting legitimate consumer reliance. Foremost among these was the increasing complexity and sophistication of products which, as has been observed, "no longer permits the user to make an informed choice but forces him to buy on trust".[2] Indeed, as far back as 1953 Justice Jackson of the U.S. Supreme Court expressed similar sentiments in the following statement of the reason for the erosion of the doctrine of *caveat emptor* (buyer beware):

> "This is a day of synthetic living, when to an ever-increasing extent our population is dependent upon mass producers for its food and drink, its cures and complexions, its apparel and gadgets. These no longer are natural or simple products but complex ones whose composition and qualities are often secret. Such a dependent society must exact greater care than in more simple days and must require from manufacturers or producers increased integrity and caution as the only protection of its safety and well-being. Purchasers cannot try out drugs to determine whether they kill or cure. Consumers cannot test the youngster's cowboy suit or the wife's sweater to see if they are apt to burst into fatal flames. Carriers, by land or by sea, cannot experiment with the combustibility of goods in transit. Where experiment or research is necessary to determine the presence or the degree of danger, the product must not be tried out on the public, nor must the public be expected to possess the facilities or the technical knowledge to learn for itself of inherent but latent dangers."[3]

Multiplicity of products and consumer reliance

7. Consumer reliance is also influenced by the fact that more and more new items are continually being introduced into the market. The novelty factor is aggravated by the modern fact, lately realized, that some product hazards only materialize many years after the circulation and use of the dangerous products. In this connexion, one should bear in mind the fact that not every product-related injury is a momentary damage resulting from an accident and caused by a single defective product; an injury could be the result of a cumulative damage which developed gradually from the prolonged use of one or more products of the same or different kinds. This latter type of damage, as has been pointed out, "frequently cannot be specified, nor can the causality be completely clarified. The development is slow and cumulative, so that the presence of danger and of injury may not manifest itself for many years or for generations."[4]

Advertising and consumer reliance

8. Yet another factor shaping consumer reliance is the widespread and modern use of advertising. By various techniques of mass advertising, the manufacturer or sometimes the distributor represents his products to the public as suitable and safe for use or consumption. While it may be an exaggeration, perhaps even a gross one, to allege, as one commentator has,[5] that "a large proportion of mass products are consciously made as inferior as the traffic will bear and are advertised by conscious misrepresentation as far superior to their known quality" and that "[t]he combination of low quality production and high quality lying makes it impossible for those using the products of mass manufacture to distinguish good merchandise from bad without the services of a general testing laboratory," the fact remains that advertising does invite and achieve reliance, with varying degrees of success, a situation to which, it may be thought, the law should respond.

9. One other significant aspect of advertising is that it is largely indiscriminate in the sense that the advertiser addresses himself to the public at large, whether by newspaper, radio, or television, building up the psychology to consume his product. This invitation extends not only to potential purchasers but reaches other consumers or users as well. The advertiser thereby creates or strengthens demand for his product among, for example, family members or employees who in turn may influence the buyer's choice and later themselves rely on the safety of the product when consuming or using it. Thus, there is often a psychological connexion reaching beyond the ultimate puchaser, the last contract party in the chain of distribution.

10. Deserving of notice too with respect to advertising is the effect which advertising by the producer or wholesale distributor has on the retailer. The latter's choice as to what brands to carry depends largely on the consumer demand created by advertisements, and in his role as distributor he is often "no more than a conduit, a mere mechanical device, through whom the thing sold is to reach the ultimate user".[6] It is not surprising, therefore, that, according to one British survey, "most people believe that the primary responsibility for defects in products rests upon the manufac-

---

[1] John G. Fleming, *The Law of Torts*, 4th ed. (Sydney, Law Book Company, 1971), p. 443.

[2] J. Comte, "Communication au nom de l'Union des Industries Chimiques", in *La responsabilité civile du fabricant dans Les Etats membres du Marché commun*, Aix-Marseille, Faculté de Droit et de Science Politique, 1974, p. 208.

[3] *Dalehite v. United States*, 346 U.S. 15, pp. 51-52.

[4] B. Dahl, "Product liability in Scandinavian law", *Scandinavian Studies in Law*, 1975, p. 64.

[5] Thomas A. Cowan, "Some policy bases of products liability", *Stanford Law Review*, vol. 17 (1965), p. 1087. The contrary view has been advanced that the producer may quite often be acting in legitimate response to consumer preference for lower quality goods at lower prices (McKean, "Products liability: trends and implications", *University of Chicago Law Review*, vol. 38 (1970), p. 59).

[6] William L. Prosser, "The assault upon the citadel (Strict liability to the consumer)", *Yale Law Journal*, vol. 69 (1960), p. 1123.

turer rather than upon the retailer".[7] However, such belief is not restricted to advertised products, being in part attributable to the other factors which create consumer reliance and in part to the fundamental idea that the producer creates the danger and is in the best position to control the risk.

B. *Risk creation and control*

11. The second of the policy considerations to be discussed, "risk creation and control", relates to society's reaction to the activities of some of its members which create the risk of loss to others. Proponents of liability for such activities argue that one who creates a risk which materializes in damage to others ought to compensate such victims for their loss. In other words, liability is justified, in the context of products liability, because the damage would not have occurred but for someone producing and circulating a hazardous product.

Risk control and deterrence

12. Besides this "risk creation" justification of liability if harm occurs, the very threat of liability is said to condition the producer, who is best able to control the danger, to be more safety conscious, thereby preventing injury in the first place. The deterrence rationale for product liability is succinctly set forth in a now classic statement by the American Judge Traynor, who said that: "Public policy demands that responsibility be fixed wherever it will most effectively reduce the hazards to life and health inherent in defective products that reach the market. It is evident that the manufacturer can anticipate some hazards and guard against the recurrence of others, as the public cannot."[8]

13. Deterrence, like other policy goals, will not, of course, be achieved in all cases where protection is desirable. In various instances, for example, there may be no deterrent effect because producers already do their best to prevent injuries, particularly when they have to operate in the midst of strong competition. Nevertheless, it is not to be doubted that the extent of liability exposure is a motivating factor in most cases where additional safety incentives seem appropriate. Circumstantial evidence to this effect may be obtained from the experience in the United States where there has been a notable expansion of liability for defective products. A recent report of the U.S. Department of Commerce, for example, mentions "increasing production expenses, *i.e.* quality control, recall, redesign" as one of "the most significant effects of increased product liability".[9]

14. Manufacturers there have reportedly taken the following actions, among others, to protect themselves (as well as their insurers who often suggested or insisted on such measures): established national standards organizations; adopted standards set up by governmental agencies and national societies as performance minima; made increasing use of independent laboratory certifications; tightened up advertising and design; developed closer control on manufacturing methods and personnel; instituted better quality control procedures; expanded the risk management function; established independent corporate level safety watchdog committees; hired independent consultants; and, in the case of some toy makers, wholesalers, and dry cleaning companies, even dropped product lines.[10]

15. Providing incentives for greater safety and shifting the loss from the victim to the responsible producer could, each in its way, further the same public policy goal of consumer protection. Although it is impractical to expect maximum possible protection for the consumer, if only because the measures required to guarantee completely safe products under all circumstances would put the price of most products out of the reach of the average consumer, nevertheless, the deterrence objective of product liability can fairly be to secure as much protection for the consumer as seems reasonable, taking into account economic considerations as well as other policies.

The economic burden argument

16. The fear is often expressed that holding producers liable for damage caused by their defective products might subject them to too heavy an economic burden. This fear, though legitimate, appears sometimes to be exaggerated. In many cases, the cost of safety measures is minimal, particularly when compared with the amounts spent on advertising. It has been noted, for example, that the cost of reducing injuries from exploding soft drink bottles, through 100 per cent pressure testing, works out to less than two tenths of a cent per bottle, and that the cost of colouring poisonous polish, so children would not mistake it for milk or syrup, is next to nothing.[11]

17. Furthermore, all that may be needed to prevent injury in many cases is merely to require producers to give proper instructions and adequate warnings to the prospective consumer or user. Providing such information often costs less than other safety measures and would rarely constitute a crushing burden on the enterprise. There are also many instances where little or no costs are incurred in modifying the product or improving relevant quality control.

18. It may be noted furthermore that no economic burden is placed on the production of goods which are not apt to cause harm entailing liability. And even in those cases where risk of harm seems unlikely and yet cannot reasonably be excluded, the producer may well, for economic reasons, decide to accept the small risk that someone might be injured and he be made to pay compensation rather than incur the higher costs of product alterations or of more intensive quality controls. He is the one best equipped to make that decision because he knows the product, its prospective use, its weaknesses,

---

[7] See *Liability for Defective Products*, Law Commission Working Paper No. 64, Scottish Law Commission Memorandum No. 20 (London, HMSO, 1975), p. 31.

[8] *Escola v. Coca Cola Bottling Co.*, 150 P. 2d 436 (Cal. 1944), p. 440.

[9] *Product Liability Insurance*, Report of the United States Department of Commerce (Washington, 1976), pp. 13, 15.

[10] Another indication of the potential deterrent effect of product liability is the success which has attended an annual "Product Liability Prevention Conference" which the New Jersey Institute of Technology has for the past seven years organized. The message of the workshop to manufacturers has been simply: "Use good manufacturing practice or else! Or else pay for product related injuries, for customer complaints, returns and replacements, for loss of business due to early product failures, and for inefficient methods of using labor and materials". (*Proceedings, PLP/76, Product Liability Prevention Conference* (Newark, New Jersey Institute of Technology, 1976), p. iii.)

[11] *Final Report of the National Commission on Product Safety* (United States, GPO, 1970), pp. 68-69.

and is most interested in keeping down his costs, including the cost of compensation payments.

19. Although therefore the threat of liability may in such a case have no actual deterrent effect, in so far as it does not bring about preventive measures, it is, nevertheless, a useful and necessary factor in forcing the producer to make that very decision.

20. The same consideration underlies the collateral reasoning for making the producer bear the risk of injury: "Where, in mass production, manufacturers find it more profitable to allow defects than to improve their standards of quality control, it may be argued that as between themselves and the injured person, the consequences of a defect should be borne by the manufacturer."[12]

21. This reasoning covers not only situations where the mere market conditions allow the profitable circulation of shoddy products, in which case additional liability seems needed as a balancing factor in favour of the victims, it applies also to instances where producers assign risks to consumers for reasons which are not necessarily reprehensible. Illustrations of that point are provided by the mass production method of sample testing.

22. In determining the sampling standard or the tolerance fraction, producers may set a relatively high level of the consumer's risk because they do not, perhaps cannot, exactly foresee and calculate the future risk exposure, or because they simply take a chance as entrepreneurs. It may also be that to a producer the setting of a lower risk level by intensifying the quality control would appear inadvisable, especially where the inspection of component parts of a highly complex product requires the destruction of the sample tested. Finally, the acceptance of a certain risk may be economically sound because the actual liability exposure is clearly lower than the costs of additional safety measures.

C. *Cost allocation and loss spreading*

The approach in general

23. The third policy rationale that has played a role in the development of products liability law is provided by the so-called "loss spreading" or "risk distribution" approach which argues for removing the economic consequences of accidents from the victim, and placing the risk on the enterprise in the course of whose business they arise. The risk, it is said, "becomes part of the cost of doing business and can be effectively distributed among the public through insurance or by a direct reflection in the price of the goods".[13]

24. Insurance, of course, by its nature and purpose, has a risk distributing effect. It eases the burden of the insured, providing him with fixed (premium) costs instead of uncertain liability exposure, and it spreads the risk over all policy holders, often utilizing the technique of reinsurance. Whilst this risk-distributing effect of third-party liability insurance is very important in practical economic terms and will be dealt with in a later part of the report devoted specifically to the subject (see part IV, below), it should be observed that it is not at the heart of the theory of product risk distribution. If liability insurance is taken out, the main and unique thrust of product risk spreading lies in the next step of cost allocation, as noted long ago by Judge Traynor of the California Supreme Court, who observed that:

> "The cost of an injury and the loss of time or health may be an overwhelming misfortune to the person injured, and a needless one, for the risk of injury can be insured by the manufacturer and *distributed among the public as a cost of doing business* . . . However intermittently such injuries may occur and however haphazardly they may strike, the risk of their occurrence is a constant risk and a general one. Against such a risk there should be general constant protection and the manufacturer is best situated to afford such protection." [Emphasis supplied][14]

25. The argument that the producer is the one best-situated to act not only as risk gatherer but also as risk distributor, spreading the loss over the community of consumers, applies not only to manufacturers who take out liability insurance and pass on the premium costs. Even with regard to self-insurers, who would pass on the costs of special money reserves or the expenses for meeting actual claims, one could adopt the same idea that "the loss should not be allowed to remain with the injured party on whom it fortuitously fell, but should be transferred to the manufacturer, who, by pricing his product, can spread it among all the consumers".[15]

26. In either case thus, the price paid by each consumer may be said to contain a small premium for accident insurance. To collect such contributions from all purchasers seems a good deal fairer than letting fate select the victim at random. To be sure, internal risk distribution amongst all buyers may operate whatever the basis of liability; under a fault system, for example, the premiums in the price of the merchandise are calculated to compensate for the consequences of fault. But the concept of what may be called here the "buyers' mutual benefit fund" and its resulting fairness tends to lessen the importance of the producer's wrongdoing and to emphasize the goal of compensating the unfortunate accident victims. It thus should be observed that the rationale of "enterprise liability", as this approach has come to be known, is not sufficiently expressed by the simple notion that the loss could be sufficiently redistributed by the proprietor of the enterprise: it rests rather on the additional consideration that spreading the risk

---

[12] *Liability for Defective Products*, Law Commission Working Paper No. 64, Scottish Law Commission Memorandum No. 20 (London, HMSO, 1975), p. 32.

[13] See *Goldberg v. Kollsman Instrument Corp.*, N.E. 2d 81, 85 (New York 1963). The risk-spreading rationale has also been used by the American Law Institute in justifying its proposed special liability rule for physical harm to user or consumer as distinguished from purchaser: "Public policy demands that the burden of accidental injuries caused by products intended for consumption be placed upon those who market them, and be treated as a cost of production against which liability insurance can be obtained". *Restatement of the Law (Second), Torts*, vol. 2 (St. Paul, Minn., American Law Institute Publishers, 1965), comment (*c*) to sect. 402A, p. 350.

[14] *Escola v. Coca Cola Bottling Co.*, 150 P. 2d 436 (Cal. 1944), p. 441.

[15] John W. Wade, "On the nature of strict tort liability for products", *Insurance Law Journal*, 1974, p. 142.

via purchase price is itself reasonable and meets the demands of distributive justice.

Risk distribution not always possible

27. A general objection that has been raised against the risk distribution rationale is that it assumes that a producer is always able to pass the risk on to the buying public, which may not be so. The example is then posed of a regulated industry whose prices and other terms are fixed or subject to approval by a public authority which is less likely to let rate scales rise in reflection of increased liability. It is asked in such a case how likely it is that the additional risk will be effectively distributed as a cost of doing business.

28. Admittedly, the extent to which a manufacturer may be free to "spread the risk" created by his product is debatable. The following general remarks could nevertheless be made in partial response. Accident costs or premiums are not different from other costs, including prevention costs. Thus, they may also be regarded as part of the typical business risk which is subject to consumer demand and other market conditions. Even the extreme case where one producer is by no means able to pass on the risk of his liability exposure to consumers could be viewed as not necessarily disadvantageous. As has been observed, "should an enterprise, due to market conditions, be forced out of business because its accident rate, reflected in its prices, makes its products noncompetitive, its resources will be available for other endeavours so that in net effect, the nation's resources will be better allocated in terms of consumer preferences".[16] Although such reallocation of resources could serve the public interest in many cases, it should, of course, be avoided in others, particularly where socially desirable and necessary production is at stake.

29. Secondly, prohibitive costs are less likely to materialize in the real world in view of the availability of liability insurance with its primary risk spreading effect. At any rate, one could also point out here that producers stand to gain by their manufacture and distribution and profit from their endangering activity.[17] While this argument may not be thought to provide by itself a sufficient reason for imposing liability on the profit-seeker, it does seem, together with the other relevant policy considerations, to provide a basis for the initial loss allocation to him.

30. In this context, though, it should be admitted that the producer often is not the only one profiting from the distribution of the product and furthermore is not necessarily always the best risk absorber. If so, it could be argued that no good reasons exist for regarding such a producer as the risk distributor. An intermediate seller may, for example, be considered as the appropriate target of liability policies, particularly "when, as is now often the case, the large wholesale supply house is actually the prime mover in marketing the goods, and the manufacturer only a small concern which feeds it".[18]

[16] Friedrich Kessler, "Products liability", *Yale Law Journal*, vol. 76 (1967), p. 928.

[17] See, for example, *Liability for Defective Products*, Law Commission Working Paper No. 64, Scottish Law Commission Memorandum No. 20 (London, Her Majesty's Stationery Office, 1975), p. 30; Jacques Ghestin, "Exposé introductif", in *La responsabilité civile du fabricant dans les Etats membres du Marché commun*, *op. cit.*, p. 23.

[18] William L. Prosser, "The assault upon . . .", *loc. cit.*, p. 1142.

PART II. BASIS OF LIABILITY UNDER UNIFORM SCHEME

A. *Contractual promise (including warranty)*

1. In search of an appropriate conceptual basis for a uniform liability scheme one could first consider basing the right to compensation on the breach of a contractual promise, including warranty. The contracts law approach has the advantage of familiarity, being the common approach in matters pertaining to commercial law. In particular, damage caused by defective products involved in international trade is related to the subject-matter of the draft Convention on the International Sale of Goods currently under consideration by the Commission.

2. The contract approach would also seem attractive because the allocation of risks, like the determination of the other relevant conditions of the contract, would be left to the negotiating parties who could set the level of "consumer's risk" and tailor the scope of liability according to their specific needs and interests. And it may even appear preferable in terms of consumer protection because contractual remedies are often provided irrespective of fault, particularly in cases of breach of warranty.

3. There are, on the other hand, many reasons militating against a product liability scheme founded on contractual principles. The ordinary laws of contracts may be thought to contain various rules and requirements which could make it difficult to achieve just and reasonable results in the very special area of compensation for product-related damage. Judged against the general policy considerations discussed in the previous part, genuine contracts law, that is to say, traditional contracts law unsupplemented by legal fictions provides an inadequate basis. Its inappropriateness has indeed often been stated to be a major stimulating factor behind the modern development of extra-contractual product liability.[1]

4. There are numerous rules, for example, which, while making good sense in a commercial transaction or similar special relationship, seem much less suitable for application in the context of an ordinary consumer's recovery for product-caused injury. One such rule, for instance, is the buyer's affirmative duty to inspect the goods immediately; another is the requirement of giving notice in due time of any defects; a third example is the usually short period of limitation or prescription, and finally the subjective foreseeability of damage as a limiting factor to recovery.

Privity doctrine

5. The difficulties presented by these and similar rules may not, however, be insurmountable since one could well imagine appropriate remedial provisions in an instrument of uniform law. Yet there remains one major feature and inherent principle of contract law which has to be viewed as the main "defect" of contracts

[1] See, for example, Peter Prag, "A comparative study of the concept and development of products liability in the USA, Germany and Scandinavia", *Legal issues of European integration*, 1975, No. 1, p. 67; Paul M. Storm, "Product liability in Europe", in *Proceedings PLP 76, Product Liability Prevention Conference* (Newark, New Jersey Institute of Technology, 1976), p. 1; Friedrich Kessler, "Products liability", *Yale Law Journal*, vol. 76 (1967), p. 881.

law for the purposes of product liability: the classic doctrine of "privity of contract" which restricts rights and remedies to the contracting parties, thus depriving third persons of protection and recovery.[2]

6. To be sure, so long as manufactured goods reached the ultimate consumer via a single sales transaction, the producer's liability for defective goods did not present a special problem. However, with the advent of mass production, large scale promotion and elongated chains of distribution, all of which are typical features of international trade in goods, a new situation is presented. Requiring privity would mean that the manufacturer quite often would be insulated against direct liability to the ultimate purchaser (let alone any non-buyer).

7. Although there remains even in such a case the possibility that he may eventually be reached indirectly, by way of recourse proceedings in the chain of distribution, such revolving procedures may be interrupted by insolvency, lack of jurisdiction, limitation or disclaimer anywhere along the chain of contracts. Above all, such recourse procedures can be time-consuming and costly.

8. The idea of "short-circuiting" this rather cumbersome procedure has, therefore, rightly been advanced as a major policy argument in favour of imposing direct liability on the producer in the interest, not only of the consumer, but of the courts, and even of the suppliers themselves.[3] The aim of saving legal costs by allowing direct claims has also been noted by the English and Scottish Law Commissions, noting the English case of *Kasler v. Slavouski* (1928) 1 K.B. 78, in which there were four successive stages of indemnity for a retailer's liability to his customer who had contracted fur dermatitis.[4]

9. The difficulties of the privity requirement become most apparent in cases where a person beyond the ultimate purchaser is injured, e.g. the buyer's spouse, child, guest, employee, or donee. At least where personal injury or actual property damage is caused by defective products, the distinction between the contracting consumer on the one hand and everybody else on the other hand becomes difficult to sustain.[5] This is particularly so because it is often a matter of chance who will be injured by a defective product—the purchaser himself, his family, his guests or perhaps an outside third party.

10. This view derives from a recognition of the essential difference in function of contractual compensation and product liability. Contract remedies may be granted to make up for loss caused by the inferior value of the goods sold, i.e. to compensate the purchaser for not having fully received what he paid for. Such non-fulfilment of contractual expectations ordinarily results in economic loss due to the lowered value of the goods to the buyer, and it typically affects primarily the buyer as such. Product liability, on the other hand, aims at compensating any victims for injuries suffered from active malfunctioning of products. Therefore, the policies and liability reasons focus on the material fact that defective goods are circulated and reach consumers and users, the underlying contracts being viewed merely as the legal forms or "vehicles" of product distribution.

Warranty liability

11. The outlined distinction is also discernible, though less apparent, as applied to liability founded on warranties. While this device sometimes is favoured as a means of imposing liability irrespective of fault, its main function relates to matters and purposes different from the ones at stake in product liability. Firstly as to content, warranties rarely concern themselves with the safeness for use of the goods but rather with specifications bearing on the goods' value and usefulness, such as durability, fitness for special purpose, performance or output level. Furthermore, even where quality conditions relevant to safety are warranted, the ordinary remedy envisaged is not compensation for consequential injury but the genuinely contractual right of avoidance, reduction of purchase price, replacement or repair.

12. The one remaining situation of pertinence to product liability is the situation where consequential damage results from the breach of an express warranty of a safety-related nature (e.g. shatterproof windshield) or of an "implied" warranty that the product is safe for normal use or consumption. Even here, however, claims based on such warranties, whether expressly stated or implied, may, under pure contracts law, be brought only against the immediate seller as the other party in privity.

Legal fictions in aid of contracts law

13. One consequence of the obstacles posed by the privity doctrine to compensating victims of product-caused injuries was the evolution in many jurisdictions of a number of artificial devices and legal fictions designed to circumvent the privity obstacle in an appropriate case. Thus, for example, with respect to defective goods something like twenty-nine different theories were evolved at one time in the United States to sustain the conclusion that there was liability without negligence and without privity of contract.[6] Similarly characterized as "artificial" in this context is the French legal doctrine that the professional seller, particularly the producer, is presumed to know the defects in his goods.[7]

14. The need to resort to such artificial devices and legal fictions may be thought to reveal the basic inadequacy of ordinary contracts law as a basis for a product liability régime especially on the international level, leaving as the only alternative a concept of an extra-contractual nature. Such a concept could nevertheless incorporate the notion of warranties by defining "defect" with reference to particular consumer expectations.

15. The goal of equal protection for all product victims would seem furthermore to favour the enactment of uniform rules which are extra-contractual in the sense also that they are applicable irrespective of any existing contract between plaintiff and defendant. One would thus differ in this respect from the Hague Convention on

[2] As to this principle and certain exceptions thereto, see replies of Governments to questionnaire, Analysis, sect. II, A, Qs. 3 and 5, paras. 2-6.

[3] William L. Prosser, "The assault upon the citadel (Strict liability to the consumer)", *Yale Law Journal*, vol. 69 (1960), p. 1124.

[4] *Liability for Defective Products*, Law Commission Working Paper No. 64, Scottish Law Commission Memorandum No. 20 (London, HMSO, 1975), p. 32.

[5] See, for example, J. A. Jolowicz, "The protection of the consumer and purchaser of goods under English law", *Modern Law Review*, vol. 32 (1969), p. 6.

[6] William L. Prosser, "Products liability in perspective", *Gonzaga Law Review*, vol. 5 (1970), p. 160.

[7] See, for example, P. Malinvaud, "La responsabilité civile du fabricant en droit français", in *La responsabilité civile du fabricant dans les Etats membres du Marché commun*, *op. cit.*, p. 138.

the Applicable Law to Products Liability.[8] The question of the relationship between such uniform law and national contract rules, including uniform sales law, is a different problem which will be addressed later in this report. (See below, part III, H).

B. *Negligence*

16. The first concept of extra-contractual liability to be considered is "negligence" which constitutes the major cause of action in a tort system based on the fault principle. Under a "negligence" régime of product liability damages would be recoverable if a product-related harm was the result of negligent conduct, such conduct being defined as behaviour below the standard of care to be expected of a reasonable person in the situation at hand. This foundation of liability could even be viewed *a fortiori* as including intentional wrongdoing which by itself would be unsuitable as a basis of liability because of its rare occurrence.

17. Three main arguments may be advanced in favour of the negligence concept: its widespread recognition; its moral appeal; and its less burdensome effect on industry and business. In the following paragraphs, these reasons will be elaborated and evaluated, though only tentatively and generally. Their persuasiveness, it must be noted, depends very much on the policy objectives and value system against which they are judged.

Widespread recognition

18. The factor of widespread recognition is naturally of special relevance to the unification of law on a global level. As replies to the questionnaire on products liability show, liability for negligent conduct seems to be universally recognized.[9] In particular, it is in most countries the normal, if not the only, basis of extra-contractual liability for product-caused damage, although the extent of liability and the burden of proof vary considerably among countries. Furthermore, even those systems which impose strict liability tend to have concurrent liability for negligence. Thus, choosing negligence as the basis of a uniform product liability law would seem to have the advantage of harmonizing with existing legal rules and concepts.

19. Against this advantage one could post the following considerations: that the project of unification, if it should be embarked upon, would not materialize for many years to come; that by that time one would expect greater industrialization world-wide with many more countries having become industrialized or quasi-industrialized and still more well along a similar path; that with industrialization there is generally a trend, spurred by consumer protection demands, away from traditional negligence requirements and towards a stricter basis of product liability; that consequently it may be advisable to look ahead and anticipate such legal developments in a régime intended to govern well into the future. Indicative of the noted trend are the various projects of law reforms, not only on a national level, but also on the regional international level.

20. There are, for example, the draft directive of the Commission of the European Communities and the Convention of the Council of Europe, both of which propose a liability system that is stricter than negligence. The Committee of Experts of the latter organization, for instance, found "that the notion of 'fault'—whether the burden of proof lay with the person suffering damage or with the producer—no longer constituted a satisfactory basis for the system of products' liability in an era of mass-production, where technical developments, advertising and sales methods had created special risks, which the consumer could not be expected to accept".[10]

Moral appeal of negligence principle

21. Such regard for special characteristics could also help in evaluating the second reason stated in favour of the negligence concept, i.e. its moral appeal. The moral appeal of negligence as a basis of liability stems from the acknowledged moral principle that a person should only be held liable for his action if he is "at fault", that is, in this case if his action falls below a standard recognized by the law as reasonable and desirable. If his conduct is in conformity with that standard, he is on this principle not blameworthy. Furthermore, as between two persons, neither of whom is blameworthy, the loss should lie where it falls (*"casum sentit dominus"*). Thus, the fault idea is said to serve justice by exempting any defendant who is as innocent as the plaintiff.

22. To focus exclusively on personal guilt may not, however, be very appropriate in the particular context of product liability. If one followed the rationales for product liability discussed in the preceding part, particularly "consumer reliance" and "consumer's risk assignment", emphasis should be placed less on the blameworthy behaviour of a single person and more on the circulating of defective and dangerous products.

23. The solution of letting the loss lie where it falls may also be criticized on the ground that it is based exclusively on the two-party relationship between defendant and plaintiff. Such a view may be thought too narrow under the "theory of risk distribution" which, as has been shown, aims at spreading the loss over all buyers of the particular product involved. Its "buyers' mutual fund" effect serves the goal of distributive justice and from the point of view of fairness might well be adjudged to have stronger moral appeal than the principle of personal fault underlying the negligence concept.[11]

---

[8] The second paragraph of article 1 of that Convention states that: Where the property in, or the right to use, the product was transferred to the person suffering damage by the person claimed to be liable, the Convention shall not apply to their liability *inter se*.

[9] Analysis, sect. II, B, 1, Qs. 1 and 2, paras. 2, 4-7.

[10] *Explanatory Report to Draft European Convention on Products Liability in regard to Personal Injury and Death*, Council of Europe, document CCJ (76) 41 add. IV, para. 10.

[11] The following historical note may be added to the discussion on the morality issue. It seems noteworthy that the fault principle, which today appears to be so deep-rooted and self-evident, was apparently not dominant at the early stages of civil liability. Like other legal systems, for example, the ancient Common Law "made a man act at his peril" and did not so much regard the fault of the actor, "as the loss and damage of the party suffering" (J. A. Kluwin, "Analysis of criticisms of the fault system", *Insurance Law Journal*, 1969, p. 390). Thus, until the industrial revolution in the nineteenth century, when civil liability was subjected to the general test of fault, the law basically imposed liability for causation rather than fault. As Fleming, commenting on this shift, observed: "We should hesitate to attribute this startling change of attitude to a 'moral advance' of the times; rather was it due to a calculated policy of encouraging the burgeoning industry of the new machine age". (John G. Fleming, *The Law of Torts* (Sydney, Law Book Company, 1971), p. 271.)

Protective effect of fault requirement on industry

24. The third, and in a sense strongest, argument in favour of the negligence concept is the fear that to dispense with the fault requirement could lay a prohibitive burden on industry, stifling growth and innovation especially of younger industries. This view which has been strongly voiced by business and other interested circles in industrialized countries in connexion with legal developments expanding liability for product-caused harm may well be thought to apply with greater force to the situation of those countries about to embark on or already in the midst of developing their industrial potential. The issues raised here are of critical importance and require careful consideration especially in a project of law unification within the framework of the United Nations. The following considerations may be thought relevant to an evaluation of these issues.

25. The first consideration is one of social policy. "No liability without fault" was a slogan of the nineteenth century philosophy of "laissez-faire", "the banner", it has been said, "of an individualistic society set on commercial exploitation and valuing property rights more highly than legal protection against physical injury".[12]

26. In contrast, industrial development is nowadays widely regarded as but one priority goal which should not be achieved in isolation from social development, particularly safe living conditions. This idea that economic growth should not infringe on the quality of life, but improve it, is of special relevance in the area of product liability and may be thought to lead to the conclusion that the development of production and trade should not be at the expense of fortuitous victims of defective products.

27. The protection-of-industry argument in favour of the negligence concept seems also to lose much force if one considers closely the export situation of developing countries in the absence of global unification of liability. A substantial and increasing amount of their products will be shipped into markets (in developed countries) where the law of the place, if applicable, as it often is, would subject them to liability irrespective of proof of fault. And in still many more countries they have to comply with often sophisticated and demanding safety standards, either by reason of competition or by virtue of import regulations. This means that if the trend in the developed countries continues, the situation would result in which only a few countries, usually developing countries, would remain as export markets in which the fault principle could, in practice, have any real protective effect for the industry of the exporting country.

28. Another reason which may be thought to undercut the protection argument as applied to developing countries is the direction of flow of industrial, liability-prone products. These, on balance, flow to rather than from the developing countries, suggesting perhaps that a uniform global compensation scheme without proof of fault might not necessarily work to the disadvantage of developing countries. Of course, the final assessment of net benefits depends on the particular situation of the country concerned as well as on the exact shape of the liability scheme proposed. It would appear to be true, however, for many developing countries that any possible loss of protection suffered by their young industries would be outweighed by the gains of consumer protection against foreign product hazards because such developing countries, even as they attempt to build up their industries, continue to import a large share of the industrial and consumer products they need.

29. A final consideration in this regard is the burden of proof. The difference between a negligence scheme and a system of liability without regard to fault is, in terms of liability exposure, a substantial one only if the plaintiff has the burden of proving negligent conduct on the defendant's part. But the plaintiff who has the burden of proof in a product liability case faces tremendous difficulties in trying to establish lack of reasonable care on the part of the producer or one of his employees, more so, if there is a foreign producer. Extraneous to the sometimes very complex process of production and unfamiliar with the internal control procedures of the producer, he would frequently find it impossible to discover and prove the necessary details constituting negligent behaviour.[13]

30. What all this may suggest is that the fault requirement with its focus on showing specific wrongdoing, assumed to be obvious and easily proven, is possibly not realistic under modern conditions.

31. A number of devices may be adopted, as already done in some systems, to try somehow to ease the plaintiff's burden of proof, while staying within the well-established negligence principle.[14] One could, for example, in some or all cases of product-caused damage regard the proof of a defect as *prima facie* evidence or as raising a presumption of fault which the defendant would have to rebut. One could also shift the burden of proof and have the defendant prove that there was no negligence on his part. Or one might treat any violation of statutory provisions, e.g. safety standards, as "negligence per se". This last method, i.e. viewing a statutory breach as conclusive evidence of negligence, would seem to be negligence in name only, being in effect indistinguishable from a substantive rule of strict liability.

C. *Strict liability*

Elements of strict liability

32. It is necessary at the outset to clarify the term "strict liability" and in particular to distinguish it from "absolute liability". Liability is said to be "strict" in this context because in contrast to negligence liability it is imposed without regard to subjective fault. But it differs significantly from "absolute" or "no-fault" liability, in that more is required of a plaintiff than proof merely that the product was a factual cause in producing his injury. He must go further and prove that the damage sustained by him resulted from a "defect" in the product. Absolute

[12] John G. Fleming, *op. cit.*, pp. 271-272.

[13] See, for example, J. Brouwer, "La responsabilité civile du fabricant dans les pays du Marché commun", in *La responsabilité civile du fabricant dans les Etats membres du Marché commun*, *op. cit.*, p. 30; Robert Patry, "Préface", in G. Petitpierre, *La responsabilité du fait des produits*, Genève, Librairie de l'Université Georg, 1974, p. VIII; *Liability for Defective Products*, Law Commission Working Paper No. 64, Scottish Law Commission Memorandum No. 20 (London, HMSO, 1975), p. 31.

[14] Analysis, sect. II, B, 1, Qs. 1 and 2, paras. 8 and 9, particularly replies by Australia, Barbados, Canada, Cyprus, Fiji, Germany, Federal Republic of, Pakistan, Sierra Leone and the United Kingdom.

or no-fault liability which requires proof only of causation but not of defect is more akin to the liability of an insurer. It is not here considered as a possible basis of unification because it is not known to have been adopted in any national product liability law, though it has been suggested by a few authors.[15]

Policy questions

33. The earlier discussion of the policy considerations for product liability,[16] when combined with the indicated limitations of either contract law or negligence as a basis for modern product liability law,[17] yields the policy rationales for strict product liability. If one agreed that the rationales of "consumer reliance", "risk creation and control", and "cost allocation and risk-spreading" justify the liability of a producer or distributor for harm caused by defective products put into circulation by him and if one furthermore were persuaded of the inadequacies of both contract law and the negligence principle in providing the desired scope of protection for the consumer, one would have but some form of strict liability as the remaining choice. Since these policy issues have, as indicated, already been covered, the remaining portions of this chapter will be devoted to a consideration of the major obstacles which might be encountered in unification on the basis of strict liability.

The defect requirement

34. A key element of strict products liability, which separates it from "absolute" liability, is the requirement that there be a defect, that there be "something wrong" with the product alleged to have caused harm. Essential though this element is, defining it in proper legal terms has proved extremely difficult. The importance of the requirement in any scheme of unification on a strict liability basis demands, however, that some elaboration of the requirement be attempted.

35. To do this one might first review various attempts which have already been made in connexion with other projects of this kind to assign a meaning to the term "defect". According to the European Convention (article 2c.) "a product has a 'defect' when it does not provide the safety which a person is entitled to expect, having regard to all the circumstances including the presentation of the product". But for the omission of the explanatory addendum beginning with "having regard to . . .", the definition in the Draft Directive of the European Communities (article 4) is essentially the same as the one just quoted. Section 402A of the American Restatement of Torts 2d, which has been approved by many courts, refers to "any product in a defective condition unreasonably dangerous to the user or consumer or to his property"; the comment to this provision then characterizes a product as defective "when it is not safe for normal handling and consumption", when it is "in a condition not contemplated by the ultimate consumer, which will be unreasonably dangerous to him" (comments (*g*) and (*h*), p. 351).

36. These and other definitions thus combine the notion of "defect" with the somehow modified idea of "unsafe" or "dangerous". Despite their similarity of use, however, each of the terms seems to serve a somewhat differing purpose of demarcation.

37. The term "defect" with its connotation of "something wrong" emphasizes a point which is not adequately expressed and clarified by mere "danger", for "dangerous products" could on the one hand be too extensively construed to include all products which are "dangerous" by their very nature and purpose (e.g. dynamite, gun, knife) or on the other hand be too restrictively interpreted as covering only those products which are generically dangerous, i.e. belong to a dangerous type or series, leaving out the category of individual items which contain foreign substances or other flaws resulting from mistakes in the manufacturing process.

38. On the other hand, the term "defect" standing alone seems insufficient, too, in that it might be too contractually interpreted in terms of "non-conformity" or even "unfitness for normal or special purpose". Furthermore, the term "defect" suggests primarily the result of a manufacturing error (a "flaw") and is less easily associated with the other important sources of product hazards, i.e. inadequate design and insufficient information, instructions and warnings, which from a policy viewpoint one might wish to include within the notion of "defect".[18]

39. Be this as it may, the crucial issue, it is submitted, is to establish the standard or required degree of safety. Though the yardstick of liability may be difficult to express in view of the great variety of goods, or product hazards, and of policy issues involved, substantive guidance can be gained by regarding the reasonable consumer's expectations as to the product's safety for normal handling, use or consumption. This is justified by the fact that it is the consumer whose expectations are relevant since it is he who is being protected by the law. The test of reasonable consumer expectations remains, of course, an imprecise one; but this has the advantage, of special importance in a uniform liability scheme for internationally traded products, of permitting one to take into account any local or regional particularities, including the "ordinary knowledge common to the community".

40. In applying this test, various factors would have to be considered and weighed. These include: usefulness and desirability of product, its utility to the user and to the public as a whole; likelihood that product would cause injuries and their probable seriousness; practicability of safety incentive, likelihood of future product improvement without impairing its utility; deterrent effect on development of new products; availability of safer substitute product; ability of user or consumer to avoid danger by self-protective measures or to bear the loss.[19]

41. It is perhaps an argument against this approach that to balance such factors and interests in applying the standard would certainly not be an easy task. The response to this may be that the difficulty involved is no greater than that encountered in determining, for ex-

[15] See, for example, Jeffrey O'Connell, "Expanding no-fault beyond auto-insurance: some proposals", *Virginia Law Review*, vol. 59 (1973), pp. 749-829; W. Freedman, "No-fault and products liability: an answer to a maiden's prayer", *Insurance Law Journal*, 1975, pp. 199-208.

[16] Part I.

[17] Part II, A and B.

[18] As to the various acts or omissions entailing liability, see Analysis, sect. II, B, 1, Qs. 1 and 2, para. 14.

[19] See, for example, David A. Fischer, "Products liability—The meaning of defect", *Missouri Law Review*, vol. 39 (1974), p. 359. John W. Wade, "On the nature of strict tort liability for products", *Insurance Law Journal*, 1974, p. 151.

ample, the "duty of care" or the "reasonable man standard" in traditional negligence cases. Furthermore, it is not uncommon, and has been considered good legislative practice, for a piece of legislation designed to govern myriad fact situations, some of which cannot be anticipated in advance, to incorporate a flexible and general standard by which judges are enabled to deal with unexpected fact-patterns and new situations.

Development and system risks

42. Two kinds of product risks create special problems. One of these is the so-called "development risk" which refers to an unsafe condition in a product not discoverable using the scientific knowledge available at the time of its circulation. The other one, though sometimes treated as a form of "development risk", may be termed "system risk" and concerns products with known dangerous conditions which cannot however be eliminated using known technology.

43. In view of the inevitability of danger, common to both risks, imposition of liability may be regarded as unfair and a too heavy burden on defendants. Particularly in the case of development risk, one could point at the incalculability of possible losses and reject liability because it would discourage innovation and progress while not providing any safety incentive.[20]

44. One might on the other hand consider imposing liability in such cases (as is, for example, proposed in both European texts) for the following reasons. If economic development adversely affects human life or health, compensation even for "unavoidable" injuries may be viewed as good social policy because otherwise, it is argued, victims would be sacrificed as "guinea pigs" for the public good. As to "unavoidability", one could argue that, in practice, it is often a matter of money and commitment for the requisite scientific or technological knowledge to be gained in time to avert the risk. Furthermore if the dangerous condition was by no means detectable, the plaintiff himself will often be unable to determine the cause of his loss and to furnish sufficient scientific proof.

45. This last factor may account for the fact that actual cases of development risks are very rare in the case law.[21] System risks appear to be rare, too. Major examples are blood containing the hepatitis virus and vaccine for the Pasteur treatment of rabies. Development and system risk cases should, it is thought, be decided on their specific merits. This might entail, for example, denying the plaintiff's claim on the ground that the product was not unreasonably defective and providing compensation to him through some other device such as by national health compensation, or imposing liability and possibly easing the burden on the defendant by state subsidy in light of the over-all utility of the product involved.

46. The latter solution could also be ultilized to encourage the development of highly needed but potentially risky products. Furthermore, inclusion of all these cases in the liability scheme would prevent defendants from raising the state-of-the-art defence in many unjustified situations. It would in addition accord with reasonable consumer expectations, which arise from the implied representation that the product is safe, to include all such cases,[22] and relate liability more to the final condition of the product than to any acts or omissions occurring in its production. Above all, in view of the actual rarity of both kinds of risks, it may well be that one could point to the policy of objective of risk distribution, including risk spreading via insurance, as an adequate response to the frequent call for exclusion from liability coverage of development and system risks, calls which may often be motivated by traditional ideas of fault and foreseeability.

Strict liability and negligence: similarity

47. If one were to separate the requirement of fault from the issue of who has the burden of proof (the injured plaintiff or the producer-defendant?) one would very likely come to the conclusion that a strict liability and a negligence régime differ in operation not by reason of the fact that the latter requires "fault" and the former does not, but rather because in a negligence régime the burden usually is on the plaintiff to prove fault and not on the defendant to prove lack of fault. If the latter would be the case, either because the burden has been legislatively placed on the defendant or because the courts, moved by a consumer protection consciousness, begin to operate under a tacit presumption of fault which it was up to the defendant to dispel, the result would be strict liability in fact.

48. This is so because, as has been observed, "a manufacturer will rarely be able to convince a court that no negligence was involved when a defective product was put into circulation".[23] This state of affairs reflects not so much a consumer bias as the widespread belief that except for development or system risks, which by definition may materialize in the absence of fault, almost all "unreasonably dangerous conditions" or "safety defects" are due to some kind of human misconduct in the planning stage or the production process.[24] Thus, strict liability is not far apart from a negligence system with a reversed burden of proof, as is often recognized by courts in requiring a very high degree of care.[25]

49. That both concepts are very close means in practical terms similar liability exposure and similar safety incentive for the producer. Although exact statistical data are still lacking and differences may exist with regard to particular products, supporting evidence may be seen in the experience of the United States where it is reported that "insurance practices permit a manufacturer to insure his products at roughly the same cost whether he makes them in a negligence or a strict state".[26] In the régimes there referred to negligence liability is reinforced by some version of *res ipsa loquitur* or a practical equiva-

[20] See, for example, Richard E. Byrne, "Strict liability and the scientifically unknowable risk", *Marquette Law Review*, vol. 57 (1974), p. 675; David A. Fischer, "Products liability . . .", *loc. cit.*, p. 350.

[21] See, for example, John G. Fleming, "Draft convention on products liability (Council of Europe)", *American Journal of Comparative Law*, vol. 23 (1975), p. 732, as to United States experience.

[22] See, for example, Paul D. Rheingold, "What are the consumer's 'reasonable expectations' ", *Business Lawyer*, vol. 22 (1967), p. 598.

[23] Werner Lorenz, "Some comparative aspects of the European unification of the law of products liability", *Cornell Law Review*, vol. 60 (1975), p. 1012.

[24] William L. Prosser, "The assault upon . . .", *loc. cit.*, p. 1114.

[25] Analysis, sect. II, B, 1, Qs. 1 and 2, paras. 6 and 7, particularly replies of Australia, Burundi, Canada, Cyprus, Germany, Federal Republic of, the Netherlands, Norway, Pakistan and Sweden.

[26] Note, "Products liability and the choice of law", *Harvard Law Review*, vol. 78 (1965), p. 1456.

lent.[27] The difference in costs would presumably be greater if the situation under strict liability were to be compared with that under traditional negligence. However, as already observed, this latter concept, with the burden of proof resting on the plaintiff, might not be thought a suitable basis for a uniform international product liability régime, in view particularly of the great difficulties in proving fault.

50. If the choice then were reduced to either a strict liability or a modified negligence régime, the better course of action would seem to be to drop the fault idea altogether and opt simply for strict liability. This would have the advantage at least of saving on the costly procedural and other complicated legal manoeuvrings typically associated with a negligence trial,[28] while presumably not providing less deterrence or more liability exposure.

51. It may also be pointed out in this connexion that producers and other sellers, to preserve or foster their business goodwill and also to save on legal costs, not infrequently prefer to pay compensation regardless of the issue at fault. Finally, it should be stressed, firstly, that the economic impact of liability rules varies considerably according to market conditions and the social climate, including the claim-consciousness of the consuming public,[29] and, secondly, that no final assessment of the relative merit of any particular liability scheme seems possible until one has considered the detailed features of such a scheme. It is proposed in the next part of this report to elaborate and consider the elements of a possible uniform liability scheme for products involved in international trade.

PART III. ELEMENTS AND SCOPE OF UNIFORM LIABILITY

A. *Persons incurring liability*

Producers

1. The first task in defining the elements and scope of a uniform product liability régime is to identify the persons on whom liability should be imposed. One obvious target of such liability is the producer, the term referring not to the single workman involved in the actual making of the product, but to the natural person or legal entity owning, controlling and profiting from the production enterprise.[1] As the earlier discussion on general policy considerations has shown, he often is the one who invites consumer reliance, creates and controls the risk of harm, and is placed at the most efficient point in the distribution chain to gather the risk and spread the losses. Indeed, the guiding General Assembly directive, resolution 3108 (XXVIII) of 12 December 1973, refers to "uniform rules on the civil liability of producers for damage caused by their products".

2. In addition to the principal producer, other independent persons may be involved in the production process, the most notable example of these being suppliers of component parts. Whether or not to include such suppliers within the concept of "producers" raises difficult questions of policy. The following considerations favour their inclusion. Firstly, inclusion would add another level of protection for the consumer, which could become important in cases where the component producer is a much larger enterprise than the final producer or assembler.[2] Secondly, applying the risk creation and control argument, it seems appropriate that the supplier of a part incorporated in another product should be held accountable where the unsafe condition of the final product arises out of a "defect" in his own product. This argument becomes particularly valid in the situation, common in practice, where the supplier has more experience and knowledge about his specific product and its potentially harmful features than the final assembler.[3]

3. Arguing, on the other hand, for a different treatment of the component supplier is the fact that the quality and harm potential of the component part depend sometimes on the specific technical instructions given by the final producer and always on the actual use to which such part is put by him. The solution perhaps is to have a separate rule which would impose liability on the component supplier only if the component part itself is "defective" in the sense alone that it does not provide the level of safety reasonably to be expected, having regard to its typical use or to the use made known at the time to the supplier. The supplier thus would not be liable if, for example, the component part were put to a different or an atypical use or were unsuitable for the purpose for which the principal producer had on his own design initiative decided to use it, thereby rendering the final product defective.

4. There are, apart from component suppliers, other independent parties who may be implicated at the production stage of goods. These may include design professionals, testers and endorsers, and even lessors and licensors. This category of persons could, it is thought, justifiably be left out because their involvement is often sporadic, marginal and not easily delineated.[4] An exception could, however, be considered for those cases where such persons under their own name invite consumer reliance, for example, by endorsing the product on labels or in advertisements. It may be noted that both Euro-

---

[27] William L. Prosser, "The assault upon . . .", *loc. cit.*, p. 1114.

[28] See, for example, *Liability for Defective Products*, Law Commission Working Paper No. 64, Scottish Law Commission Memorandum No. 20 (London, HMSO, 1975), p. 32.

[29] For more detailed consideration of this point, see part IV.

[1] The producer is in fact the person most frequently mentioned in the replies to the questionnaire as a potential defendant under the extra-contractual liability notion; see Analysis, sect. II, B, 1, Q.3, para. 1 (*a*), (*b*). As to employees, although their liability may be theoretically recognized, especially under compensation rules based on personal fault, recovery is in practice rarely sought from them, but almost exclusively from the employer who, having more resources, is made to answer for his employees' acts or omissions ("*respondeat superior*"). And as to strict liability, it obviously is unsuitable for application to an employee, since it is objective, attached to the commercal circulation of defective products, and based on the ability of the enterprise to spread the loss, via purchase price.

[2] See, for example, "Proposal for a Council directive relating to the approximation of the laws, regulations and administrative provisions of the member States concerning liability for defective products, Explanatory memorandum", in *Bulletin of the European Communities*, 1976, Supplement 11, pp. 14-15.

[3] Suppliers of component parts are specifically mentioned as potentially liable in the replies of Australia, Barbados, Madagascar, and the Union of Soviet Socialist Republics; see Analysis, sect. II, B, 1, Q.3, para. 1 (*c*).

[4] See, for example, Note, "Liability of design professionals—the necessity of fault", *Iowa Law Review*, vol. 58 (1973), pp. 1223-1236; Note, "Torts—negligent misrepresentation—liability of non-manufacturer certifiers of quality—endorser of defective products for pecuniary gain may be liable to purchaser whom product injures", *Georgia Law Review*, vol. 4 (1970), p. 632; W. A. Wiseman, "Strict liability of the bailor, lessor, and licensor", *Marquette Law Review*, vol. 57 (1973), p. 137.

pean texts propose liability for "any person who, by putting his name, trademark, or other distinguishing feature on the article, represents himself as its producer".[5]

Commercial distributors

5. A basic question is whether, under a uniform scheme, liability should be imposed on persons other than "producers", namely, wholesalers, middle-level distributors and retailers.[6] The argument against imposing liability on these is essentially that such persons ordinarily neither create nor control the risk but merely transfer the goods as they are. Thus, is it argued, they are not a suitable target for the policy of deterrence, i.e. harm prevention by the operation of safety incentives.

6. Other considerations however argue for the imposition of liability on such distributors. Firstly, importers, wholesalers, and retailers, particularly large ones, often conduct quality and safety tests themselves and are in a good position to know about previous instances of similar product defect. Secondly, the goal of deterrence would be served, directly in those cases where the defect results from the distributor's own malfeasance, such as improper handling or storage, and indirectly in the fact that the innocent distributor who is made to pay compensation usually can obtain indemnification from his supplier or the producer. Thus, even a retailer could be regarded as a "conduit through which to pass the burden of the risk of loss back to the manufacturer where it really belongs".[7]

7. Consumer protection provides a further justification for imposing liability on distributors since the producer, particularly in the case of an imported product, is often less accessible to the plaintiff than the domestic distributor. One method which has been proposed for alleviating this hardship, which may be aggravated by disputes over jurisdiction and enforcement, is therefore to subject the importer to liability, as is proposed in both European texts[8] and recommended by the Ontario Law Reform Commission in Canada.[9]

8. Finally, the liability of distributors in general may be supported by the rationale of consumer reliance and by the policy of risk distribution. Sellers quite frequently invite reliance by advertising in newspapers or in stores, and on radio or television, often issuing specific recommendations and promises; and, like the producer from its production, they stand to gain from the distribution of the product. Furthermore, they could, though on a lower level than the producer, spread their loss or insurance costs over the buyers through pricing.

9. Most of the reasons stated in favour of distributors' liability are valid only in respect of those persons engaged in some business of product distribution. Therefore, it is submitted, liability should be imposed only on professional, commercial sellers or similar distributors such as, for example, persons transferring goods in the context of rendering services, and should not extend to a sale by a party not engaged in the business of distributing products (e.g. sale between neighbours) or to a non-commercial distribution (e.g. by mother to child, host to guest). By the same token, in view of the policy target of product liability, i.e. the commercial circulation of defective products intended for use or consumption, the liability of commercial distributors or producers should remain unaffected by the fact that there has been such private sale or non-commercial distribution in the distribution chain.

Channelling of liability

10. The foregoing review of potential defendants reveals that liability could in principle be imposed on numerous categories of persons involved in the production and distribution of a product causing harm. A régime which would hold all or most of these persons potentially liable would, however, encounter many practical problems. There most likely would be uncertainty and confusion as to who would be the most appropriate defendant in a particular case. There would certainly be problems relating to recourse actions based on internal indemnities and other devices of loss-shifting; and most significantly, there would be a multiplicity of duplicate insurance coverages, with attendant cost consequences, as essentially the same liability risk would be covered by every potential defendant. The practical measure which has been devised to combat these problems is to single out one such potential defendant and to "channel" liability to him.

11. Channelling of liability has the advantage that legal responsibility can be more clearly ascribed in any given case and, by relieving all but one defendant from the need to effect insurance for appropriate indemnities, avoids "the pyramiding of insurance".[10] Details of these insurance consequences, including related benefits such as cost savings and enhanced loss predictability, will be discussed later in the separate part on insurance (part IV, especially paras. 31-34).

12. The device of channelling is one which is well known in international conventions. It has most notably been used in conventions regulating liability for nuclear damage, where there exists both a need to ensure that someone has clear responsibility for compensating the victims, and thus for taking out the necessary insurance, and the possibility of costly duplication of insurance if every potential defendant had to provide for the very high exposure potential involved.[11] Channelling also lies at the heart of joint insurance plans by which coverage is provided for the suppliers of aircraft component

[5] Proposal for a Council directive relating to the approximation of the laws, regulations and administrative provisions of the member States concerning liability for defective products, article 2; European Convention on Products Liability in regard to Personal Injury and Death, article 3,2.

[6] Such persons in the chain of distribution are noted as potentially liable in the replies of quite a few countries. See Analysis, sect. II, B, 1, Q.3, para. 1 (*a*), (*d*).

[7] Note, "Tort—strict products liability for retailers?", *Washington Law Review*, vol. 45 (1970), p. 439; see also Geneviève Viney, "L'application du droit commun de la responsabilité aux fabricants et distributeurs de produits", in *La responsabilité des fabricants et distributeurs*, Recherches Panthéon-Sorbonne (Université de Paris I, Paris, Economica, 1975), p. 94.

[8] European Convention on Products Liability in regard to Personal Injury and Death, article 3,2; Proposal for a Council directive relating to the approximation of the laws, regulations and administrative provisions of the member States concerning liability for defective products, article 2 (for "import into the European Community").

[9] See John G. Fleming, "Draft convention on products liability (Council of Europe)", *American Journal of Comparative Law*, vol. 23 (1975), p. 735.

[10] John G. Fleming, "Draft convention . . .", *loc. cit.*, p. 734.

[11] See, for example, (OEEC) Convention on Third Party Liability in the Field of Nuclear Energy, Paris 1960, article 6 (*a*) and Vienna Convention on Civil Liability for Nuclear Damage, 1963, article II, 5.

parts,[12] and it underlies the proposal in both European texts to impose strict liability in the main on producers, excluding retailers and other sellers.[13]

13. It seems clear from the foregoing account of channelling that this device is most effective, and its advantages best realized, if it is adhered to systematically and few exceptions admitted to the principle. Thus in contrast to the Council of Europe's Convention in which the liability of retailers and other sellers under non-convention law is left untouched and several other exceptions admitted to the exclusive Convention liability of the producer (most notably the imposition of liability on the importer), the scheme under consideration should, it is suggested, adopt a strict form of channelling. This would mean that every effort should be made to settle, if possible, for a single exclusively-liable defendant and to make the uniform scheme the exclusive liability régime with respect to matters covered by it.[14]

The importer as target of channelling

14. The next step, assuming that channelling were favoured, would be to decide to whom liability should be channelled. All the reasons which were identified as arguing for the liability of the producer would seem also to point to him as the most suitable target of channelled liability. However, convincing reasons could be advanced in favour of channelling liability for damage caused by internationally distributed products rather on the importer, or, as he may be conveniently termed, the "first national (domestic) distributor".

15. First, there are all the arguments advanced in favour of imposing liability on distributors (including importers), such as their greater accessibility and the possibility of thereby avoiding complex issues of jurisdiction and enforcement. Secondly, the importer, as compared to the foreign producer, is apt to be more familiar with domestic safety regulations, normal product uses, specific national laws and compensation features. He is in a better position to know earlier of injuries, to give warnings, stop distribution, or organize recalls. Furthermore, he is often the most active promoter of the product within the territory involved and may even distribute products under his own name and without mention of the foreign producer.

16. A rule that would channel liability exclusively to the importer may, however, need modification in at least one respect. Channelling to the importer contemplates the typical case where the product is imported for redistribution, with the importer being the first of possibly many distributors or even the only one. Where, however, the importer buys for his own use and himself suffers damage (e.g. his factory is set on fire by defective imported machinery), the conceptual difficulty arises under channelling that the importer then has no remedy except against himself.

17. This situation could be dealt with in a number of ways. One would be to expressly exclude it from the scope of the uniform product liability régime, leaving the importer to pursue his traditional remedies, contractual and otherwise, against his supplier or manufacturer. The other would be to expressly provide in the scheme, as an exception to the importer's exclusive liability, that the importer may recover directly from the producer in such a case. The third, and perhaps least desirable, alternative would be to say nothing in the rules about such a case. The result of this would almost certainly be a divergence in interpretations by the courts, with some holding that, the case not being provided for under the new régime, the importer was free to seek remedy under traditional law outside the uniform rules, and other courts holding that the intent in not providing for this case was to let the loss lie on the importer where it had fallen.[15]

18. Finally, it may be noted that although channelling liability to the importer rather than the producer reduces the opportunity for risk distribution from a global to a national scale, the difference in practice may not be significant since much would depend on factors such as the size of the producer's operation and the extent to which he actually spreads the loss from one market territory over the other territories rather than simply making the price in each territory reflect the experience within that market. At any rate, for many importers the market over which their loss is spread is the entire national market, which for this purpose may be sufficiently sizable. Also as will be discussed later in relation to insurance (see part IV), the possibility exists of shifting the importer's loss directly or indirectly back to the producer, thereby achieving in effect risk distribution at the producer level. The devices for accomplishing this might include, for instance, a contractual indemnification arrangement, price adjustments, the taking out of insurance by the producer naming the importer as an insured or even assumption by the producer of the obligation to pay the premium on the importer's liability insurance.

B. *Scope of application of uniform rules*

Products of foreign or domestic origin

19. The first issue of relevance to the scope of application of a uniform liability scheme such as is under consideration is whether the scheme should cover damage caused by products both of domestic and foreign production or should simply be limited to products of foreign (i.e. international) origin.

20. This, of course, is a policy question which cannot be resolved in this report and one which the Commission may wish itself to address at an appropriate juncture. It may, however, be observed, briefly, that in favour of not limiting the scheme to imported products is the consideration that to so limit it might create in countries in which the prevailing products liability régime provides a lower standard of protection to the consumer than is provided under the uniform scheme (e.g. negligence as against strict liability) a situation in which the buyer has an incentive, based on his differing

[12] John G. Fleming, "Draft convention...", *loc. cit.*, p. 734.

[13] See, for example, Werner Lorenz, "Some comparative aspects of the European unification of the law of products liability", *Cornell Law Review*, vol. 60 (1975), p. 1025.

[14] The relationship of the scheme being considered to relevant national law is discussed later in this report, subpart I below. For a critique of the European Convention in draft form, see John G. Fleming "Draft convention...", *loc. cit.*, p. 734, where the author remarks of that convention that it "merely toys with the goal [of channelling] without pursuing it systematically".

[15] The problem of the importer-consumer should in practice not be as serious as the foregoing theoretical analysis would suggest, at least in the case of a business entity. This is because such an importer would most likely carry some other form of business insurance which would cover losses of the kind under discussion.

legal position with respect to each, to choose a foreign product over an identical domestically produced one.

21. On the other hand, it may be thought that damage caused by domestically produced products do not raise the sort of considerations (e.g. inaccessibility of foreign producer) which justify the elaboration of an international uniform liability scheme, and that, furthermore, it is appropriate that a scheme such as is envisaged limit itself to activities having an international repercussion. Thirdly, although it is not clear that the issue was being specifically there addressed, General Assembly resolution 3108 (XXVIII) of 12 December 1973, paragraph 7, refers in this context to "products intended for or involved in *international* trade or distribution" (emphasis added), which appears to direct attention to imported rather than domestically produced products. Attention has consequently been focused in this report on the international rather than the domestic aspect of products liability.

The "international" element

22. Assuming then that only products of foreign origin would be embraced within the scheme under consideration, the question arises as to what international nexus should be recognized. One could think of two basic approaches. Under the first, it would in general be sufficient to invoke the uniform rules that the product causing harm was produced in a country other than the one in which injury occurred.[16] The other approach would make the scheme cover only products which have been the subject of an international sale or distribution.

23. The principal advantages of the first approach are, firstly, that the test would be easy to apply, since there would be no need to inquire whether somewhere down the line there had been with respect to the product involved an international sale or distribution; and, secondly, that it would reduce the temptation for an organization to seek to avoid its liability exposure by arguing that a product made abroad by its branch or division (not a separate legal entity) was not covered by the uniform rules, since the product was not the subject of a sale or distribution, having simply been made by the organization for itself.

24. On the other hand, in favour of the second approach is the argument that the type of cases which would be covered under the first approach and not under the second might be precisely those cases with respect to which no need exists for an international liability régime since they do not, for example, raise any problems of the producer's inaccessibility to the injured plaintiff. At any rate, the pertinent General Assembly resolution cited above does refer to "international sale or distribution", implying, it would seem, the second approach.

25. As to the second approach, the term "sale or distribution" appears to indicate that forms of distribution other than sale are to be included. This construction appears sound from a policy perspective in that although sale is the most relevant and frequent type of product distribution, the exact character of the international link in the often long distribution chain has much less significance in the context of products liability than it does in the context of, say, the special rules governing the rights and duties of parties to a contract. Here, the actual fact of product distribution would seem more important than its legal form or vehicle, bearing in mind especially the feasibility of risk spreading via price.

26. One would, therefore, consider bringing within the scope of the rules not only distribution by sale, but such other forms of distribution as, for example, leasing, hire-purchase, barter, and franchises or similar service contracts. In order, however, to underline the business nature of the transaction and to exclude cases not warranting liability under the uniform scheme (e.g. charitable aid or grant, private sale or a similar transaction across the border), one would presumably require that the distribution be "commercial".

27. The "international" character of the distribution is the next important element to be considered. The simplest and most common case of international involvement would be where products are produced in one country and from there commercially exported into another one. In other cases, there may be two or more international links in the chain of production and distribution. However, in view of the major goals of unification, one such link should be sufficient to bring the case within the ambit of the uniform liability scheme.

28. The requirement that the chain of distribution end in a country other than the one of production needs clarification in two respects. The first difficulty stems from the fact that it is not always that products are produced, assembled, and packed in the form in which they are intended to reach the ultimate user or consumer, all in one country. Thus, the decision would have to be made whether the uniform rules should also govern those cases where the only "importer" somehow contributes to the final production, e.g. by changing certain features, assembling, packing, bottling, dividing into smaller units. Should it be decided to include such cases, it would be advisable to specify the kind or degree of work which such a party might do and still remain an "importer" for this purpose. This would make it possible to exclude cases of essentially domestic manufacture though involving some imported ingredients or component parts. Inclusion of such domestically finished products, particularly if broadly defined, would appear more defensible if the importer would be the only person to whom liability would be channelled.

29. The second point relates to the case of the importer-consumer discussed above (paras. 16, 17). As there noted, one solution to the problem might be to expressly exclude the case from the uniform régime. If so, this could be done by reading into the definition of "international distribution" the requirement that the product originate in a country other than the one in which the last distributor had his place of business.

C. *Types of product covered by uniform liability scheme*

Movables, including those incorporated into other movables or into immovables

30. One issue to consider in relation to a uniform products liability scheme is what kind of product, applying the traditional classification of property into "movables" and "immovables", should be covered under the scheme. Few would doubt that pure movables, by far the preponderant kind of product involved in products

[16] An exception might then be considered for certain special cases, such as where the injured party himself bought the product while abroad and brought it into the country of injury.

liability cases, should be included. Similarly many would agree that pure immovables should, on the other hand, be excluded, although the dividing line is not easy to draw in some instances (e.g. pre-fabricated houses, oil-rigs, machines fixed to the land). It may be observed in this connexion that production of immovables (such as construction of buildings) seems to be relatively rare in the international context and is often, where it occurs, subject to specific régimes of liability.

31. Some doubts exist with regard to mixed cases where movables lose their individuality. If they are incorporated into immovable property, one could follow the rule of exclusion and the considerations relating to immovables as such. However, inclusion of such cases might be favoured as the special régimes regulating such situations tend to focus on the immovable as a whole and to overlook the liability of producers of parts incorporated into such immovable. Inclusion would also allow one to treat the incorporation by the "distributor" (constructor) like the practically similar case of incorporation of a component into a movable product by the last buyer or user. Similar treatment would be accorded movables incorporated into other movables. In support of the foregoing proposals are those reasons earlier advanced as favouring the liability of suppliers of component parts.

New products, low-quality items, second-hand goods

32. While there is little doubt that new products, being the typical object of products liability, should be included in the scheme, there may be the point of view which would question the wisdom of including low-quality and used items within the scheme, to the extent at any rate that these categories of products are not accorded special treatment. The argument would be that imposing strict liability for such products ignores possible consumer preference for low-quality bargains. However, lower quality in, for example, second-choice china or furniture does not ordinarily affect safety. In the exceptional case where it does so, it would be only to a small degree and this could be taken into account in applying the test of "defect" having regard to reasonable consumer expectations and in evaluating appropriate defences (e.g. assumption of risk, third-party intervention).

33. Similar considerations would apply to used products. Although consumer expectations here are typically lower, there remains some reasonable reliance on there being no original defects in the products (as distinguished from the results of normal wear and tear or misuse). Besides, actual liability would be rare in practice, reducing the possibility of undesirable results, owing to the inherent difficulties of proof and to the possible expiry of the limitation period. On the other hand, in view of the small amount of used items in international trade relative to over-all volume, one could also consider excluding this category altogether from the uniform scheme.

Manufactured products, items of industrial mass production and of small-scale manufacture

34. Industrial goods produced in large series are clearly the main target of the general policies in favour of products liability; this becomes clear when one considers, for example, the rationale of the assignment of risk to the consumer through the setting of the control standard under the sampling method of quality control. However, items of small-scale manufacture may also be subjected to liability because the same rationales apply here too, though perhaps not with equal force, and the dividing line is difficult to draw.

35. In addition, manufactured items not industrially produced in series are not the most common goods in international trade, and they tend to fall into one of two categories, inclusion of which in the uniform scheme should cause no great harm. Either they are very complicated, valuable pieces, with a relatively high risk potential on whose operational safeness the buyer is strongly invited to rely (e.g. special machinery), or alternatively, they are simple, inexpensive pieces, such as handicrafts, which generally are less hazard-prone or at least not unreasonably dangerous according to ordinary consumer expectations (e.g. textiles known not to be colour-fast).

Natural products

36. Primary natural products, particularly those of agriculture, farming, and fisheries, present special problems which require careful consideration. Calls for their exclusion from uniform liability, particularly one entailing strict liability, focus on the fact that the products are "natural", are only harvested and forwarded by farmers or fishermen in more or less the same state they occur in nature. However, these products, particularly as found in international trade, increasingly bear the mark of human intervention, being often processed or somehow treated, for example, with chemical fertilizers, insecticides and preservatives. Thus, their inclusion might be justified on the basis that such human intervention could bring about harm to the consumer.

37. One specific aspect of the "natural" quality argument deserves special notice. This is the argument that various kinds of foods are by their very nature, as "allergens", detrimental to some consumers. This problem of a product being unavoidably unsafe for some consumers should, it is thought, be solved in the context of determining "defect" applying, *inter alia,* the "unreasonably dangerous" test, just as in the case of a manufactured product. It is suggested that this, if done, would almost invariably avoid liability for allergenic natural products (e.g. strawberries, milk, tomatoes) because their allergy potential is common knowledge.

38. Another aspect of natural products that may raise concern is the likelihood of their deterioration, which could occur at any stage between production and consumption. As this may be due to improper storage, unexpected delays in distribution or other factors beyond the producer's control, imposing liability on him might be thought inappropriate. However, obviously rotten or stale food is unlikely to be consumed and, if it is, the defences of lack of "latent danger" or "assumption of risk" would help to avoid liability. Even the other cases of harm caused by deterioration would only entail liability if the product were already "defective" at the time of circulation by the producer or other person potentially liable.

39. Furthermore, if under the scheme liability would be channelled to the importer, two further objections would become less forceful. One is the difficulty in identifying the individual producer because natural produce is often bulked. The other is the concern that strict liability (or the attendant insurance costs) would constitute

a crushing burden on the "small neighbourhood greengrocer".

40. Above all, not only are "defects" in natural products much less frequent than in manufactured goods, they also are typically the result of some kind of human fault (e.g. including foreign objects in food, such as stones in rice, bees in honey). Even with regard to the seemingly exceptional case where environmental conditions rather than the producer is to blame (e.g. fish from waters not known at the time to be polluted), liability could nonetheless be justified in the interest of equal treatment with other producers and on the theory of risk-spreading as well as in recognition of the profit-making goal of the enterprise.[17]

Products related to subjects of separate liability schemes

41. Some types of products could be excluded from the uniform scheme because they are covered by, or related to, subjects of separate, specific liability schemes, often in international conventions, or because their inclusion might infringe upon the purposes of one or other such scheme. Thus, for example, nuclear materials and all parts installed in nuclear reactors or similar facilities should be excluded in that they generally are the subject of special regulatory schemes, both national and international, recognizing their extraordinary risk potential.[18] A similar consideration would seem to apply to aircraft and ships, including their component parts.

D. *Persons in whose favour liability is imposed*

Possible restriction of plaintiffs under strict liability

42. The next problem in identifying the elements and scope of liability is to determine the range of persons who may claim compensation. As the replies of Governments to the questionnaire indicate, recovery under fault systems is not generally limited to certain categories of plaintiffs;[19] it is merely restricted by some legal requirement concerning the connexion between the negligent act and the injury or damage suffered, e.g. that there be "proximate", "direct", or "adequate" causation, that the harm be "foreseeable", "within the risk", or "contemplated by the rule", and so on.[20]

43. In strict liability, one could either follow this familiar path, possibly with some refinement, or allow recovery only to certain classes of plaintiffs, because liability irrespective of fault to all potential victims could be regarded as too extensive. Resolution of this question should reflect the general policy considerations justifying products liability as well as the goals of unification. For this reason, it is proposed in the ensuing paragraphs to consider the case for protection of each of the categories of possible plaintiffs.

Last buyer

44. The last buyer (or one, such as a hirer, standing in a similar contract position) does not present a difficult case. If he suffers damage while using or consuming the product himself, few would deny his standing to recover. Even where he does not use or consume the product, his position *qua* "buyer" would justify compensation for any recoverable damage which he can persuade the court he has suffered. From a policy standpoint this situation should not be viewed as directly flowing from the contract because a contractual right would merely exist against the other party to the contract, the immediate seller, who might not be the person liable under the proposed uniform scheme. It should rather be seen as a consequence of the fact that the buyer chooses the product in reliance on its safety and, above all, contributes via purchase price to the "buyers' mutual benefit fund" discussed above.[21]

45. There may be some doubts with regard to the buyer's damage from products bought for commercial, industrial or professional use.[22] Those cases where commercial use means resale (or similar distribution) will be discussed later in the context of recoverable loss (see below, sect. E, paras. 62-63), because, there, the damage suffered by the last purchaser consists usually in pure economic loss. As to products used by the last buyer for industrial or professional purposes, their exclusion, which might be favoured by advocates of consumer protection who have only private users or consumers in mind, can be supported on a number of grounds.

46. Firstly, the rationale of consumer ignorance and reliance seems far less applicable to professional users whose adequate knowledge of product characteristics may rightly be assumed. Furthermore, it is not unusual for such buyers, with their stronger bargaining position as compared with private consumers, to be able to influence the risk level by, for example, insisting on certain specifications. Thirdly, to the extent the damage is caused by mechanical products such as machines or tools, the underlying explanation may be misuse, poor maintenance, or disregard of instructions.[23] Finally, protection via third-party liability seems, at any rate, less needful because first-party insurance is more easily available for business risks and because the loss in question may already be covered by a workmen's compensation scheme.

47. Against the foregoing position, however, are the following considerations. Though the arguments advanced above may be valid to some extent, they do not appear to command the kind of weight that should, it is suggested, be required in order to justify detraction from the desirable goal of comprehensive unification by the exclusion of a considerable portion of the goods involved in international trade. Secondly, to the extent the arguments are valid, a proper response could probably be found within the system to accommodate such cases. For example, the issues of the plaintiff's expert

[17] There may even be an element of deterrence because the producer is at least nearer to the source of the danger and thus to information about it than the ultimate consumer.

[18] Thus, for example, Vienna Convention on Civil Liability for Nuclear Damage, 1963, article II, 5.

[19] Analysis, sect. II, B, 1, Q.5, para. 1.

[20] As to such rules delimiting liability, see Analysis, sect. II, B, 1, Q. 6, paras. 16-19.

[21] Part I, C, above.

[22] See, for example, Geneviève Viney, "L'application du droit commun . . .", *loc. cit.*, p. 94.

[23] See, for example, Leon Green, "Should the manufacturer of general products be liable without negligence", *Tennessee Law Review*, vol. 24 (1957), p. 93.

knowledge of the product's characteristics or of misuse of the product by him or his employees could be dealt with in the context of determining the "unreasonably dangerous condition" of the product or by recognizing appropriate defences.[24] Other specific circumstances of business use could be taken into account also by allowing the commercial buyer's supplier to insert clauses in their contract limiting the buyer's right of recovery, which would appear to be a better solution than general exclusion of commercial use from the scheme.[25]

Consumer or user

48. The next, somewhat broader, category to be considered is comprised of the persons actually consuming or using the product. While most of them would also be buyers, recovery should not, however, be based on any narrow contractual notion, such as theories of warranty. As already argued above (see part II, paras. 9, 10), contracting and non-contracting consumers or users should be treated alike, in view particularly of the fact that it is often a matter of chance who will be injured by the defective product.

49. Consumers and users, as such, deserve protection because they rely on the safeness of the product, which itself is intended for the very purpose of consumption or use, and because they are, besides being the targets of production and distribution, the beneficiaries of the policy of risk control and harm prevention. These policy considerations should, it is suggested, justify recovery even by those not contributing to the "buyers' mutual benefit fund". This result may further be supported by the consideration that such consumers or users are usually in some kind of family, social or business relationship with the buyer who, thus, can be assumed to pay his contribution for their benefit as well.

50. Following the foregoing rationale for recovery, the terms "consumer" and "user" should then be construed in a very broad sense so that "consumer", for example, would include a person who does not in fact consume the product but prepares it for consumption by someone else, and "user" would also cover anyone who passively enjoys the benefit of a product, e.g. car passenger.[26] Even such extensive interpretation of a rule favouring users and consumers would, however, still leave out some potential victims, whose case for protection will be discussed next.

Non-user in sphere of risk ("innocent bystander")

51. Under a strict liability scheme it may be disputed whether compensation should be awarded to persons other than users or consumers, e.g. pedestrian hit by car with defective brakes. Even in the United States where strict liability has been most widely adopted there is far from uniform agreement on the issue: the American Law Institute in its Restatement of Torts issues a caveat, expressing no opinion on the matter; and the courts remain divided on the issue, though with a clear trend in favour of extending liability.[27] Both European texts favour recovery, it appears, since recovery is not limited to certain classes of plaintiffs.[28]

52. Recovery by a non-user in the sphere of risk, who is commonly labelled the "innocent bystander", may be opposed on the simple ground that the injured bystander is neither a buyer nor a user or consumer of the product. As one authority has said of him, "he has relied upon nothing, he is not the kind of person the defendant has been seeking to reach, no representation has been made to him expressly or impliedly, he has done nothing except to be there when the accident happened".[29] Such reasoning, however, seems to focus entirely on the consumer reliance rationale, ignoring the theories of enterprise liability and risk distribution, under both of which no valid distinction seems possible between the bystander and the user. To let bystanders benefit from the buyer's contributions may also be supported on the ground that buyers profit from the use or consumption of the product and thereby, though innocently, endanger others.

53. Another reason for extending strict liability to innocent bystanders is the policy of deterrence, the desire to minimize the risk of personal injury, which is valid for all potential victims regardless of status. It has even been suggested in this connexion that greater protection should be extended to the bystander than to the user in that "the bystander is even worse off than the user—to the point of total exclusion from any opportunity either to choose manufacturers or retailers or to detect defects".[30]

54. If strict liability were thus also imposed in favour of persons not using or consuming the product, the consequence would be that, as with negligence liability, the range of plaintiffs would not be categorically restricted to certain groups. The resulting co-extensiveness with negligence liability could, perhaps, be supported by the argument that strict liability with its notion of the product being "not duly safe" is close to fault liability, at least where negligence is presumed. This in turn raises the question whether it would not be appropriate in that case to recognize a general restriction to "persons [whom] the defendant should expect to be endangered by the probable use of the product, as in a negligence case".[31]

---

[24] See, for example, Fleming James, "General Products—should manufacturers be liable without negligence?", *Tennessee Law Review*, vol. 24 (1957), p. 927.

[25] This problem is further discussed below, paras. 81-82.

[26] See, for example, William L. Prosser, "Products liability in perspective", *Gonzaga Law Review*, vol. 5 (1970), p. 168; *Restatement of the Law (Second), Torts*, vol. 2 (St. Paul, Minn., American Law Institute Publishers, 1965), comment 1 to sect. 402 A, p. 354.

[27] See, for example, 63 *American Jurisprudence 2d*, Products liability (New York, Lawyers Co-operative Publishing Co., San Francisco, Bancroft-Whitney Co., 1972), sect. 144; Dix W. Noel, "Defective Products: extension of strict liability to bystanders", *Tennessee Law Review*, vol. 38 (1970), pp. 4, 13; Comment, "Products liability—New York adopts rule protecting bystanders—strict liability in tort v. breach of warranty", *New York Law Forum*, vol. 19 (1974), p. 888.

[28] European Convention on Products Liability in regard to Personal Injury and Death, article 3, as explained in Explanatory Report, Council of Europe document CCJ (76) 41 add. IV, para. 53; Proposal for a Council directive relating to the approximation of the laws, regulations and administrative provisions of the member States concerning liability for defective products, article 1, as explained in Explanatory Memorandum, in *Bulletin of the European Communities*, 1976, Supplement 11, p. 14.

[29] William L. Prosser, "Products liability in perspective", *Gonzaga Law Review*, vol. 5 (1970), p. 170.

[30] *Codling v. Paglia*, 298 N.E. 2d 622 (New York, 1973), p. 624.

[31] Dix W. Noel, "Defective Products: extension of strict liability to bystanders", *Tennessee Law Review*, vol. 38 (1970), p. 12.

E. *Heads of damage and consequential damages covered*

Bodily injury and death

55. There will be little dispute about covering bodily injury and death because life and limb are commonly regarded as the archetype of interests deserving of protection. Difficulties with this category of protected interests concern rather the extent of compensation, the recoverable types of damage, and, particularly in case of death, the persons entitled to sue.

56. According to the general indemnity principle of compensation ("*restitutio in integrum*"), the plaintiff should without doubt be compensated for the cost of medical treatment and, perhaps less clearly, for loss of earnings. Admittedly, medical costs and salary levels vary considerably from one country to another, but even within a country the defendant typically "has to take his victims and the doctors as he finds them", and regional differences become less relevant if liability is channelled to the first domestic distributor.

57. The next problem, whether persons beyond the one who is actually injured should be entitled to sue, is most acute in death cases. Some legal systems allow recovery for loss of support or service to all persons who were in fact supported by the deceased, others only to those who were legally entitled to the support, and yet others merely to certain, named dependants.[32] It would have to be decided whether one of these alternatives, preferably the first, should be adopted, or whether this matter should be left to national law, because unification seems difficult and not really necessary, at least from the point of view of the impact on insurability and insurance costs.

58. It would, however, appear preferable to deal expressly with the following two matters in a uniform scheme. First, consideration might be given to disallowing the award of punitive damages, which are only known in some systems and even there have been deemed objectionable in the field of products liability.[33] Secondly, consideration might be given to allowing compensation for "pain and suffering", including loss of enjoyment of life. Recovery for such non-pecuniary loss has sometimes been rejected on the ground that damages here are too hard to measure and the idea itself perhaps even offensive. But such loss, it may be countered, is "real", too, and from the point of view of calculability not more difficult than some other kinds of recoverable loss which the law nevertheless attempts to quantify.[34]

Damage to property (other than product itself)

59. Tangible property is commonly protected under liability systems based on fault.[35] Its inclusion in a strict liability scheme may, however, seem objectionable. In general, damage to property does not seem to call for recovery in the same way bodily injury does although, for example, a farmer might well consider the loss of his crop or livestock a greater loss than, say, a broken arm. Another factor at work here is possibly the fear that the risk exposure in property damage cases may be too extensive in that it may entail large financial losses (e.g. loss of profit after factory fire). Furthermore, it has been observed that in the context of property damage, insurance taken out by the property owner (first-party insurance) is superior in terms of practical efficiency and of economy of operation than third-party liability insurance taken out by the would-be defendant.[36]

60. The foregoing reasoning, however, is most telling in the case of commercial or professional users for whom property damage is just another form of economic loss. Private users do not ordinarily take out first-party insurance for property damage, except perhaps for such major items as a house, car, boat, etc.; and their loss, usually small in comparison, may affect them very considerably (e.g. loss of shelter). Thus, one might follow the suggestion of one commentator, as incorporated into the European Communities' proposed directive, to allow recovery only for "damage to or destruction of any item of property other than the defective article itself where the item of property is of a type ordinarily acquired for private use or consumption and was not acquired or used by the claimant for the purpose of his trade, business or profession".[37]

61. Even if the foregoing proposal were not accepted, and damage to commercial property were included, one should, it is suggested, exclude damage to the defective article itself, for whether a defective part of it causes damage to the product itself or whether the article simply fails to work, the cause for complaint is the same, and so is the person suffering damage, i.e. the buyer.[38] Thus, compensation may be properly left in this case to the law of sale.

Pure economic loss

62. Pure economic loss means financial loss standing alone and not consequential to personal injury or property damage. It appears in various forms, some of which may call for different solutions: for example, expenses may be incurred for repairs or recalls of products with detected defects; loss of profit may result from product failure; sellers may have to compensate unsatisfied buyers and may suffer additional loss of business if word spreads about the defective product.

63. The various causes of economic loss and the relevant policy questions would have to be discussed in detail if serious consideration were being given to extending uniform liability to such loss. Such a prospect seems, however, unlikely, for even under present fault schemes purely economic interests, such as expectations of

---

[32] See, for example, Harvey McGregor, *Personal Injury and Death*, in International Encyplopedia of Comparative Law, vol. XI, chap. 9 (Tübingen, J. C. B. Mohr), pp. 90-96, and Analysis, sect. II, B, 1, Q.5, para. 3 and Q.6, paras. 5-7.

[33] Thus, for example, Bert M. Thompson, "Products liability—a company view", *Federation of Insurance Counsel*, vol. 23 (1972), pp. 7-8.

[34] See, for example, Sally Robins, "Developments in absolute and no-fault liability in products cases: The cents and nonsense of no-fault", *American Bar Association—Section of Insurance, Negligence and Compensation Law, Proceedings 1971*, p. 486.

[35] Analysis, sect. II, B, 1, Q.6, paras. 9, 10.

[36] J. A. Jolowicz, "Product liability and property damage", working document No. 7, Commission of the European Communities, Directorate-General for internal market, Directorate Approximation of laws: companies and firms, public contracts, intellectual property, fair competition, general matters (XI/359/75-E), p. 4.

[37] Proposal for a Council directive relating to the approximation of the laws, regulations and administrative provisions of the member States concerning liability for defective products, article 6; J. A. Jolowicz, "Product liability . . .", *op. cit.*, p. 8.

[38] See, for example, J. A. Jolowicz, "Product liability . . .", *op. cit.*, pp. 2-3.

financial advantage or the interest in not incurring out-of-pocket expenses, are rarely protected. At any rate, it may be felt that the contractual remedy is sufficient and appropriate in most of these cases, which seem to concern unmerchantability rather than active malfunctioning of the product.

F. *Defences (and burden of proof)*

64. Some preliminary points may be made in discussing the subject of defences. Firstly, there are a number of special pleas by which the defendant's liability exposure may be limited or extinguished. Two of these —a ceiling on the maximum amount recoverable, and barring by expiry of the prescription (limitation) period —are discussed later in the report (see G and H, below). Secondly, there are a number of general defences to a tort (or delict) action such as "voluntary assumption of risk", *force majeure*, contributory (or comparative) negligence, intervening act of third person recognized in most systems, which may exclude or reduce a defendant's liability in particular circumstances.[39] These have been adequately set out in a previous report[40] and it does not seem necessary to restate them here in detail. Thirdly, it should be observed that the concern here is with a defence in the strict sense of a counter-attack raising an additional point and not a "defence" in the sense merely of denying an essential element of the plaintiff's case.[41]

65. It would not be feasible to attempt a discussion in detail of the subject of defences at this point, since much would depend on the decision as to the basis of liability and the detailed conditions thereof. All that can be done at this stage is to indicate a number of possibilities. If liability were based on negligence, the traditional defences such as voluntary assumption of risk, contributory (or comparative) negligence, and faulty intervention by third party would presumably remain.

66. These same defences could also be admitted in a strict liability scheme, subject to certain qualifications. Thus, for example, the defence of assumption of risk may be allowed in cases where the plaintiff fully recognizes the danger and voluntarily consents to the risk. Similarly, contributory (or comparative) negligence could be a defence in cases of obvious defects in the product, but preferably "not in case of an objectively negligent failure to discover the defect in a product or to guard against the possibility of its existence".[42] Lastly, negligent acts by third persons could be dealt with by recognizing a specific defence in those terms or simply under the general rules of causation.

67. There are, apart from the foregoing, certain possible defences which are peculiarly relevant in the context of strict liability. Firstly, if strict liability were adopted but development and system risks were not covered, one would then have to provide for the specific defence that the product was made in conformity with and reflected the state-of-the-art in science or technology; other defences become relevant, if, on the other hand, these cases are not left out. Similarly, in order to preclude or to limit liability in cases of misuse or abnormal use of products, it would be necessary either to define "defective" in terms of fitness for "normal" or "foreseeable" use[43] or expressly to recognize in the uniform scheme a suitably worded defence for such cases.

68. The burden of proof, i.e. the onus of establishing the facts and the risk of non-persuasion, lies usually with the party favoured by the rule or requirement at issue. But it should also matter in whose sphere the doubtful circumstance falls. Thus, for example, the plaintiff could be required to prove that his damage was caused during normal use of the product by an unsafe condition of a type which typically or probably exists at the time of circulation. The defendant could then rebut that, establish non-existence of the defect when the product left his hands, or show that the condition was not "unreasonably" dangerous.

G. *Maximum amounts as absolute limits*

Purpose and alleged benefit of absolute limit

69. According to a widely held opinion, strict liability, being a departure from the recognized fault principle, should be accompanied by a maximum limit. This idea of a trade-off of one thing for the other seems, however, to be purely a matter of history, and recent history, for that matter, considering the situation in pre-negligence days. The matter should, in principle, be decided strictly on its own merits.

70. The main reasons stated in favour of absolute limits are to provide certainty and to avoid crushing liability on defendants. Proponents of maximum limits have usually had catastrophe exposure in mind, with reference especially to the insurance consequences.[44] Detailed consideration of maximum limits from the insurance perspective will be made in the special part of the report devoted to insurance questions. Suffice it to note here that catastrophe exposure is not unique to strict liability but quite possible under a fault system, too. It may also be recalled that only in very few cases does strict liability for defects amount to liability without any actual fault.

Possible methods and inherent problems

71. Even if agreement were reached in principle on setting absolute liability limits, the difficulties in finding a suitable method could well prove insurmountable. There are basically two ways of setting liability limits which could be considered as alternatives or used in combination. One is to establish a ceiling per claimant per occurrence. Although such a rule has the advantage that it would be easy to administer, it could be unfair to victims, unless the ceiling were fixed at a very high level. On the other hand, if the ceiling were fixed at a fairly high level, it could lose much of its limiting effect except with regard to a relatively small category of defendants

[39] See Analysis, sect. II, B, 1, Q.7, paras. 2-10.

[40] A/CN.9/103, paras. 76-82.

[41] An example of the first (pure) kind of defence would be the plea of contributory negligence in a negligence suit and of the second, a plea that the defendant could by no means have avoided the unsafe condition of his product, i.e. a denial that the defendant was negligent.

[42] Dix W. Noel, "Defective products: Abnormal use, contributory negligence, and assumption of risk", *Vanderbilt Law Review*, vol. 25 (1972), pp. 128-129.

[43] Cf. similar suggestions concerning the definition of "defective", para. 39.

[44] See, for example, A. V. Alexander, "The law of tort and non-physical loss: insurance aspects", *Journal of the Society of Public Teachers of Law*, vol. 12 (1972), pp. 120-121.

(such as producers of products with a potential to cause serious injury, should an accident occur, which injury would normally have called for compensation exceeding the per claimant limit). Furthermore, a limit of this sort may not be very meaningful in the case of mass-produced products where a single defect could affect a whole series of products, thereby causing a huge aggregate exposure for the producer, even with application of the per claimant ceiling. At any rate, as later noted in the part on insurance, it does not appear significantly to affect calculability of exposure or insurability.

72. The other method is to limit the aggregate liability of every defendant per defined period (e.g. one year) for one type of product or for all his products.[45] Apart from the insurance aspects, there are some inherent problems in this approach which deserve due consideration. First of all, it seems difficult to find appropriate maximum amounts that would differentiate in an acceptable way between big and small enterprises, on the one hand, and between various categories of products, on the other. Furthermore, if only one limit were set for all, it would have no actual limiting effect on many defendants who tend anyway to get insurance coverage only up to the point they and their insurers feel is their actual exposure. Thirdly, a uniform maximum limit might seem unfair in that it would tend merely to ease the burden of some defendants; and, fourthly it could cause great administrative problems when claims are brought in various different courts and jurisdictions and the maximum amount has to be distributed amongst many claimants.

73. In the light of these difficulties, which admittedly would be less serious if liability were channelled to the importer, it is perhaps helpful to note that there may be a practical alternative to a maximum limit in the case of a catastrophe. This is that the Government of the State concerned, where appropriate, could step in and provide support, as it would in other cases of disaster and emergency. One might well conclude that the issue of maximum monetary limits to liability is one which, in the context particularly of unification on a global level, calls for further analysis and consideration.

H. *Prescription (limitation) period*

Limitation period for particular plaintiffs

74. It would seem appropriate to set time-limits for bringing compensation claims, in order to give defendants (and their insurers) more certainty about liability exposure and to exclude litigation after a long period of time has expired and relevant evidence become hard to come by. One possible limit is a subjective period for each particular plaintiff. This would have the advantage of getting information early to the defendant, who then could take steps to prevent further damage. The period could run from the time when the product was acquired by the last purchaser or, preferably, when the plaintiff became (or should have become) aware of the damage, or when he became (or should have become) aware of the damage and the defect, or, it has been suggested, when he became (or should have become) aware of the damage, the defect and the identity of the defendant.

Period for circulated product

75. Calculability of exposure and insurability may further be enhanced by setting an objective period of limitation which would commence with the circulation of the product by the defendant and close at a fixed time some years after.

76. Despite the variety of products which would be covered by the scheme, it should be possible to agree on one such objective period for all. It is true that there are some products, such as machines and tools, intended to be used for a long time, much longer than consumer items such as children's shoes, for example. However, as mentioned earlier, malfunctioning by such products may often be attributable to poor maintenance, misuse or disregard of instructions; these factors, and the fact that one is considering the commercial context where parties generally are able to look out for their own interests, might justify a period of limitation shorter than the normal life expectancy of such products in order to reduce the problems of proof. If thus a relatively short period were chosen, there would be less need for the other, subjective, period of limitation, although both periods could be accommodated in a uniform liability scheme.

I. *Relationship of uniform scheme to other liability rules*

Relationship to laws concerning extra-contractual liability

77. In view of the main goals of the present unification effort, the uniform scheme should, with respect to compensation, replace the extra-contractual liability rules because, otherwise, certainty and equality would not be achieved. Such exclusivity should obviously be restricted to matters falling within the scope of the scheme; matters not governed by the scheme would, of course, remain subject to the law otherwise applicable. This might, for example, be the case with topics such as economic loss, property damage, or certain kinds of products if these were left out of the uniform scheme.

78. Another possible exception may be made in cases where special liability laws already exist under national law for specific products; here, however, one could require that the protection accorded the claimant be no less than he is accorded under the scheme. As regards statutes regulating safety standards or similar provisions, there is no real conflict because they would be applied in determining "defect" or "unreasonably dangerous condition" under the uniform scheme. It would then be up to the courts to decide whether compliance with such regulations was conclusive evidence of the lack of a "defect" or whether those regulations should be treated merely as minimum requirements.

[45] A similar approach, though without a limitation per defined period, has been adopted in both European texts. Proposal for a Council directive relating to the approximation of the laws, regulations and administrative provisions of the member States concerning liability for defective products, article 7, limits the total liability of the producer for all personal injuries caused by identical articles having the same defect to 25 million European units of account (EUA), for damage to movable property to 15,000 EUA and to immovable property to 50,000 EUA; European Convention on Products Liability in regard to Personal Injury and Death, annex, allows States to reserve the right to limit the amount of compensation to not less than the sum in national currency corresponding to 70,000 special drawing rights (SDRs) for each deceased or injured person and to 10 million SDRs for all damage caused by identical products having the same defect.

Relationship to contract rules

79. If the uniform scheme were to replace existing extra-contractual liability rules, one might then consider applying the same principle of exclusivity to contractual compensation rules because, firstly, the dividing line between contractual and extra-contractual compensation rules is not easily drawn and, secondly, because it is drawn differently in various systems. Above all, the purpose of unification cuts across, and does not correspond with, traditional subject-matter boundaries of law but looks at the actual liability exposure whatever its origin. In view of the differences between private and commercial use, one could at any event consider exclusively in the case at least of private buyers.

80. Such exclusivity, once again, would be limited to the scope of the uniform scheme. This means, firstly, that it would cover only the compensation aspects of a case, leaving to contracts law such other contractual issues as the rights of avoidance of the contract or of price reduction. Secondly, it would be restricted to injuries and consequential damages caused by the active malfunctioning of the product ("materialisation of the danger of the defective product"), thus leaving out such matters as the consequences of the frustration of the plaintiff's expectations and unmerchantability or unfitness for some purpose of the product.

Validity of clauses excluding or limiting uniform liability

81. Even if none of the foregoing suggestions as to exclusivity were adopted, one must still face the question whether liability under the scheme could be effectively excluded or limited by exemption or disclaimer clauses. In general, such "contracting out" would adversely affect the goals of unification, particularly those of certainty and equal consumer protection.

82. Turning to particular application of the concept of exclusivity, one might possibly make an exception in the case of professional or commercial buyers, who have an interest in modelling compensation rights according to their own needs. However, private buyers (and consumers) should possibly be protected, at least where personal injury or death is involved. This exclusivity principle should, furthermore, be expressly stated in the uniform rules, but should not, however, be construed to limit or foreclose the possibility of factual disclaimers in the form of warnings or instructions which are taken into account in the determination of the question whether or not the product was in an "unreasonably dangerous" state and in the adjudication of the defences of misuse and of comparative negligence.

PART IV. INSURANCE ASPECTS OF PRODUCTS LIABILITY SCHEME

1. This part of the report will, as requested in the decision taken by the Commission at its eighth session,[1] examine the relationship between the subject of products liability and schemes of insurance which have been or may be developed in relation thereto.

2. With regard to personal injury and economic loss associated therewith, suffered as a result of accidents involving products, two different schemes of insurance, both of which are relevant to the present discussion, may be distinguished: third-party liability insurance provided by commercial (private or State owned) enterprises and publicly operated compensation schemes managed more or less on insurance principles and providing benefits typically on a first-party basis. In many countries the two kinds of insurance schemes coexist side by side while in others only one or the other exists or is relevant. It is typically to third party liability insurance that people refer when they express concern about the effect of products liability on insurance costs, since it is realized that the publicly operated compensation schemes (national health insurance) are often determined by different policy considerations (e.g., emphasis on compensating the victim regardless of whether or not there is someone on whom to impose liability, public subsidizing of the programme, etc.). It is, therefore, to third party liability insurance that the ensuing discussion will be devoted. The survey will be in two segments. The first will attempt to describe the current practice relating to third party products liability insurance, while the second will be devoted to a somewhat detailed consideration from an insurance perspective of some of the key features envisaged for a uniform liability scheme.

A. *Current coverage practices relating to products liability insurance*

The coverage described

3. Products liability insurance or, as it is better known in the trade, "products hazard coverage", essentially is coverage designed to protect the producer/distributor of a product against third party civil liability claims for injury to person or damage to property allegedly caused by such product. In modern practice, the insurer in providing this coverage undertakes to (*a*) defend the insured in any suit brought against him the basis of which is the risk insured, and (*b*) pay on behalf of the insured such sums, if any, as he may become legally obligated to pay as damages resulting from such suit.[2]

4. In practice products liability insurance may be written either as a specifically identified coverage within a general business liability policy or as a separate policy. In either case it is important to note that products hazard coverage is increasingly viewed in the insurance market as a coverage separate and distinct from any other liability insurance, whether general or specific, which the business might carry, and one thus which must be specifically purchased. In short, it is common to view this coverage as having characteristics and features

[1] See above, introduction, para. 1.

[2] See generally on this subject Roger C. Henderson, "Insurance protection for products liability and completed operations —what every lawyer should know", *Nebraska Law Review*, vol. 50 (1971), p. 415; Howard C. Sorensen, "The new comprehensive general liability policy's products liability coverage", *Insurance Law Journal*, 1966, p. 645; Howard C. Sorensen, "What a lawyer ought to know about products liability insurance coverage", *Trial Lawyer's Guide*, 1968, p. 322; Jean Bigot, "L'assurance de la responsabilité civile des fabricants pour les produits livrés", in *La responsabilité civile du fabricant dans les Etats membres du Marché commun*, Aix-Marseille, Faculté de Droit et de Science Politique, 1974, p. 213; Jean Bigot, "L'assurance de la responsabilité civile des fabricants", in *La responsabilité des fabricants et distributeurs*, Recherches Panthéon-Sorbonne (Université de Paris I, Paris, Economica, 1975), p. 157.

of its own which, as far as the insurer intends, are not reproduced by any other coverage.[8]

The coverage distinguished from related coverages

5. To understand better the function of the products hazard coverage it is necessary to place it in the over-all context of business insurance by examining its relationship to other business coverages. Perhaps the most distinguishing feature of this coverage is the fact that it operates only as regards products over which the manufacturer or distributor has relinquished control, has passed on by sale or otherwise to others. Thus it is usually an explicit or implicit requirement of such coverage that the accident on which a claim is based occur (*a*) after the insured has relinquished possession of the product, and (*b*) away from the insured's premises. It is this fact that in the ordinary case the risks contemplated are those materializing after delivery of the goods that distinguishes the products hazard coverage from a "premises and operations" coverage, which businesses generally also carry.[4] The latter coverage, much the older of the two kinds of coverage, insures the businessmen essentially against liability to third parties resulting from accidents occurring on the insured's premises and accidents occurring during production.[5]

6. Another business insurance coverage which it is necessary to refer to in this context, not only because of its importance in business risk management but, more significantly, because of its close relationship to products hazard coverage, is the "completed operations coverage".[6] So closely related are these two coverages that it often is impossible in certain cases to decide as between them which coverage is applicable, and which not. For understanding, it is best simply to consider the completed operations coverage as a "service counterpart" to the products hazard coverage, which, like the latter, protects against liability for accidents occurring away from the insured's premises but which, unlike the latter, operates with respect to a service which the insured has performed regardless of whether or not a defective product also is involved. Thus this insurance would cover liability incurred as a result of work performed by the insured retailer at the owner's home on, say a television set from which a fire and subsequent injury arose, even if the material used in the work was not defective and the allegation, was, for example, the insured's negligent performance of the job in question. If however, the injury or damage were caused by a defective product used in such performance, then the loss could just as easily fall within the provisions of either the products hazard coverage or the completed operations coverage, or both.[7]

Excluded losses

7. A feature of products hazard coverage that it may be of some importance to refer to is the category of exclusions, the various kinds of risk expressly excluded from coverage under a products liability policy. One such exclusion which sometimes is written into the policy is the so-called "business risk" exclusion. This clause attempts in effect to exclude from coverage, often in circumstances not too clearly defined, loss attributable to errors in the planning or design of a product.[8] A simple example would be an insured manufacturer of fertilizer who puts out a new kind using a novel chemical combination which turns out to be too rich in nutrients, causing mutations in crops and heavy losses to farmers. The insurer might then in such a case seek to avoid coverage, pleading the "business risk" exclusion. The rationale for the exclusion is that the intent of the products hazard coverage is to cover defects arising at the production stage but not those attributable to management decisions at the planning stage, on the ground, it has been argued, that the latter is merely a "business risk", much like making a poor investment decision the disappointments of which should be compensable, if at all, only by a special form of insurance.

---

[3] This state of affairs no dobut reflects the growing importance of the subject of products liability as a distinct topic within the general realm of torts. Significantly in a number of jurisdictions where hitherto it had been customary for, say, a manufacturer to take out but one general liability policy to cover his tort exposure, doubts have arisen, as products liability law has developed, as to whether such policies are sufficient in themselves to provide complete products hazard coverage, and insurers consequently have felt the need to develop specific products liability clauses which the insured may add to his general policy. Such appears to be the case, for example, in the Federal Republic of Germany. See on this the report by W. Rosener and E. Jahn in *Product Liability in Europe* (Deventer, Kluwer, 1975), pp. 80-81.

[4] This point is well brought out in the insurance practice of French-speaking countries where the products hazard policy is specifically referred to as *"police de la responsabilité civile après livraison"* or *"police R.C. produits livrés"*. Cf. the products hazard endorsement commonly used in the United States which states that an accident arising out of the use of the insured's product is covered "if the accident occurs after the insured has relinquished possession thereof to others and away from premises owned, rented or controlled by the insured".

[5] Cf. the "police R.C. exploitations" in French insurance practice. Until late developments in products liability law in many countries suggested the need for products hazard coverage, "premises and operations" coverage was apt to be the only liability coverage carried by businessmen for their extra-contractual exposure.

[6] In France, *"L'assurance R.C. après travaux"*. See Jean Bigot, "L'assurance de la responsabilité civile des fabricants", *loc. cit.*, p. 163.

[7] This dichotomy between products hazard coverage and completed operations coverage which exists in some insurance markets is by no means a necessary one as is evident from the considerable overlap which exists between the two coverages. In the United States, for instance, prior to 1966 the risks contemplated by the two coverages were insured under one coverage, then called "products hazard (including completed operations)" coverage and became separated only because of certain problems of legal interpretation that had arisen. It is important, however, to note this separateness, where it exists, because a business in order to be fully covered for accidents arising out of the manufacture or distribution of products may well find that it needs to take out both coverages.

[8] An example of such a provision is that found in the products hazard and completed operations portions of the Comprehensive General Liability Policy in general use in the United States, which excludes: "bodily injury or property damage resulting from the failure of the named insured's products or work completed by or for the named insured to perform the function or serve the purpose intended by the named insured, if such failure is due to a mistake or deficiency in any design, formula, plan, specifications, advertising material or printed instructions prepared or developed by any insured; but this exclusion does not apply to bodily injury or property damage resulting from the active malfunctioning of such products or work."

Leaving aside the much disputed question of the effect of the proviso at the end, one notes that many different kinds of risk are covered by the wording of this exclusion clause. Not only, for example, does the exclusion cover risk of loss from misleading instructions on how to use the product, but it seems also to cover what are usually termed "development and system risks", that is, loss arising from the exhibition by the product of harmful effects which having regard to the state of knowledge at the time of its production were not, or could not be, foreseen or, being foreseen, could not be avoided.

8. The standard products hazard and the completed operations coverages also exclude several other heads of risk which are worth mentioning here. One is damage to the product itself. Thus, for instance, if because of an internal electrical defect in machinery sold by the insured, the entire factory in which such machinery is housed is destroyed by fire, the products hazard coverage would cover the cost of rebuilding the factory but ordinarily not that of replacing the machinery itself. Also not compensable under this coverage is damage consisting simply in the fact of the buyer having lost his bargain by receiving defective goods, even though the loss to the insured may be quite substantial as when, to take an example, he has to rebuild or replace defective machinery. In short, the coverage contemplated here is for tortious or "extra-contractual", rather than contractual, liability.[9]

9. A related and increasingly important category of non-compensable damage is economic loss which the insured or anyone else incurs in withdrawing defective products from the market. Recent instances in many countries of massive recall from the market of hundreds of thousands of products—cars, electrical goods, toys, food, drugs, etc.—by their manufacturers well show how substantial a cost may be involved in this step.[10]

Limits of coverage

10. The two matters to be considered next relate to the limits of the products liability coverage with regard to both space and time, that is to say, territoriality and duration. As to territoriality, the first question is, what, if any, are the geographical limits within which it is contemplated that the policy will be effective to provide coverage against third party liability? One should perhaps start by noting that most products liability policies are written by domestic insurers on domestic businesses which do little or no business outside of the particular country in which both insured and insurer are located. Consequently, the standard products liability policy will generally limit coverage to claims arising within a particular country or group of countries.

11. Other reasons for this situation relate to the capacity, both legal and factual, of insurers to provide multiterritorial coverage. Thus an insurance company may conceivably be precluded by its charter or articles of incorporation or by the law of its domicile from insuring risks other than those which it is contemplated would materialize, if at all, only in a given territory. Furthermore, even without such legal limitations a great many companies have neither the capacity to service extra-territorial or multiterritorial risks nor the expertise about local conditions elsewhere to want to venture into such risks. As a result one finds that in every insurance market the number of companies which write multiterritorial policies, especially when world-wide coverage is contemplated, is usually fairly small. These companies tend to be the larger ones, some of which actually specialize in international risk insurance. It is, therefore, to such companies that a business entity would turn for coverage for its export business.

12. Even given the desire by the insured for such coverage and the capacity of the insurer to provide it, there often are other obstacles to the maintenance of a single products liability policy that covers every territory into which the insured's products are imported. It is not unknown, for example, for the law of the place into which the products are to be imported to require the importers involved to maintain insurance with a local insurer;[11] if such an importer happens to be a direct subsidiary, affiliate or agent of the producer's the effect may be the same as requiring the producer to maintain such insurance as a condition of doing business in the jurisdiction in question. Often, too, the insured for reasons of his own may wish to have different insurers insuring him in different territories.

13. What results in practice, therefore, is a rather variegated picture in terms of territoriality provisions in products liability policies.[12] As far as the company with a significant export business is concerned, the main interest of this report, there thus are basically two options: to take out with an insurer able to furnish it a single policy with the appropriate territoriality endorsement; or to take out with a local insurer a policy in and for each territory or group of territories in which it is interested. The latter route is apparently the one more commonly taken by companies large enough to have substantial overseas operations.[13] Where this route is taken, it also is quite common for the insured, in addition to such individual policies providing primary coverage, to maintain a single "umbrella" policy with a world-wide coverage endorsement for liability in excess of that provided by the primary policies.

14. The second question with regard to territoriality is the effect, if any, which territorial considerations may have on the premiums which the insured has to pay. While it is not possible to say for certain that the territorial limit factor has no effect on rates, it seems nevertheless to be the case that the role which this factor

[9] See, for example, the relevant provision of the Danish Standard Public (Commercial including Products) Liability Policy, reproduced in *La responsabilité civile du fabricant dans les Etats membres du Marché commun*, Aix-Marseille, Faculté de Droit et de Science Politique, 1974, p. 123.

[10] Incidentally, this item of damage is excluded from coverage even though the policy may contain at the same time a provision obligating the insured to take all reasonable steps to prevent further injury or damage from arising from the same or similar causes, which provision evidently contemplates actions such as recall of defective products. In some markets, however, the practice is for the insurer to share such costs with the insured. Cf. Danish policy cited in preceding note.

[11] Such a requirement is more often aimed at strengthening the local insurance industry than at ensuring the financial accountability of the insurer to local judgement creditors though, of course, it has a favourable effect on the latter as well. One example is Brazil, which, it would seem, requires all importers to maintain their transportation insurance with a local insurance company. See "Insurance in developing countries, Developments in 1973-1974", Study by the UNCTAD secretariat TD/B.C.122/Supp.1 (1975), para. 76.

[12] The provisions themselves take many forms: there may be an express clause limiting coverage to a defined territory, a clause excluding certain territories from the operation of the coverage, an express endorsement for world-wide coverage, and far less common, though not unknown, omission of any reference to territorial limitations creating at least a theoretical argument in favour of territorially unrestricted coverage.

[13] Inquiry reveals this to be the case among United States companies, for example. It should be added that these questions only arise where the exporter has decided to take a general liability coverage for such business. It sometimes is the case that the exporter carries no such insurance, except as may be contractually agreed upon with a buyer with respect to a specific transaction, and relies instead on a previously worked out general indemnification arrangement with its distributor in the importing country which ordinarily is the defendant in product liability cases.

plays in rate-making or in the calculation of individual premiums is relatively small, perhaps insignificant. First of all, except where special local conditions call for a separate rate structure for a particular market, products liability rates are normally constructed to yield a single uniform rate per product or product classification regardless of territory. Individual premiums are then arrived at simply by applying the rate to the unit of exposure (sales volume or receipts) exhibited by the insured business.

15. This situation stems presumably from the fact that the loss-producing characteristics of a product are by and large inherent to it—there must be a defect—and thus have very little to do with the place of use: the defect with consequent injury could have manifested itself anywhere. The fortuitous fact of occurrence in one place rather than another is seen, therefore, to afford no rational basis for territorial rate classifications. Also inappropriate, it would seem, is a territorial classification based on place of origin or production of a product, for once again, unless there are definite characteristics associated with producers in each particular territory, such a classification would be of little use as an indicator of the relative loss propensity of the products encompassed within the classes or of the producers concerned.

16. Indeed, it would seem that only with regard to loss-severity (i.e. the size of a judgement award or other settlement) might differences exist as between territories significant enough to justify rate distinctions. This is because the size of awards reflects a number of factors that often vary from society to society: the general cost, as well as standard, of living, social attitudes towards personal injury and towards defendants, consumerism, etc. However, the trouble of constructing a rate structure that would reflect such differences may make the effort not worth while. Besides, to the extent that the insurer and the insured are both operating in the context of an industrialized society, the chances are good that the rates, being based on conditions there, would be at a level at least as high as (if not higher than) they would have been if based on conditions in, say, a foreign market in a less industrialized country; consequently the insurer in such a case would stand to lose nothing by using his ordinary rates on a world-wide or multiterritorial basis.

17. The conclusion that emerges from the foregoing consideration of the role of territorial limits in products liability insurance appears to be, therefore, that its most crucial role is at the stage at which the underwriter decides whether or not to provide coverage on the terms desired by the insured, that is, to include certain territories within the coverage area contemplated by the policy. Once the decision is made to give such coverage, there is likely to be no great effect on rates. The underwriter, in other words, attempts to control his loss and, just as important, his ability to predict it, by keeping coverage within familiar territory rather than extending coverage to the unfamiliar but at a rate designed to offset the perceived disadvantages of such a move.

18. As to the other limit to coverage, its duration, no single uniform practice seems to exist.[14] Often the policy is written on a 12-monthly basis. This means from the insured's point of view that the cost of his insurance is guaranteed for one year and that the policy too is immune from cancellation—except for such serious acts of non-performance by him as non-payment of premiums; it means on the insurer's side that he has the opportunity every 12 months to reassess the insurance both in terms of continuing coverage and of price level. It is not unusual, however, to find policies of longer duration (three to five years, for example). Such policies often are used for the larger cases and usually con • in either a premium adjustment provision enabling the insurer to revise the premium annually, if required, or, in some countries, a "retrospective premium adjustment" provision under which, contrary to the ordinary practice of quoting one rate prospectively which stands regardless of experience during the policy period, the parties agree that if the loss experience during the policy period is better than expected the premium will be adjusted downward up to a certain minimum and if worse adjusted upwards up to a specified maximum.

B. *Products liability insurance rating*[15]

19. The crucial importance of the subject of insurance costs to any products liability scheme warrants a brief survey of the pricing process in products liability insurance.

Rate-making techniques

20. Two rate-making techniques will be examined: the "pure premium" method and the "loss-ratio" method. The following preliminary remarks might be found useful in this connexion. Firstly, one might note that within the insurance company it is the function of the actuary to set the rates for the various lines of insurance that the company may offer. Since the essential object of insurance is to compensate those as yet unidentifiable members of a group who will suffer pecuniary loss out

[14] Not dealt with here is the otherwise complex legal question of the relationship between the duration of the insurance coverage and the act to which the damage is traceable, whether, that is, coverage exists, for example, only with respect to acts done during the policy period or only to injury or damage suffered during the policy period, or to both. See on this Jean Bigot, "L'assurance de la responsabilité civile des fabricants", *loc. cit.*, pp. 193-198.

[15] This account of the rate-making process in products liability insurance is based primarily on information gathered with respect to the pricing process in the United States insurance market. The reasons for basing the account on the practice in one insurance market are, firstly, that the theory of insurance rate-making itself based largely on the statistical theory of probability, purports in principle to be valid regardless of the insurance market involved, although local differences may exist in the actual actuarial techniques employed. Secondly, given this fact and the fact that one's interest is simply to discover how rates actually are constructed, with the specific objective of determining the role, if any, played in that process by changes in the rules of legal liability, it seemed most profitable to examine this question in a single well-defined context. The choice of which insurance market to use was determined by the fact that, except for the few works cited below, which mostly deal with the United States situation, very scant literature is discoverable on this specific topic; thus it has been possible to obtain some of the requisite information only through direct interviews with people in the insurance business, those in New York being the most accessible. Specific reference was made to the following works: C. A. Kulp and J. W. Hall, *Casualty Insurance*, 4th ed. (New York, Ronald Press, 1968); C. A. Kulp, "The rate-making process in property and casualty insurance—goals, techniques, and limits", *Law and Contemporary Problems*, vol. 15 (1950), p. 493; Morris, "Enterprise liability and the actuarial process—the insignificance of foresight", *Yale Law Journal*, vol. 70 (1961), p. 554; McCreight, "The actuarial impact of products liability insurance upon choice of law analysis", *Insurance Law Journal*, 1972, pp. 335-352.

of a pool of funds previously contributed by all members of the group, the actuary has two main goals in performing his task. His first and primary goal is to produce rates which will be adequate to cover the expected losses during the period in view; secondarily, he wants to the extent feasible to produce a rate structure which is equitable in distributing the cost of insurance among the group of insureds based on their individual loss-producing characteristics.

21. Secondly, there are a number of terms which will be encountered in discussing this topic. The first is "unit of exposure". This is the concept used by the insurance actuary to measure and express the cost of protecting against losses from the covered risks. It is as such simply a counting device for measuring the quantitative extent of the hazard, enabling the price to be expressed in terms of a fixed concept. In the case of products liability insurance, for example, the unit of exposure may be expressed in terms of say, each $1,000 of sales of the product in question. By "rate" of insurance may be understood the price of such insurance per unit of exposure. Applying the rate to the number of units of exposure generated by a particular insured's business yields the "premium" (i.e. the total price) which that particular business must pay for the insurance in question.[16]

22. In order to devise rates which will yield adequate revenue to meet the anticipated losses, the actuary must first attempt to predict the aggregate quantum of such losses. This he does by resort to the law of averages. From this he knows that, given a large enough group, the over-all incidence of loss-causing events on that group will tend not to vary by much from one period to another, though its distribution within the group will. Consequently, his aim is to be able, by studying the past claims experience data of the group over a defined period, commonly a three-year period, to predict what the claims experience of the group as a whole will be over an equivalent prospective period. He "assumes", in other words, "that the immediate future will be much like the recent past. Last year's plaintiff will not be injured again next year, but someone much like him may well be."[17]

23. Since this actuarial assumption underlying rate-making is valid only for large aggregates, the actuary must try to work with such aggregates. In many cases, where a large enough enterprise is involved, it is possible for the actuary to have adequate data just from consideration of one individual enterprise's experience. In that case such enterprise will usually be individually rated based on its own loss experience. For most insureds, however, it is not possible because of their small size to generate reliable ("credible" is the more exact actuarial term) experience data. Consequently the actuary creates broad rate classifications in which risks are grouped on the basis of selected common loss-producing characteristics. His aim is to make each such grouping large enough to permit the drawing of valid statistical conclusions and yet homogeneous enough to permit the rate for such group to reflect the loss-producing characteristics peculiar to that group. It is to each of these broad groups thus that the actuary applies his comprehensive statistical analysis and from his calculations is able to project the future losses of the group and thus to compute a rate for the group which he expects would cover such losses.

24. In arriving at a final rate figure the actuary considers not only the past statistical history of the group concerned, but, to a lesser extent, also any other factors which to him are likely to have an effect on the size or frequency of loss. Such factors may be economic (e.g. inflation), legal (e.g. administratively enforced safety regulations) or even intangibles such as changing social attitudes to a particular activity. The extent to which these factors, which are called "trends", influence the end-result may vary from actuary to actuary since even as regards economic trends, which are relatively quantifiable, there is still an element of judgement involved in assessing them—much more so with regard to the others. Often, however, the problem is avoided in practice by applying to the rate a pre-computed rate factor used in common by insurance companies.[18]

25. In addition to the portion of the rate which is devoted to meeting anticipated losses and which often is referred to as the "underlying pure premium", and when expressed as a percentage of the rate as the "loss ratio", there are two other components of the rate. One of these is the expense factor, that is, the amount needed to defray the necessary cost of providing and administering the insurance (taxes, agents' commission, overhead, etc.). This component is often also, like the pure premium component, the product of statistical analysis and projection. Finally there is a portion representing anticipated profit, into which also is built a factor for error called a "contingency margin".

26. Under the "loss ratio" method, which is often used by actuaries when it is either not desirable or not feasible to undertake the creation of a wholly new rate-structure, the actuary starts off with an idea as to what the desirable or necessary loss ratio should be (loss ratio being, as noted, the percentage of the rate taken up in the payment of losses). He then analyses the existing rate structure and paid claims to determine what the incurred loss ratio has actually been in the relevant period. By comparing the incurred loss ratio with the desired loss ratio, he is able to determine algebraically what rate level, given the anticipated losses, would be needed to produce the desired loss ratio. He then adjusts the existing rate level upward or downward as may be required.

Relevant underwriting factors

27. The rate having thus been established for each category of risk, responsibility passes from the actuary to another insurance professional, the underwriter. It is the latter who, taking into account the exposure characteristics of a particular applicant for insurance, decides whether or not such applicant is an acceptable risk and, if he is acceptable, into what rate category he belongs

[16] To illustrate, in the case of products liability insurance, the annual premium for a business which grosses $5 million from sales of a particular product with respect to which it is seeking liability coverage would, assuming a rate, let us say, of $3 per unit of exposure (a unit being $1,000 of sales) come to 3(5,000,000/1,000) or $15,000.

[17] Morris, "Enterprise Liability ...", *loc. cit.*, p. 560.

[18] In many countries products liability rates, like many other rates, are promulgated for insurance companies by a common rating organization (rating bureaus) to which most of them subscribe and to whose published rates they generally adhere. These manual rates are, however, often not used for the really large cases where the individual experience data are sufficiently credible to warrant individual rating.

and what his actual premium should be given the applicable rate.

28. It may perhaps be helpful to an understanding of the subject of insurance costs in the context of products liability coverage to note some of the factors which the underwriter uses to make his decision whether to underwrite a particular risk and at what level of premium and under what conditions. Such factors include: type of product, end use, whether used directly by consumer or by other producer, other potential uses; product design, history, claim experience, useful life of product; expected future claim experience (frequency, severity); product claim exposure from earlier years (product still in use after many years); annual sales; management attitude and history, commitment to safety and loss prevention; advertising and warranty claims made with regard to the product; size of exposure and insurer's ability to offset exposure with reinsurance; other lines of coverage maintained by the applicant; type of insurance plan desired, coverage limits, deductibles, etc.[19]

Summary of rate determinants

29. The principal object in exploring the rate-making process was, by increasing understanding of that process, to throw some light on the matter of insurance costs, more specifically the relationship between such costs and the prevailing rules of products liability. This question of whether, and if so to what extent, a stricter régime of liability necessarily entails significantly higher insurance costs is of obvious importance to an assessment of the desirability and feasibility of any scheme of liability for products involved in international trade. While detailed discussion of the question will be made later in this part, it is nevertheless instructive to note the following points emerging from the foregoing account of the insurance rate-making process: that the principal determinant of rate levels is the past loss experience over a period of time of the group or the individual, as may be applicable; that the actuary is interested in knowing, if he can, the aggregate losses he can expect with respect to a given class of insureds over a defined period and, furthermore, is primarily interested in over-all trends rather than in specific isolated losses, no matter their size; that factors such as stricter rules of liability appear to have very little direct effect on rates except to the extent they have become translated into a trend of actual losses; that for most insureds, for whom the manual or group rate is used, the effect of individual losses can become very much diluted in the pool of over-all group experience.

C. *Insurance implications of channelling*

30. The matters to be discussed next are the insurance implications of some of the key features suggested for possible inclusion in a uniform liability scheme. The approach will be to consider what obstacles, if any, to the implementation of each such feature are presented by the theory and practice of insurance. The questions to be addressed, specifically, are, first, whether a given feature of the scheme could make the liability thus imposed "uninsurable", and, secondly, what the cost consequences of such a feature might be in terms of products liability insurance premium.

[19] See, for example, *Product Liability Insurance*, Report of the United States Department of Commerce (Washington, 1976), pp. 34-35.

Cost consequences of channelling

31. Taking first the general question of the cost effect of channelling liability exclusively to one defendant (be it importer or producer), it seems apparent that this should produce net savings in the over-all cost of insurance viewed from the standpoint of the consumers of the products involved who ultimately must bear such costs. This would be so at any rate in those jurisdictions where more than one potential defendant is recognized in products liability cases. The savings should come in the lower administrative costs of providing coverage under one policy administered by one insurance company in place of the present situation in which each of the potential defendants in the chain of distribution of a product carries a separate policy administered by his own insurance company. There should also be real savings resulting from the elimination of the overlapping coverages that now exist in situations where more than one defendant may be sued and someone low in the distribution chain (e.g. the retailer) carries his own insurance even though he is also covered by the policy maintained by someone higher up (e.g. the manufacturer).[20]

32. Another way of looking at the matter is this: even though all or any one of a number of persons involved in distributing a product may be subject to the risk of being sued, the realities often are that in practice only one of them (e.g. the retailer) gets sued regularly, with the result that the insurers of the other potential defendants continue to collect premiums without paying out much by way of claims. Reducing the choice of potential defendants to one by channelling (and, as previously suggested, excluding duplicating rights under national law) should in most cases eliminate the need for the others to maintain coverage resulting, one might expect, in a not-insignificant reduction in the over-all cost of providing for the compensation of victims of defective products.[21] The potential for savings is appreciated even more when one realizes that under the present situation where more than one potential defendant is recognized, the insurer in contemplating the exposure of each such defendant acts usually on the assumption that this particular insured would be subjected to a claim for the full amount of any loss, not just a pro-rated portion of it. Consequently, a relatively high policy limit would appear advisable in each case and the coverage presumably priced to reflect this assumed exposure.

33. There should also be some savings resulting from elimination of the causes of the subrogation disputes and litigation that commonly arise under the present

[20] One reason why this sort of situation may arise, apart from any excess of caution on the retailer's part, is because a business usually takes out a single products hazard insurance to cover all the products it handles, with the result that an overlap would exist with regard to any particular product whose manufacturer's insurance policy contains a "dealers coverage" endorsement extending that policy's protection to the retailer.

[21] How much savings will actually result is difficult to predict since the effect of channelling will also be to subject the one policy to all the claims that in theory at least used to be spread among a number of policies; nevertheless it seems to be the case that it is cheaper to provide coverage for an anticipated total loss in one policy than to provide a similar aggregate amount of coverage by a number of policies with lower limits. It is cheaper, that is to say, to provide for an anticipated $100,000 loss, for example, under one policy than to cover the same loss by 10 separate policies each with a $10,000 limit. Stated differently, the first dollar of coverage is more costly to buy than the ten thousandth.

state of affairs between the various insurance carriers involved as they try to establish among themselves which carrier should bear the ultimate responsibility for meeting a claim.

34. Channelling liability to one defendant alone would also have the favourable insurance consequence of enhancing loss predictability. Since all claims must be brought against the one defendant (i.e. against the one policy) the insurer has a much better idea of what the loss experience on that particular policy will be like. Greater loss predictability means a sounder and more reliable rate structure, which in turn usually means increased market capacity as more underwriters become willing to write such coverage. As with most market situations, the greater the number of underwriters willing to write a particular coverage, the less upward pressure there is on premiums and the more competitive the price quotes which the underwriters make in their bids for a particular contract. Channelling liability to one defendant should therefore have a beneficial effect on the availability of insurance ("supply") and on rate levels.

Channelling to importer

35. If the uniform scheme were to channel liability to the importer, this would make him the sole defendant in any claim based on the rules and, consequently, the one who normally would take out liability insurance in the first instance. There appears to be no reason why such a system could not be implemented from an insurance point of view. In many legal régimes currently existing the importer as such is not excluded from the category of possible defendants, other conditions of liability having been met. In such jurisdictions virtually anyone who has dealt with the goods or handled them in the course of trade be it producer, importer, wholesaler, distributor, or retailer is a potential defendant. The plaintiff still has, of course, the problem of showing, in a negligence régime, that he has been damaged by the negligence of the particular defendant he has picked, and in a strict liability régime, that this defendant distributed the particular product that caused him damage, but this all goes to a different question.

36. As it happens, it is not often that the importer, if he plays no further role in the distribution process than simply passing the goods on to others in the chain of distribution, is sued—not, at any rate, where he is made the only defendant. This is because in the majority of cases the criteria which the plaintiff would use in picking one defendant from a list of possible defendants would tend to point to entities other than the importer. However this may be, the important point for present purposes is to note that the importer is a familiar defendant and recognized potential defendant in many existing products liability régimes. Consequently, it is not unusual today for the importer under such régimes to carry products hazard coverage.

37. If, and to the extent this is so, a liability scheme which would make the importer the sole defendant would have introduced nothing new in terms of creating in the importer the need or the obligation to take out products liability insurance.[22] The only aspect that is new is the fact that the importer alone would have need to carry such insurance, but this relates to the question of possibly higher costs and the internal allocation of such costs among the parties involved in the production and distribution of the product and not to the question whether or not insurance would be available to the importer to offset the liability now channelled to him.

Possible insurance arrangement

38. Assuming then that it is feasible for the importer to be insured against the liability that he would bear under the proposed channelling scheme, the question may still be asked in assessing the channelling idea who, the importer or the producer, would from the insurance perspective be a preferred defendant. Which, in other words, would (from the point of view of cost and efficiency) be a better insurance scheme for a uniform product liability régime, one in which the producer himself took out the policy covering all his export business, or one in which individual importers took out local coverage?

39. No easy choice exists between these two approaches, for there is strong merit on both sides. Having the manufacturer take out the coverage may have the advantage of simplicity and perhaps economy. In place of the many individual policies that would be issued—one for each importer—by perhaps as many insurance companies and with possibly as many variations in actual policy provisions, one would have but the one policy for each producer-exporter, with resulting identity of coverage for all importers of the product wherever located. This would be particularly advantageous in a situation where there are several importers of the product for one country because, coverage being provided by the one policy for all the importers involved, it would then not be as crucial as it might otherwise have been for the injured plaintiff to be able to identify the particular importer of the specific product which has injured him. An additional consideration in favour of having the producer take out the coverage is that he himself would then be paying the premiums directly. This would not only permit risk spreading at the highest level, but would go some way towards meeting the objective of having the consequences of any defects in a product impinge directly on the producer of that product, thereby promoting greater product safety concern on his part.

40. Against this approach, and thus favouring the arrangement whereby the importer takes out the insurance, are the following considerations. First of all, as appears from the discussion above on the question of territoriality,[23] it may not always be feasible for the manufacturer to secure insurance effective in every territory where his product may cause injury or damage, especially where the liability to be covered is by law imposed on the local importer. Secondly, it may in fact be simpler for the importer to carry this coverage in many cases. This is because products hazard coverage, as was earlier noted, is most often furnished as part—albeit a distinct and separable part—of a general liability insurance. Hence, a business entity would be covered by that one policy for liability for all products which it handles as well as for other kinds of liability. In the context of the

[22] In many existing régimes, of course, the importer, not being a likely products liability defendant, does not, and has no need to, carry any products hazard insurance. The crucial question, however, is whether he could, if he needed to, obtain such coverage, and the answer to this is clearly in the affirmative.

[23] See paras. 10-17 above.

present discussion, therefore, an importer who imports several different products, all from different manufacturers, and who in addition handles domestically-produced goods would, if he took the insurance out himself, nevertheless have but one products hazard coverage to deal with. Thus current insurance practice would seem to favour the alternative whereby the importer in each country took out his own separate coverage.

41. Furthermore, it may not in every case lead to significant net savings in the over-all cost of the insurance to have but one policy taken out by the manufacturer covering all his business world-wide, since it is quite possible that any cost savings which would thus result might be largely offset by the administrative costs to the insurer of maintaining servicing capabilities in every jurisdiction where a suit is likely to be brought requiring intervention by the insurer. Individual policies adapted to local conditions and written by local insurers on each local importer might well turn out in some circumstances to cost less in the aggregate than one single world-wide policy covering all exports.

42. A related question is that of the fair allocation of the liability insurance costs among buyers of the product. If the coverage is taken out by the producer on a world-wide basis and he makes no allowance for variations in loss propensity between countries, which may come about because of, for example, differing rules of liability, larger awards in some countries than in others, etc., the result would be that buyers of the product in one country would to a greater or lesser extent be subsidizing those in other countries. One thinks particularly of the situation where the manufacturer does business in both States which have adopted the uniform rules and those which have not. Such a problem would, of course, not arise under the "importer insurance" alternative since *ex hypothesi* only one country is involved in every case. But, on the other hand, a different form of "unfairness" might arise, namely that the importer if he deals in more than one product (all of which are covered by the same policy) may not always be able to allocate the insurance costs equitably among such products, with the effect that consumers of "safe" products may be subsidizing buyers of the relatively "unsafe" ones.[24]

43. It thus appears that the considerations are evenly balanced with respect to choosing the better form of insurance arrangement as between the two approaches just reviewed, although if one had to state a preference one would on balance perhaps favour the arrangement which under current insurance practice seems easier of implementation, namely, the taking out of the insurance on a regional and local basis by the importer. The fact, however, is that insurance considerations by themselves do not in this case afford a sufficient basis for choice because of the considerable flexibility that insurance practice affords and the difficulty of forming solid conclusions on the cost consequences of the various alternatives. Thus, for example, even if liability were channelled to the importer, it would still be possible for the producer to take out a single coverage naming all of his importers as insureds,[25] if liability were on the other hand channelled to the producer, he could still take out coverage under individual local policies rather than a single global one.[26]

D. *Insurance implications of basis of liability*

Strict liability and insurance rates

44. The next issue to be considered is the effect which a change in the basis of liability (essentially from a fault idea to that of strict liability) might have on the cost of products liability insurance. Whether or not a relationship exists between rules of legal liability and liability insurance rates is quite clearly a complex question and one which can be answered definitively, if at all, only by means of a scientific survey of actual trends in legal liability and in insurance rates for a given jurisdiction or selected jurisdictions during a predetermined period. Unfortunately, the Secretariat knows of no such studies.[27] Nevertheless an attempt will be made in the ensuing paragraphs to evaluate this question in light of principle and the scant evidence available. Such evalua-

[24] In point of fact neither of these situations would be anything new. Exactly the same situation exists today when manufacturers sell to countries with differing régimes of products liability, and when importers, wholesalers and others take out coverage without differentiating in their prices the relative cost in terms of products liability premiums associated with each product. Furthermore, whether or not it makes any difference to the price paid ultimately by the consumer in a particular country at what point (at the producer or importer level) the insurance costs are spread, and if so, how much, depends on such factors as: the extent to which the producer charges each territory with the cost experience therein (e.g. by taking out individual local policies) or spreads such costs at a broader level, the extent to which the producer and the importer respectively absorb some of the insurance costs (by way of reduced profit) or pass them fully on to buyers and the extent to which the producer or the importer, as the case may be, is allowed to shift the loss back to the one whose "fault" caused the loss. By and large, though, spreading the risk at the local level would seem to favour those countries, mostly developing countries, where products liability actions appear to be less frequent and the damages award level comparatively lower.

[25] There might perhaps be a question here whether the producer had an "insurable interest" (i.e. something to protect) seeing that liability now rested on the importer. The "insurable interest" factor is, it is submitted, supplied by the fact that the producer would still stand to lose business reputation and goodwill, and hence sales, if a situation developed in which victims of product defect were not seen to be fairly compensated. The arrangement would be comparable to the "dealer clause" already familiar in a number of insurance markets under which the manufacturer names his distributors and retailers as insureds in his own products liability policy, thus providing them coverage at his own cost against possible liability for harm caused by his products which they have distributed. Such coverage, as noted above, often overlaps with coverage taken out by the distributor or retailer for himself. See Allan P. Gowan, "Products liability insurance—duplicate policies—concurrent coverage—industry recommendations—loading and unloading", *Insurance Counsel Journal*, 1959, pp. 411-414.

[26] Cf. the earlier discussion on territoriality, above paras. 10-13. Other variations are also possible and may even prove the more desirable depending on the situation. One such variant could be an arrangement whereby the importer to whom liability is channelled took out the insurance for himself but the premium was paid by the producer either directly or indirectly through reimbursement of the importer.

[27] The only attempts to study this question of which the Secretariat is aware are still currently under way in the United States where, in response to continuing outcries by the business world about the rising cost of products liability insurance, both the United States Department of Commerce and the insurance industry recently ordered separate studies on the question, the results of which are expected to be available shortly. The Commerce Department did, however, issue a preliminary report in which it cited stricter rules of liability as a contributory factor to rising insurance costs, though it acknowledged the absence of any hard data to support this contention. (*Product Liability Insurance*, Report of the United States Department of Commerce, Washington, 1976.)

tion is all the more pressing because the relationship between the adoption of stricter rules of liability and the incidence and severity of judgement awards against defendants is a question of undeniable importance in the assessment of the case for an international products liability régime and the rules of which such a régime might be composed, having regard especially to the possible impact on industrialization in many countries.[28]

45. It is perhaps helpful to approach this topic at two levels. Firstly, one would want to know the extent to which the adoption of stricter rules of liability produces higher or more frequent judgement awards against products liability defendants; secondly, one should consider what effect, if any, such awards if established to be more frequent or more severe have on insurance rates.

46. Quite apart from the question whether hard supporting evidence is available, it seems justified in principle to suppose that any change which dispenses with the need for a plaintiff to prove fault, and not just anyone's fault but this particular defendant's fault, currently the most elusive element in building a plantiff's case, cannot but lead to an increase in the number of cases brought as well as in the number won by the plaintiff. This is so if only because such a change would tend to tip the scale in favour of bringing an action in cases which hitherto had been considered doubtful of successful prosecution by plaintiffs' lawyers. In most jurisdictions such a change would leave but the elements of defect and damage attributable to it to be proved by the plaintiff.

47. Still, it is not the fact that the adoption of strict liability tends to generate more cases that is significant in the present context: what is significant is how much of an increase it will bring. The answer to this depends to a large measure on the state of the pre-existing law in the jurisdiction concerned. Thus it is logical to suppose that such a change will have more significance in a jurisdiction where the law as applied has remained more or less true to traditional negligence doctrine than in one where that doctrine as applied in the cases has become so whittled down as to be virtually indistinguishable in its effect from a strict liability régime. The latter, it is generally recognized, was the situation in many jurisdictions of the United States prior to their adoption of strict liability, with the result that many observers there have downplayed the significance of strict liability as such for the major increase in products liability cases noted in recent years.[29] The more important cause, it has been suggested, is perhaps not so much "legal" as it is "social-ideological", meaning by this the rise in consumer consciousness ("consumerism") which demands much higher standards of performance and safety from products and services and, furthermore, is not hesitant to back up these demands with lawsuits, which in turn are adjudicated by judges and juries more or less sympathetic to the same consumer protection philosophy.

48. The importance of this last factor of consumerism, especially the active variety encountered in the United States, on liability recoveries in general and products liability recoveries in particular should not be underrated. Quite often the complaint of defendants and their insurers in products liability cases relate not so much to the fact of the recovery as to its size; in other words, it is not strict liability itself, which goes merely to the condition, not the amount, of recovery, as what is perceived as the propensity of the judicial system to award "excessive" amounts in damages that under this view is to blame for the so-called "crisis" of products liability insurance. Under this view "excessive" awards, by which is included awards (such as for "pain and suffering" and similar general damages) that go beyond the simple aim of restoring the injured party to the position he was in before the loss, are to blame not only because the large amounts involved deplete insurance reserves, necessitating higher insurance rates, but also because they encourage potential plaintiffs and unscrupulous lawyers to gamble for a financial windfall with each and every wrong, real or imagined.[30]

49. This view that it is not so much the content of the rule of liability itself, whether one has a rule of strict liability or one based on fault, but the surrounding social climate which bears the most on the incidence and size of judgement awards against products liability defendants, and hence the aggregate loss borne by insurers, appears to be consistent with the fact, first of all, that the so-called products liability insurance crisis is most acute in the United States, and secondly, that the problem has in intensity kept pace with the growth of active consumerism.[31] Thus most jurisdictions of the United States had strict liability for injury caused by certain classes of products—e.g. food and beverages—for many years without there being observed any explosion in the num-

[28] Not surprisingly such hard evidence as there is comes primarily from the experience of the United States where the condition for a factual, rather than merely conjectural, evaluation exists, namely, the coexistence over a sufficiently long period of both strict products liability and insurance for the same. Furthermore, an analysis of the situation in the United States should be useful because that situation is usually cited by opponents of strict liability as the paradigm case of the costly consequences of introducing such a basis of liability.

[29] Cf. the earlier discussion of the similarity in effect of strict liability and negligence criteria as they may actually operate in practice (part II, paras. 47-50).

[30] This complaint is well stated in an article in the 5 July 1976 issue of *U.S. News and World Report*, at p. 100, in which the president of one of the larger insurance companies in the United States, commenting on the urge to sue and its effect on that country's reparations system, is quoted thus: "... Jury awards are often in excess of the amount necessary to restore the injured party to the position before the loss .... Too often now our courts seem to have become gambling places where people who have suffered a loss go to spin some wheel of fortune, expecting a windfall profit. The few who do win big only serve to inflate the expectations of all .... In the courts, much of the action is in the products area. Last year alone, 1 million product suits were filed: 1 for every 200 men, women and children in the country .... The cost of liability insurance has become a major part of business-operating expenses. Not long ago liability insurance accounted for 1 per cent of manufacturing costs. Today it accounts for as much as 10 per cent of the costs of some products. It would be unconscionable to limit the amount of compensatory damages paid to an injured party for such losses as property damages, lost income, and medical expenses. But there should be a limit to general damages for pain and suffering and mental anguish. There are [also] sound arguments in favour of limiting the amount that lawyers can collect under contingency-fee arrangements." (*Note by the Secretariat*: a "contingency fee" arrangement is one under which an attorney agrees to take a case on the contingency that if he loses he is paid nothing, but if he wins he gets a fraction, usually one third of the recovery.)

[31] This is not to say, of course, that there are no other factors at work here which may contribute to the situation in the United States: the growth, for example, in the number of kinds of products on the market (currently estimated by the United States Commerce Department at 11,000 for consumer products alone) and in the number of each kind being produced is no doubt a factor in the rise in products liability cases.

ber of cases. The latter has come only with the rise of consumerism as a social philosophy.

50. The importance of isolating just how much of the increase in the incidence and size of products liability judgements which admittedly has been observed in many strict liability jurisdictions is due to the change in the rule of liability *per se* and just how much to other factors becomes most pronounced when one considers the matter of insurance costs. Clearly, to the extent strict liability generates more cases and more awards it is bound to affect adversely the insurance rates, since the insurer must charge more in order to meet the anticipated higher aggregate claims and administrative, including defence, costs.

51. Yet the relationship between the rule of liability and insurance costs is by no means a simple or direct one. In the first place, as was seen from the discussion on rate-making,[32] the actuary rarely concerns himself with the rule of liability as such. To the extent legal factors feature in his thinking he is concerned with trends, that is, with the over-all milieu of which the rule of liability is but a part and, as has been suggested, a not predominant part: he does not separate the fact of strict liability from factors such as the urge to sue, the sympathetic disposition of courts to large awards, high attorney's fees and other defence costs, all of which factors may well coexist with a different rule of liability producing the same cost effect to him and which, more importantly, may vary from jurisdiction to jurisdiction.

52. Furthermore, the actuary perceives these influences on costs through the medium of past over-all loss statistics for the period in view without any examination of the individual cases, or any breakdown of them into strict liability-associated and negligence-associated cases, thereby precluding any possibility of asserting that the same result would not have been reached without strict liability even given the other factors. The point thus is that it is at least doubtful whether a change in the rule of liability alone, unaccompanied by the other loss-influencing factors discussed, would produce a change sufficient to make a difference to the actuary's calculations, and yet this reasoning is implicit in the view that would blame strict liability for any anticipated or actual increase in products liability insurance costs following its adoption.[33]

53. This view of the limited role of legal rules *per se* in the rate-making process (seen in the context at any rate of a difference between "strict" and "fault" liability) tends to be confirmed by the fact that although a sizable number of jurisdictions in the United States have adopted strict liability as opposed to the fault principle still held by the other jurisdictions, the insurance actuaries there have found no reason to change their practice of using essentially one rate structure for the whole country.[34] That they have continued this practice in the face of what seems to be the differing exposures of an insured in a strict liability state and one in a negligence state suggests strongly that there perhaps is not that much of a difference from the actuarial viewpoint between these two situations. Put differently, the actuary may well have concluded that relative to the other factors shared by all the jurisdictions concerned the legal rule of strict liability is by itself not that significant.[35]

Strict liability, safety measures and insurance costs

54. There is one other determinant of the behaviour of insurance rates which deserves discussion here. This is the insured's or the industry's product safety record. Sometimes the improvement in that record and thus the reduced prospect of an accident may be so significant that it offsets, and occasionally more than offsets, the effects of loss-producing factors such as an increased number of claims and unfavourable legal and economic trends. The net result could then be a stabilization or even a lowering of rates. A dramatic illustration of this has been noted with regard to aviation liability insurance premiums in the United States which in 1975, according to one commentator, were running well below what they had been five years previously in spite of major increases in loss-producing factors.[36] Likewise it may be supposed that if strict liability encourages producers and others who handle products to become more safety conscious, it may well lead in the long term to a stabilization or at least a slower rate of increase in products liability insurance rates.[37]

55. A related question which has sometimes been raised by way of an argument against strict liability is

[32] See paras. 20-24 above.

[33] There may, however, be a different point that is being made, namely, that these other factors seem invariably to coexist with, if not be generated by, strict liability. It seems evident, though, that there is no necessary cause and effect relationship between strict liability and these other factors. What is true, however, is that because strict liability has historically come about in most jurisdictions by judicial evolution rather than legislative fiat it has tended to come about only in a climate in which the other factors were already at work, which explains the historical coexistence of strict liability and these other factors but does not permit one to draw the inference that strict liability could not exist without them.

[34] The only exception to this is the New York metropolitan area which has traditionally been treated as a separate rate territory for this purpose, but not, it would seem, for reasons of strict liability since the practice pre-dates the adoption of strict liability by New York State and furthermore appears to be confined to New York City and its environs.

[35] Other considerations may also have inclined the actuary not to attempt a differentiated rate scheme for the various parts of the country (e.g. the administrative costs of creating separate rate structures) but it is hard to believe that these would be decisive if in fact sound actuarial practice calls for such differentiation, particularly since insurance rates to be used in a state have often to be reviewed or approved by the insurance authorities of that state who wish to ensure that the particular rate structure is both adequate and fair.

[36] See John V. Brennan, "No-fault insurance in aviation products and services—one insurer's viewpoint", *Journal of Air Law and Commerce*, vol. 41 (1975), pp. 239-240 (foot-notes omitted). The author, who, as Executive Vice-President of United States Aviation Underwriters, Inc., is himself an insurance man, makes the following observations: "General aviation aircraft owners and operators are able to purchase all the insurance they desire at rates that are approximately forty per cent of what they were five years ago. This is true in spite of the fact that during the same period there have been between 600 and 700 fatal accidents per year and between 1,300 and 1,400 fatalities per year .... Airline insurance rates are currently twenty-five to thirty-five per cent of the rates in effect five years ago. These favourable rates apply in spite of the fact that there were only 146 fatalities arising out of United States airline operations in 1970, whereas 1974 saw a record 467 fatalities."

[37] There is no doubt that the trend in many industrialized countries toward stricter products liability, especially where coupled with consumerism, has produced greater safety consciousness among producers, particularly of consumer goods. This is well exhibited in the many publicized recalls and withdrawals of defective and merely suspected items which now take place.

whether the substitution of strict liability for liability based on fault would not operate as a disincentive to the safety-conscious, as opposed to the sloppy, producer in the fact that, as the argument goes, the insurer who hitherto had drawn a distinction in terms of rate treatment between the two would now simply treat them the same on the ground that it no longer mattered from the point of view of potential liability whether the producer acted reasonably or not.[38]

56. It is perhaps possible that strict liability would have this effect of obliterating, from the point of view of the insurer, the distinction between the careful and the not-so-careful manufacturer. This would be difficult to understand, though, for even under that régime the insurer would still have sound actuarial reasons for making the distinction. In the first place, the best insurance practice seeks first and foremost the reduction and, if possible, elimination of accidents rather than the strengthening of the legal position of the insured defendant, for once an accident occurs there is always the chance that the insurer will have to pay either because he cannot legally resist or because the cost involved in resisting (in terms both of money and business image) may be unacceptable to him. Since, therefore, the careful manufacturer is by definition less apt to provoke an accident than his more sloppy counterpart, even though their respective legal positions may become identical once an accident has occurred, the insurer under a strict liability régime still has good reasons to favour the former in his rating practice. There is also the point that the insurer knows that though the fact of liability may be as easily established in the case of the careful manufacturer as in the case of the not-so-careful one, the actual amount of damages awarded by the court, especially under a régime employing jury trial, may very well differ in the two cases in reflection of the court's judgement as to the relative "fault" of the defendants.[39]

57. The foregoing discussion of the relationship between strict liability and insurance rates may be summarized as follows. There is good reason to expect that the adoption of strict liability would lead to some increase in the number of products liability cases that are brought and in the number which go against the defendant. How much of a difference this simple fact of a change in the legal rule would make would depend on the pre-existing legal situation and the over-all legal and social climate. As far as insurance rates are concerned, although in the long run the cumulative effect of the increase, however small, in the number of claims against insureds will begin to tell on rates, there is reason to believe that only a small part, if any, of any rate increase occurring in the period after adoption of strict liability is properly attributable to the fact of strict liability itself as distinguished from the effect of the other loss-generating factors which sometimes, though not necessarily, go with strict liability.

E. *Monetary limits, prescription and certain defences*

Insurance implications of monetary limits to liability

58. The next issue to be considered relates to limits of liability. More precisely, the question is whether it is desirable or perhaps even necessary from an insurance point of view to have a maximum limit to the defendant's potential liability and, if so, what form this should take. The two kinds of proposal most often mentioned in this connexion are a maximum over-all limit per defendant per year (or per other defined period) for each product or for all products, and a maximum limit per claimant with regard to each occurrence or related series of occurrences. A third position would combine the two and provide a limit per claimant with an over-all ceiling on the aggregate amount payable by each defendant.

59. With regard to the aggregate limit idea as distinguished from the per claimant concept, it has often been pointed out that it is essential for the insurer when he writes a policy to have an idea of his possible total exposure in order to be able to calculate his risk and the consequent premium due and that as a result it is essential to provide in a uniform scheme for a maximum limit to a defendant's liability. While this statement is substantially true, it does nevertheless call for elaboration and some refinement. There are several reasons why an insurer needs a maximum figure to work with. He needs it, firstly, for his actuarial calculations, including determination of premiums and the appropriate reserves[40] to maintain; secondly, he would need it if he should wish to reinsure the risk with another insurer; and, lastly, he may need it to ensure compliance with a common statutory provision in many jurisdictions which forbids an individual insurer to assume liability on any one risk in excess of a certain proportion of its surplus.[41]

60. It is not, however, essential, though it may be desirable for reasons soon to appear, that the limit be stated in the liability scheme itself, such legally established limits being after all the exception rather than the rule in the general law of civil liability. Insurance has operated in the civil liability area (including liability for tortious negligence) for years and continues to do so even though the insured's liability exposure is in principle unlimited.[42] What the insurer does in such a case, however, is to provide by contractual agreement with the insured for a maximum limit which is inserted in the policy and operates to delimit the insurer's liability on

---

[38] See, for example, *Liability for Defective Products*, Law Commission Working Paper No. 64, Scottish Law Commission Memorandum No. 20 (London, HMSO, 1975), p. 36.

[39] It is also true that prior to insuring the producer, the insurer reviews the producer's safety and quality control programme and uses this as one element in his decision whether or not to insure such a product and at what level of premiums. Incidentally this point is one argument against channelling liability to the importer rather than to the producer. Since the importer generally has little to do with the way the product is produced and so with its safe or dangerous condition, a distinction between importers on the basis of product safety certainly appears less meaningful. (Indeed such a distinction may not be feasible except where one is dealing with businesses each of which imports but one or two products.) In any case, the problem remains in the case of the importer that the insurance underwriter will have to wait till he can look at the actual safety records of the products concerned whereas with the manufacturer an *a priori* evaluation of the manufacturing process is possible.

[40] A "reserve" in its simplest signification is the technical term for the amount which the insurer puts aside (reserves) for the purpose of meeting claims on the insured risk.

[41] Quite apart from such legal prohibitions, it seems doubtful that an insurer as a prudent businessman would wish to risk his entire assets on a single contingency.

[42] Although, therefore, it has become the common practice in internationally established liability régimes, especially ones imposing liability on a basis stricter than fault, to insert into the scheme a maximum liability limit, there is nothing inevitable about this.

the policy. Should the proposed scheme thus be introduced without a maximum limit provision, the consequence would simply be that the pre-existing practice of contractually determined policy limits would continue to operate, with resulting variances, of course, in the limits chosen by the individual insureds.

61. The effect, therefore, from an insurance perspective of including a maximum limit provision in the liability scheme proposed would be that instead of every insured making his own estimate of the amount of coverage he needed to take out, he would have a figure to aim at, which, it is thought, should result in many insureds carrying coverage for or close to the amount of the maximum liability.[43] This would have the advantage of reducing under-coverage on the part of the businesses affected; it might possibly also have the effect of increasing the ordinary cost of doing business either because a particular business is then carrying more coverage than it really needs or simply is carrying adequate coverage where once it used to be undercovered from the point of view of its exposure.

62. The other kind of limit, as indicated, is the per claimant limit. As to this, it is often said that it has no functional value from the point of view of insurance calculability. This statement too requires some qualification. It is true that as compared with the aggregate limit device, the per claimant limit is of secondary, if not minimal, value in calculating potential exposure for the simple reason, of course, that it sets no limit to the total possible exposure. Yet, it is not altogether without significance for the insurer in that even if he does not know what the upper limit of liability is, he does know that no recovery in excess of a certain amount can be had by any one claimant. This means that if he can estimate the number of claims there might be in the relevant period, which he ordinarily tries to do anyway, he is able to have some idea of the total loss to expect. Thus even this represents an improvement in calculability from the current situation in most jurisdictions where the exposure is open-ended at both the single claimant and the total group level.

63. One final comment which may be made on limits relates to the level at which the aggregate limit is fixed. It obviously should not be fixed so low that there would not be enough funds even if the whole amount were used up to meet a reasonable number of claims arising from the insured's defective product. On the other hand, it ought not to be so high as to defeat its substantive objective of protecting the defendant from the possibility of catastrophic liability, that is, from aggregate claims beyond an order of magnitude that is considered reasonable or possible for him to bear, particularly with regard to claims arising out of one malfeasance or one act of bad judgement. Considerations of "insurability" come into play in this context in that high exposure amounts coupled with high risk may mean such heavy insurance costs as would make the difference between an "economic" and an "uneconomic" business venture. This would be particularly true of a young industry or enterprise, which often must embark on its period of growth, experimentation and learning on very meagre resources and thus could ill-afford high insurance costs.

[43] This calls to mind, too, the possibility of requiring under the scheme that the defendant on whom liability is channelled maintain liability insurance of a specified level.

64. Furthermore, if the exposure is not merely high but reaches the level of the catastrophic, the problem may shift from the simple one of high insurance costs to that of finding any insurer that would even accept the risk, for although the insurance market is able by reinsurance, joint underwriting and similar "pooling" devices to provide a sizable insuring capacity, that capacity is obviously not unlimited. Consequently an excessively high exposure, especially if coupled with the significant probability of loss occurrence which does exist for some products, may have the result of making it difficult for some businesses to find insurance or to find it for the full amount of the prescribed limit. In practice, however, the limit, and thus the potential exposure, would have to be set at a very high level indeed for this question even to arise if one had regard to global insurance capacity, as is evident from the high level of exposure in many risks that are routinely insured every day—nuclear hazards, aircraft and general aviation risks, factories, etc. The question assumes its greatest significance, therefore, only when one thinks of domestic and regional insurance capacity especially in the developing world.[44]

Prescription (limitation period) and insurance costs

65. The one aspect of prescription (limitation period) which calls for special notice in the context of insurance is the perennial problem of products liability insurance sometimes called the "long tail" factor. This refers to the situation under which insurers often find themselves paying claims arising out of products manufactured or injuries suffered before the current policy came into being because of the fact that products liability policies typically cover all damage occurring or substantiated during the policy period regardless of when the act or omission creating the injurious defect took place or, depending on the policy and subject to requirements relating to prompt notice of loss, the injury sustained.[45]

66. The problem is most noticeable in the case of capital equipment such as machinery and with respect to durable goods where it is not uncommon to have a large number of the products covered by the policy be 5, 10 and sometimes even 20 years old. This obviously poses many problems for the insurer. Apart from the higher propensity for generating loss which older products, made according to different standards and without benefit of current know-how, must exhibit, loss predictability itself is adversely affected. This is so because even if one could predict the frequency of accidents involving, say, a particular machine, the size of the claim settlement will depend on whether the claim arose this year or five years later when there will have occurred not only economic inflation but an inflation, too, in terms of

[44] Such a situation might, on the other hand, stimulate the development of the domestic insurance industry in those countries as well as give impetus to the sort of co-operation among them in the insurance sector that is contemplated by the 1974 General Assembly Declaration on the Establishment of a New International Economic Order. See, on this, the UNCTAD secretariat study cited at foot-note 11 above, especially para. 86 *et seq.*

[45] Cf. following provision of Danish policy: "This insurance covers liability for bodily injury and physical damage *substantiated* during the currency of this policy regardless of the date of any act or omission in which the liability for the occurrence has its origin" (emphasis added), reproduced in *La responsabilité civile du fabricant dans les Etats membres du Marché commun*, *op. cit.*, p. 124.

social expectations. Insureds too have the problem of keeping track of durable products sold many years ago in case new technology or experience reveals a safety hazard which they are either obligated to or wish themselves to remedy.

67. It is no wonder then that one of the factors persistently blamed by business and insurers for the rising cost of products liability insurance, in industrialized countries especially, is the "long tail" effect. Limitation of the period during which a claim may be brought in respect of a product (creating a sort of legal-liability-life-period for products) is therefore a key point in many industry and insurance group recommendations for reform of products liability law. Particularly is the need for this stressed if strict liability were to be admitted, for then the insured could not even show in defence lack of negligence in the manufacture of the aged product in question. The proposal in the earlier part of this report[46] to provide for the cut-off of all claims with regard to a product at some point after that product was first put into circulation should serve, therefore, to alleviate the concerns harboured by the business and insurance sectors in this regard.

Development and system risks

68. As pointed out in the earlier discussion of current insurance practice in the products liability field, products liability policies sometimes contain an exclusion which is intended to deny coverage for this kind of risk. Furthermore, even where the policy is silent on this point there is exclusion in fact in many jurisdictions in that the defendant is able to avoid liability by showing that the alleged defect occurred in spite of all reasonable precautions on his part or was one which according to the state of scientific knowledge then in existence was not or could not be known to be a defect, or, being known, could not be avoided. With no liability on the part of the insured, no question arises of a development risk exclusion.

69. There is thus great interest among producers (and their insurers), in the treatment that might be accorded "development risk" under the uniform scheme. One must ask then what the effect might be on "insurability" and insurance rates should the defence not be recognized, that is, should the defendant be liable although the product was produced in accordance with and met the highest scientific and technological standards then available.

70. There is evidence to suggest that such a development might tend in many insurance markets to limit the number of companies writing products liability insurance. As it is, insurers do not appear in general to show much enthusiasm for writing this coverage even with the exclusion and there is evidence, in the United States, for instance, of some withdrawal by insurers from this line of insurance and a growing reluctance by others to continue writing it.[47] Furthermore, it seems too that coverage for the kind of risk contemplated under the development risk exclusion would be similar to that currently provided under what is called an "errors and omissions" policy. This latter coverage, which typically is carried by engineers, research scientists and others likely to commit design errors, is, however, available only from an insurance market that is even more specialized and limited than the one from which products hazard coverage may be obtained, thus suggesting that fewer companies than at present might be willing to write products liability insurance that would include elements of what is now covered under the "errors and omissions" policy.

71. A similar conclusion is suggested with regard to insurance rates. Rates for what is now "errors and omissions" coverage are typically higher than those for products hazard coverages. Consequently coverage for an insured which would include features of the current products hazard coverage and the errors and omission coverage, whether issued in one policy or separately, might well be expected to cost more than the present products hazard coverage.

72. There are, on the other hand, certain considerations which tend to suggest a less severe impact on insurance from the proposed change than may at first sight appear. First of all, as far as is discoverable from case law and legal literature, instances of true development risk materializing appear fortunately to have been very few indeed, suggesting a very low frequency of loss for the insurer even should coverage exist. Secondly, not all products liability coverage is currently written with the development risk exclusion, and though this in itself may signify only the insurer's confidence that the insured would be able to avoid liability in such a situation (see para. 68 above) it does nevertheless indicate a certain acceptance by insurers of the possibility that they may have to cover such loss. What all this does, therefore, is to raise the question whether insurers truly foresee a major increase in loss frequency or severity should they now have to provide coverage for this risk or whether their current position on the issue derives more from tradition and an abundance of caution.

73. A third factor to take into account, at any event, is the inclusion of maximum limits in the scheme of liability contemplated. This should go a long way towards making insurers more receptive to the idea of providing coverage for development risk since the major factor underlying exclusion of such risk is, it may be supposed, the fear of huge or uncontrollable losses arising from a planning or design error which perforce infects every product produced under that plan or utilizing such design. Such loss potential would now be limited by the applicable maximum limit, becoming thereby in addition more predictable.

74. Should insurers decide, however, that it makes a lot of difference to the premium chargeable that the policy provides or does not provide coverage for development risk, then one would think it would be preferable to have that coverage provided by way of separate endorsement to be bought and paid for separately. This would allow the coverage to be bought by those insureds alone who need it and thus avoid foisting the extra cost of that coverage on the many insureds for whom there will be only the remotest likelihood of liability on this account: an insured who deals in writing paper, for example.

Conclusions

1. The analysis of replies to the questionnaire reveal the existence of considerable divergencies among legal

[46] See part III, paras. 75-76.

[47] This point is continually made in the business press of that country. Cf. *Product Liability Insurance*, Report of the United States Department of Commerce (Washington, 1976), espec. p. 36.

systems in respect of liability for damage caused by products. These divergencies pertain to important issues such as the legal basis of liability, the grounds of exemption from liability and the kinds of damage for which compensation is recoverable. Depending on which law is applicable and in which jurisdiction damages are sought, the question whether compensation can be obtained and to what extent, and from whom and under what circumstances, will thus often receive a different answer.

2. In the setting of the international movement of goods, where increasingly goods produced in one country are used or consumed in others, the disharmony in the law of products liability has resulted in uncertainty from the point of view of both the consumer or user and the producer.

3. The survey made in parts I to IV of this report would appear to indicate that the preparation of rules establishing a uniform liability scheme is feasible.

4. The Commission may wish to consider whether there are *prima facie* sufficient grounds that would justify a continuation of work on products liability.

5. Should the Commission conclude that a continuation of work on products liability is at this stage justified, it may wish to consider in what direction such work should proceed and indicate the issues which in its view need further study.

6. It is suggested that further work be concentrated on the preparation of a preliminary draft set of rules for a uniform liability scheme. This draft set, to be accompanied by explanatory notes, should envisage alternative solutions, particularly in respect of the legal basis of liability and the persons incurring liability. It is expected that, if work were organized in this way, it would show more clearly the feasibility of a particular scheme and facilitate the policy decision which the Commission may wish to take at a later stage of the work, namely whether the subject-matter is of sufficient importance in the context of international trade to justify the drawing up of uniform rules and, if so, what would be the appropriate type of instrument.

7. If the Commission should conclude that work towards the preparation of uniform rules should proceed, the Secretariat suggests that such work should be guided by the following considerations.

(*a*) The scheme should be inspired by the general policy considerations underlying the evolution of products liability law that were identified and evaluated in part I of this report.

(*b*) As to the legal basis of the scheme, for the reasons stated in part II of this report, the contract approach, including warranty, is not thought to constitute a suitable basis for a uniform liability scheme. The scheme should instead focus, by means of alternative sets of draft rules, on the following alternatives:

(i) The traditional negligence concept under which the burden of proving fault would be on the plaintiff;

(ii) The modified negligence concept under which negligence on the part of the defendant is presumed; in other words, under which the defendant has the burden of rebutting that presumption or proving absence of fault;

(iii) The strict liability concept, based on the defective, dangerous condition of the product. As has been suggested in part II of this report, except for development or system risks which call for special consideration, strict liability can be viewed as virtually similar to the concept of "presumed negligence" ((*b*) (ii) above).

(*c*) As to the persons incurring liability, it has been submitted in part III of this report that producers, including suppliers of component parts, and commercial distributors, could be regarded as potential defendants. However, a case has been made in favour of limiting the number of potential defendants so as to provide greater certainty as to who is liable and to avoid the pyramiding of insurance costs. Although the report reflects a preference for channelling liability to the importer ("the first national distributor"), it is suggested that further consideration should be given to the possibility of channelling liability to the producer, or to the importer and the producer, and that alternative sets of draft rules should reflect such possible options.

(*d*) The preliminary draft rules would also be concerned with such issues as the types of product covered by the scheme, the persons who could claim compensation, the interests to be protected, what damages are recoverable, defences available to the person liable, periods of limitation, maximum amounts, the scope of application of the uniform scheme and its relationship to other liability rules.

B. Report of the Secretary-General: analysis of the replies of Governments to the questionnaire on liability for damage caused by products (A/CN.9/139)*

CONTENTS

* 13 April 1977.