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Product Liability Overseas: Competitive Effects on Canadian Industry

*Grant Murray**

In a recent mini survey that I did of several of my business colleagues and some insurance brokers in Canada, I found that Canadian firms are not facing any serious product liability problems or, indeed, insurance problems in overseas markets, although I am sure there are some exceptions.

It is true that there are some proposals outstanding in some countries, particularly in Europe, that could increase the exposure. However, because of a combination of the existing laws in these overseas markets, and the difficulty foreign plaintiffs have in obtaining recourse against Canadian companies in Canada, there are currently very few problems.

However, this same survey also made it very clear that Canadian firms and the insurance industry are very concerned about their exposure when Canadians are selling into the U.S. market. While it is difficult to claim that the United States is an overseas market, I only plan to deal with the problems Canadians face when selling into the U.S. market. On the surface it would appear that the product liability laws in the United States do have an impact on the ability of Canadian companies to be competitive in the U.S. market. On the other hand, I believe this is much too simplistic a conclusion and that this situation is attributable to other, more fundamental, factors.

Having reached that conclusion, the challenge becomes how to approach this subject, because as I researched it I found it was like dealing with a Rubik's Cube. So the road map I propose to follow is first to look at what I perceive to be some of the significant differences between the legal environments in Canada and the United States and therefore, the relative exposure in each country. Then I will move on to some real life situations and give you some specific experiences of Canadian companies and the highlights of some surveys that have been done in Canada. Following that, I will venture into the area where it becomes rather difficult to separate law from fiction and deal with what is being called the insurance crisis. Finally, I will draw some brief conclusions.

First then, some observations on the differences in the legal environments. Here I plan to be short on specifics and long on generalities.

At the outset let me state that in Canada in recent years, there has been a clear trend toward strict liability or, at least, a significant increase

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in the number of judgments where the plaintiff has succeeded without having to prove negligence or lack of care on the part of the defendant. Although none of our courts have yet enunciated a general principal of strict liability for defective products, they are applying concepts such as "inherently dangerous goods," "failure to warn," and "no reasonable expectation of inspection" more widely. In addition, three provinces (New Brunswick, Saskatchewan and Quebec) have enacted statutes which, for all practical purposes, establish strict liability for defective consumer products.

Nevertheless, there are still numerous situations where the plaintiff must prove negligence and where the traditional common law defenses are available to the defendant. Notwithstanding the trend toward strict liability, however, the exposure in Canada is not as great as it is in the United States where strict liability is much more widely applied. Therefore, on the basic question of liability, a supplier in the United States faces a greater exposure than a supplier in Canada.

Moreover, as you have already heard, there are differences between the tort litigation systems of our two countries and, indeed, between the United States and other countries, which clearly do increase the exposure to anybody supplying the U.S. market. Let me deal with just a few of these. You may have already heard some of them. First, in 1978, the Canadian Supreme Court, in a series of cases, imposed a ceiling on non-pecuniary damages and generally speaking that ceiling today is \$100,000. Although some states have enacted statutes which place a ceiling on damages, it is my understanding this is still the exception and not the rule here in the United States.

With the exception of Ontario, and probably Quebec, Canadian provinces do allow contingency fees of a sort, but these fees are very rigorously controlled and they are not of the same nature and character as the contingency fees in the United States. As you know there is a widespread American rule that a losing plaintiff need not pay the successful defendant's costs, thus the American plaintiff can litigate at virtually no risk. In Canada, as in a lot of other jurisdictions, a losing plaintiff will usually be required to pay the defendant's costs, including some of defendant's legal fees.

So, there are significant differences between the product liability laws and more importantly, the litigation systems in the two countries. As a result, Canadian companies face a greater potential exposure when selling into the U.S. markets than when selling into their own market. If I were to assess the nature and size of the product liability exposure on a scale of one to ten, I would certainly put the exposure in the United States at ten. Currently, in Canada, I would rate it at about six or seven. Further, if you looked around the world, on the same scale, product liability exposure would be much less than that.

So far I have been talking about the potential exposure for product liability. The question becomes how does that exposure relate to product

cost? Well, most prudent businesspersons will try to protect themselves either through insurance, or, in some cases, by self-insuring. Therefore, they start to incur real costs in terms of these exposures. When Canadian companies are shipping into the United States, they usually have no choice but to take out third-party insurance because in some cases they are required to purchase it as the price of crossing the border, or in other cases, the products are distributed to sales agents in the United States who will demand proof of adequate insurance before taking on the product line.

Of course, we are all aware of what happened in the insurance markets in 1985. While the legal exposure in Canada is clearly less than it is in the United States, the insurance crisis had a major impact on Canadian firms, even in their home markets. For example, Armstrong Monitoring Corporation, outside of Ottawa, is a small manufacturer of gas detection equipment that exports to the United States. In 1985, Armstrong, which had no claims against its policies, paid \$15,000 for its liability coverage. In 1986, one year later, this small company paid \$20,000 for coverage of its products sold in Canada and another \$40,000 for coverage of its exported products. Moreover, its deductible increased from \$10,000 to \$100,000.

Wampole Incorporated, a small pharmaceutical company in Toronto, had to adjust to a 300% increase in 1986. Although it had no previous claims, its premiums went to \$150,000 from \$50,000.

Another company, Semtex Limited, which makes abrasive discs, was informed by its Canadian insurer that its policy would not be renewed. Semtex brokers shopped around and were finally able to find alternative insurance coverage in the United States, but the coverage was given on the condition that Semtex transfer all of its insurance to the American based insurance company. As a result, the premium for its liability insurance went up over 164% in 1985 and its fire insurance went up 140%. These are small companies who export to the United States, but the problems are not limited to small companies.

Cooper Canada, a well known Canadian company which manufactures sporting goods, including hockey helmets, exports a great deal of its products to the United States. Cooper was paying a premium of \$200,000 on liability insurance in 1984. That premium went up to \$2 million in 1985. Connaught Labs of Toronto is a well known Canadian company that produces whooping cough vaccine as well as a number of other vaccines. It supplies about 65% of the whooping cough vaccines in Canada and about 25% to 35% of the U.S. market. As of mid-1986 it had been cited in over forty lawsuits in the United States. Because it has been unable to obtain coverage, it has been adding a surcharge of \$3.00 to each dose of vaccine since January 1986, and this surcharge has essentially tripled the cost of the vaccine in the market.

Those are a few specific, but not isolated, examples. Now let me give some survey information. In April 1987, the Canadian Federation

of Independent Business, which represents about 12,000 small businesses, conducted a survey and found that 72% of those surveyed still had a major concern about the size of their liability premiums. A year earlier the Canadian Manufacturers Association surveyed its members and came up with several significant findings. Forty-two percent of the companies had their liability insurance at least doubled in the previous year. For those exporting to the United States the number was 46%. Fifteen percent had increases of more than 400% and for those exporting to the United States the number was 18%. Finally, almost 2% reported that they had stopped selling in the U.S. market, while another 6.5% reported insurance cost as a serious threat to future sales in the United States.

Admittedly, these facts do not quantify the impact of insurance on the cost of product and on competitiveness. However, they certainly do indicate that there is a significant concern in Canada about the ability of a sizeable number of firms to succeed in the U.S. market.

I am sure by now you are asking yourself: are not American companies faced with the same insurance problems? This is true, as you have heard. However, bad as the situation is in the United States, you will be surprised to hear that the costs are higher, often significantly higher, in Canada. This is due to several factors. I will touch on the main ones. The crux of the problem stems from the fact that for the most part Canadian companies are much smaller than their American competitors and this has several consequences.

First of all, they cannot tolerate as large a deductible as their American counterparts. Their balance sheets will not allow them to do that. Next, the premiums for adequate coverage, because they have to have the same coverage, represent a higher percent of these companies' total costs. This drives their per unit cost much higher. Finally, large organizations have insurance departments or at least individuals who are responsible for risk management. Smaller companies usually cannot afford this kind of in-house expertise.

There are two other factors which compound the cost differential. Not only can smaller Canadian firms not afford the cost of high deductibles, but a low deductible policy versus a high deductible policy has a significant impact on the cost of reinsurance, and hence the premium which the insured has to pay. Because the insurers are now taking responsibility for greater exposure and a greater number of claims the premiums for first-dollar coverage go up very high and very fast.

Finally, nearly all the insurance companies operating in Canada are U.S. based or subsidiaries of U.S. companies. In most cases, though not all, they are unwilling to recognize that the exposure in the Canadian market is less. Therefore, they underwrite the coverage based on their U.S. experience for all of the firm's products, whether exported or not. Since the per unit costs are already higher for reasons that I have mentioned, this certainly has a compounding effect and drives those per units cost even higher. So there is considerable evidence that insurance costs

are having a negative impact on the competitiveness of Canadian firms who are selling in the U.S. market.

However, before we blame all this on the U.S. product liability laws, it is necessary to ask ourselves what caused the insurance crisis and the dramatic increase in costs? This is where it becomes difficult to separate law and even, in some instances, fact from fiction.

Certainly since the crisis erupted, there has been a lot of finger pointing and the rhetoric has been almost identical in both countries. Consumer groups and the trial bar in both countries put most of the blame on the insurance industry, alleging the insurance industry has been greedy and gouging the market.

Primary insurers blame the crisis on what they are calling "judicial inflation" as evidenced by the trend toward strict liability, the huge increase in claims and the high damage awards. They also point to the fact that the consumer is increasingly aware that he or she can be compensated in product liability cases because there is insurance. Reinsurers also blame judicial inflation, but at the same time they blame the primary insurers who, in the days of high investment returns, went after market share with unrealistic premiums. When the economy took a downturn, reinsurers were called upon to pay large losses, particularly those incurred by smaller insurers. Of course, governments and regulators received their share of the blame.

The fact is that there is an element of truth in all of these allegations in both countries. However, there are many observers who are taking a much broader view of the problem and describing it as a societal problem. In one way or another, they are saying that the problem we are experiencing is the result of society's search for a risk-free environment and the willingness of the legislature and the courts to drift away from our traditional tort system toward a compensation system.

In Canada, the Ontario Provincial Government appointed a special task force to analyze the problem and to make some recommendations in response to the insurance crisis. The task force, under the chairmanship of Dr. David Slater, prepared a very lengthy and very comprehensive report. In the report, Dr. Slater put his views best when he said that:

the pressure to compensate, particularly in the personal injury area, has resulted in a virtual explosion in liability and liability litigation. In large part, the cause of the crisis is the very existence of liability insurance. The phenomenon of modern liability insurance has played a major role in transforming tort law and in creating a judicial environment that is becoming increasingly uncertain and unpredictable.

So, to return to my original thesis, blaming the product liability laws for our competitiveness problems is too simplistic. Rather, in my view, it is the relationship and interaction among the product liability laws, the tort litigation systems, and the operation of the insurance markets, all fueled by society's desire for compensation, which are driving up the

costs. Until we find some way of melding this patchwork of problems into a more effective and less costly system, the Canadian businessperson will continue to be at some competitive disadvantage when selling products into the U.S. market.