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Discussion

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Discussion After the Speeches of Mr. Oreffice and Mr. Gow

QUESTION, Professor King: The market orientation of investment in the United States involves leveraged buy-outs and short-term orientation. Doesn't this have a profound effect on the ability of the United States to compete in innovation?

ANSWER, Mr. Oreffice: There is no question about it. Sometimes we talk about U.S. management being short-term oriented, but U.S. managers have had to become somewhat more short-term oriented because of the threat of leveraged buy-outs. A fellow who is running a company from a leveraged buy-out recently bragged to me, "You know what our research expenditure is?" I said, "No, what is it?" He said, "Zero." And I said, "Well, you have a marvelous company for the next two or three years. I hope you're broke ten years from now."

QUESTION, Professor King: I have a question for Mr. Gow in connection with the position of Canada. I have noticed that countries such as France, which have limitations, target certain industries as the basis for their industrial development. Then they develop sort of a national concept of where they want to go. Do you think Canada's limited resources will lead her in that direction?

ANSWER, Mr. Gow: I think in some respects that is a necessity because of our vast size and our low population of 26 million people. We have to be a little bit more focused. There will always be fringe groups that are developing in these other directions. I think we have an obligation now, from our participation on the new bilateral trade agreement between our two countries and other trade agreements, to become very proficient at what we do best. At this point we must focus on building on our strengths and not try to be all things to all people.

QUESTION, Mr. Bradley: There is a controversy related to the whole question of using government funds to procure technology and somehow in the process stimulating R&D in the local economy. I have always had trouble with that in Canada, especially in light of the fact that we spend a great deal of time trying to open up U.S. government procurement to Canadian companies, including research institutions. In fact, some of us believe that under the Free Trade Agreement we may accomplish that in time. It seems to me that we cannot have it both ways. We want to close down government procurement and cannot criticize the United States for doing so. Which, in your view, is the better track?

ANSWER, Mr. Gow: Well, let me put it this way. Most of the gov-

ernments buy U.S. or U.S.-distributed goods. There is a fairly open market for that. I do not think that is going to change much.

What I was referring to in my procurement discussion is the establishment of R&D, so that if an agency has identified a business that needs to develop something, R&D support is there to encourage that small firm. By the way, the firm does not have to be strictly indigenous, it can be a foreign firm doing business in Ontario. It is also possible to submit a proposal, say to the Department of Health, to do cooperative research in Ontario and obtain funding from the government for R&D. That department or that ministry is not required to buy the finished product, but this is a way of trying to get people to focus on the fact that they have to invest in R&D. So I guess in my role as an initiator, I need to put a carrot there to try and encourage people to do more R&D. It is not really cutting out other countries because they in fact do the same thing.

I do not believe that there is a problem with our opening or closing of government procurement under the Free Trade Agreement. We certainly have a balancing factor because we are shut out of the U.S. defense programs in those R&D areas.

COMMENT, Mr. Bradley: That is my point. Several of us in the Embassy spend a great deal of time examining the new U.S. regulations which have been promulgated as a result of the Free Trade Agreement. It is understood that U.S. R&D procurement contracts above \$25,000 are now open to competition from Canadian firms. While it takes some time, I would expect that in two to three years many Canadian companies will be getting those kinds of R&D contracts. That's why I say we can't have it both ways. If the United States perceives us as shutting down our government procurement, they will do the same.

COMMENT, Mr. Gow: I think we have to work very hard to keep that communication line open to make sure that we are not.

QUESTION, Professor King: We have heard about the necessary role of government in R&D in Canada. What should the role of government in the United States be in R&D so that we will remain competitive with the Japanese and the West Germans?

ANSWER, Mr. Orefice: I personally think that the government should only do research in areas such as defense and maybe some humanitarian areas where you cannot get private research. I believe most research has to be done via private means in the corporate and academic worlds. That is where I feel we have failed in the last three years. I think the role of government is that of a facilitator. Consider our tax laws, for instance, I think laws ought to be designed to help research remain in the United States as opposed to elsewhere. Laws should not hinder research, as has been the case. Nor should the government make direct handouts. I think direct handouts by the government for research are usually ineffective. Private enterprise has to go out and get financing.

COMMENT, Mr. Stayin: I have been active in the Washington ef-

fort to pass a federal product liability bill. Many companies feel, as you do, Mr. Oreffice, that product liability may be the number one limiting factor on U.S. innovation.

Over the years Members of Congress have criticized the business community for not making an all-out effort to get this bill passed. They say that while the business community cares about product liability, it is not high on their list of priorities for action in Washington. The usual description of priorities places product liability fourth, fifth, sixth or maybe lower, so it does not get the same attention as other issues. The Members of Congress are saying that other issues have more priority, and, therefore, the product liability bill is not moving. On the other hand, lawyers and consumer groups who oppose the bill are aggressively fighting it.

COMMENT, Mr. Oreffice: I think that is the classic cop-out in Washington when they do not want to do something. For the last five years I have made product liability my number one issue in Washington. The Business Roundtable has also made product liability one of its two top issues along with the budget deficit. The coalition which includes the Chamber of Commerce, the National Association of Manufacturers, corporations, and so forth, also made product liability a top priority, and worked very, very hard on it last year. The cop-out is to say it is not a priority. I think the business world has made it a top priority. But as long as we have Fritz Hollings in the Senate, and a few other people in the House, we are not going to get anything passed. They are going to find a way to stonewall it. There are too many trial lawyers in Congress.

It gets frustrating and as a result people have dedicated more time and attention to the state level where progress can be made. Real progress was made here in Ohio last year. I think the response of state legislators is one of the reasons why the effort is put forth on the state level.

About two years ago, the Business Roundtable named one of us to be the "head guy" for each state. In Michigan, I was chosen to put all our efforts together. I am not one of the most successful state appointees; we haven't accomplished anything in Michigan yet. However, the effort is there. It is a very frustrating issue.

QUESTION, Mr. Mackey: I'd like to further explore this liability issue. You called for tort reform. My question is premised on the perception in the United States that an injured person needs to have an opportunity to recover, and does not have to be rich to be able to go to court and do so.

I agree that there is a need for tort reform, but this reminds me of the preacher in church who was talking about all the sinners out there and what was going to happen to them because they were not in church. The problem was the sinners could not hear him.

What do you perceive as an ideal solution to what I will characterize as the "social" problem? In addition, how do you provide a reasonable

basis for industry to go forward and carry on risky research and other risky ventures?

ANSWER, Mr. Oreffice: This "social" problem exists all over the world, yet we seem to be the only country that constantly worries about the poor people who would not be able to sue. We operated under a pretty good legal system for a long time. Going back to the negligence standard, instead of strict liability, does not deny the rights of people. Negligence establishes that there should be fault before somebody is guilty or has to pay.

The problem today is the way the system has been skewed. One of the most miserable decisions I have to make arises when our legal people come to me with a huge lawsuit. They say, "We are 90% sure to win it. However, you should understand that it is going to take between three and five years and will require days and days of depositions from the company's management. It is going to cost us a minimum of \$5 million to defend it and the plaintiff will settle for \$200,000." What do you do? You hold your nose and say, "Pay and let's get on to the next thing." This is why I call it settlement blackmail, because they know they have you.

We have to re-establish the system and provide some balance. If somebody is guilty, if a product is defective, I think we ought to throw the book at them. The problem today is that there is really no defense against things that are not defective. We need to bring some balance back to the system.

QUESTION, Mr. Mockensturm: Is product liability as big a hindrance to research in Canada? If so, is the provincial government looking at any reforms in the Canadian legal system?

ANSWER, Mr. Gow: No, it is a little bit different in Canada. I think one of the things that assists us is that our legal system prevents lawyers from operating on a contingency fee basis. Many of the lawyers in the United States do product liability cases on a contingency fee basis and hope they will eventually win and get paid. Canada operates upon a fee structure, not a contingency fee basis. However, the law society and a few others have begun talking about contingency fees. When they start talking you know that they are picking up some momentum. I think they are getting a good education from their U.S. counterparts on what they should be doing and all the money that can be made.

QUESTION, Mr. Oreffice: Isn't it also true that in Canada if you bring suit and lose, you are very likely to have to pay the other side's legal fees?

ANSWER, Mr. Gow: That is correct. If you lose, you can be assessed all charges, costs and other expenses.

COMMENT, Mr. Oreffice: Another problem with the U.S. product liability system is that you have to go to trial on the same thing over and over. This is so frustrating and so tough on innovation. We have one

pharmaceutical product, *Bendectin*, for which we have now had twenty-seven cases, including one case which consolidated 1100 separate actions. So far, we have won twenty-three. Of the four we lost, two have already been reversed. We expect the other two will also be reversed, since the courts are saying there is no scientific data at all to support these actions, but we have suspended the product because of the costs involved. Still we have to keep fighting year after year, making the same arguments in different courts. Something needs to be done to ease this burden.

COMMENT, Mr. Allen: I wanted to make an observation with respect to the point Mr. Gow made concerning Korea. I have had experience in Korea over the last dozen years or so. The Koreans are a very hard working group of people, but they are not terribly innovative. The real advantage that Korea has is that labor costs are low. Workers put in long hours, and get very little monetary reward.

Japan had that advantage ten or twenty years ago, but recently Japan has worried more than anyone else about the Koreans. Eventually, there will be a time in the future when the Koreans will be worried about the Malaysians, and the Malaysians will be worried about the Thais. It's all a question of the cost of production.

An interesting example of this situation is American Telephone & Telegraph ("AT&T"), which no longer produces telephone sets in the United States. Instead they are produced in Singapore. Northern Telecom is the last major supplier-manufacturer of telephone sets in the United States. At one point Northern Telecom was competing with AT&T in Singapore to supply telephone sets to the Singapore Telephone Authority. Northern Telecom ended up getting the contract. They supplied the sets from a licensee in Korea and got the order because they were able to quote a lower cost.

It is a very complex world and we are going to have to learn to compete with these costs. One way Northern Telecom has done this is to re-design telephone sets. Instead of a telephone set requiring forty-five minutes of labor to manufacture, technology has been put into microchips which reduce the labor content to about seven minutes. Thus, North American employees can be very competitive, but this is a cost factor.

COMMENT, Mr. Oreffice: The last thing you said is the key. The U.S. chemical industry is still number one in the world and exports exceed imports because we are not labor intensive. Our total cost of salaries, wages, fringe benefits and so forth, is less than 17% of the dollar sales. So the dollar differential of doing business in Korea is not significant enough to make any difference.

COMMENT, Mr. Allen: But we must not make the mistake of the U.S. steel industry, and stay with a very old, ancient installed business base, we have to innovate. We have to spend the money today.

COMMENT, Mr. Gow: I agree. I do not have any sympathy for

any of the steel companies. They did not put forth the effort to research when they should have, nor did they invest in research for advanced materials that they should be competing with now.

The last company that I was with, Gandalf Technologies, had a target of 4.5% of manufactured costs in labor in order to keep themselves in business. We had to apply all available technology to get to 5-5.5% of our manufactured costs. You have to really concentrate on the innovation of labor productivity.

QUESTION, Mr. Blackburn: Mr. Oreffice has spoken of restoring the authority of regulatory agencies as part of the solution on the liability side. In Canada, our national advisory group has identified the need for improved regulation in the area of biotechnology. Establishing a more secure regulatory system capable of dealing with new biotechnology products is probably the main thing that the government could do to facilitate the growth of that industry. Do you feel that regulatory agencies in the United States have developed systems capable of providing a secure regulatory framework? In other words, are regulatory agencies capable of being the authority in these new areas of technology at this stage?

ANSWER, Mr. Oreffice: The Food & Drug Administration ("FDA"), overall, does a really good job in the technological department, although that varies from agency to agency. The frustrating thing about the FDA is the bureaucracy. Sometimes if you get a product through technical evaluation, you wait indefinitely for marketing approval. In the case of one of our major drugs, the data sat on one desk for three months because the person responsible for it had back surgery. The file could not move until this person came back. A very useful drug just sat there for three months. In general though, I think that regulatory agencies are very capable of handling new areas of technology.

By the way, since last year, Ohio has taken the position that FDA approval is a legitimate defense in court. The only limitation is that you must have correctly completed all of the steps for FDA approval. That is what I meant by the establishment of authority.

COMMENT, Dean McNiven: Mr. Gow made reference to the lack of people going into science and technology related fields in the university. I went back into the university field after a dozen years, and have as one of my responsibilities a business school. I was struck by the fact that in the business schools at Dalhousie University in Halifax only 45% of all new MBA students are from science and technology backgrounds. The average across Canada is about 30%, or perhaps a little higher. Dalhousie University is a little above average, but not that much.

I asked some of these students why they were pursuing business degrees, and the answer was very simple. As MBA graduates they get 25-50% more money than with a masters degree in engineering or science. It didn't make any sense economically for them to pursue a science or

engineering career. I think that goes back to Mr. Allen's discussion of cost relative to the Korean market and the United States. If you are not going to compensate scientists and engineers, then why would people want to pursue these careers?

COMMENT, Mr. Oreffice: Those figures you mentioned regarding MBA students certainly do not apply to the United States, with the possible exception of those who go to Wall Street and start making \$100,000 six months later. When you actually look at the pay scale, a person with a bachelor's degree in chemical engineering makes almost as much as a person with an MBA.

I think our biggest problem in the United States is that we have discouraged science in junior high and high schools. While it is very useful for technical people to have an MBA, it is a very negative trend. It is a negative trend because science students with an MBA do not want to go into science, they want to go into business. This is draining even more of the scientific innovators. I agree that this is a terrible problem. When we look to the future to determine where our people, our engineers and scientists are going to come from, we are very concerned.

Today, The Dow Chemical Company hires 10% of the graduating class of chemical engineers across the whole United States. It is staggering, but there are not that many chemical engineers.

COMMENT, Dean McNiven: I agree with your concerns, but I was just trying to express the fact that whether they are right or wrong, students who might otherwise go into engineering say they make more money by going into business.

COMMENT, Mr. Gow: This is where we have to come up with an infrastructural change. The structures of our companies are such that you cannot advance through the ranks unless you become a manager. Why can't an excellent engineer progress through the ranks of the company in a parallel stream? But then you open up another can of worms. We have some problems in Canada because there are discrepancies between the working hours and salaries of engineers and managers. You have an imbalance here that has to be straightened out, it is an infrastructure problem. We have to cure these problems and change the way we run companies.

We have to change the way we run the government, because the government should not be handling this. The government should be a facilitator, nothing else; it should push, encourage and be a cheerleader. It should not be the quarterback on the field; it needs to get out of the way. We have allowed government to take over too much.

QUESTION, Professor Edwards: Is this a business where a person pursuing a career in a technical field, in order to be successful financially and to gain prestige, has to move out of the sciences and become a manager? Because then you may end up managing scientists, but you won't

actually be doing the technical work. I was wondering if, in a firm like Dow, there are variations that would make that an inaccurate statement?

ANSWER, Mr. Orefice: Yes. Ten or twelve years ago we recognized the problem and did something which was considered very noble. We allowed a scientist to move up in a scientific lab, just be a top researcher, and make more money than the manager of research. We set up some scientific labs for people who were excellent scientists and lousy managers so they could still get compensation for the contributions they were making.

Incidentally, we have done the same in sales. We used to take very good salesmen and make them into lousy sales managers. We have now made it possible for top-notch salesmen to make more money than the sales manager. But this is not prevalent in the industry.

COMMENT, Mr. O'Grady: I just wanted to point out that North America is distinct from the rest of the world because there is a certain amount of hostility in viewing science as a business establishment. These sentiments are not really expressed in other countries because of their political or social structure.

Listening to your remarks about tort liability, even assuming that your technical case is well-founded, made me wonder what the political faction is doing to make the situation understood by the claimants. Whatever they are doing, they should also be doing something to create the image that if you make mistakes, you will be responsible. Responsible could mean being quickly responsive to the people who are caught up in this rush of innovation.

This has implications for the educational structure. People do not want to go into science if they perceive it as socially unattractive. That's not an informed opinion, but I think it is prevalent out there.

COMMENT, Mr. Orefice: I agree with you completely. We have a terrible problem to overcome, because regardless of what we do, all you have to do is flip on the television at night to see businessmen portrayed as ruthless people who kill to make higher profits. In addition, scientists are portrayed as people who know their product will hurt everybody but don't care.

This image problem is very tough to overcome, however, we are working very hard in the chemical industry. In the last few months, we have approved a program which we call Responsible Care. This program entails caring for our products all the way from the laboratory to the market. The companies proffer safety standards and so on. Responsible Care has been made a condition of membership of the Chemical Manufacturers' Association of the United States. If you do not subscribe to the principles of Responsible Care, you are not part of the Association. We wanted to start small and make something that really worked. We do not want to make it a big public relations thing, but if it works, we expect to get some better publicity.

Incidentally, the founders of the program were Canadian. They had a Responsible Care program. We copied it by working very closely with them. Now, we have stepped ahead of them by making it a condition of membership. Hopefully these things will help, but it is still a big hill to climb.

COMMENT, Mr. LeNeveu: I appreciate knowing that the Responsible Care Program did start with our association in Canada several years ago. By the way, it is also a condition of membership in our association and is now being picked up in the United Kingdom, Australia and even Holland. But the problem still exists. The problem is in the public perception of chemical manufacturers, not just in the chemical industries, but the pulp paper and steel industry as well as other industries which are seen as purveyors of products that are dangerous to the public and the environment.

I think this is really having an impact on the level of interest of younger people going into chemistry courses. The fact that Dow is hiring 10% of the chemical engineering graduates in the United States is astounding. We had a meeting with the heads of the technical engineering and chemistry departments of all of the universities in Canada. They confirmed the sort of numbers that we were starting to hear. Now we are starting to look ahead to the future in terms of where we are going to find those young people. I don't really know the answer to this problem, or how we are going to deal with it.

