Product Liability In Licensing At Universities

BY JERALD E. ROSENBLUM* and KATHY A. FIELDS**

Liability for products licensed by universities — how commercialization is effected; legislative solutions

This paper first explores the current state of the law in the United States regarding the application of the doctrine of strict product liability to technology licensors[1] and then discusses its effect on university licensing activity, particularly under the Dole-Bayh Act.[2] Finally, a legislative initiative is proposed.

STATE OF THE LAW

Generally, U.S. state courts, beginning in the early 1960s, have created a new common law doctrine under which all persons and entities with a significant participation in the introduction of a product into the stream of commerce are strictly liable for injuries caused by that product. Previously, liability attached only upon negligent failure to exercise due care or upon extension of a contractual product warranty.

An examination of several cases applying and interpreting the doctrine of strict liability incorporated in state product liability law illustrates the uncertainty that technology licensors face. These cases provide some indication (and sparse comfort) regarding the probability that such licensors will be held strictly liable in either a third-party suit for indemnification or an action brought by a person injured by a product embodying the licensed rights.

In imposing strict liability on a trademark and technology licensor, the California court of appeals articulated the "stream-of-commerce" basis for liability which has been followed in numerous jurisdictions. *Kasel v. Remington Arms Co.*, 24 Cal. App. 3d 711 (1972). *Kasel* was an action by a person injured by a defective shotgun shell that had been manufactured in Mexico under a license from the defendant. In this case, the defendant (1) caused the manufacturing entity to be created, (2) entered into three contracts with the licensed manufacturer,[3] (3) owned 40% of the outstanding stock of the manufacturer, (4) created common and interlocking officers and directors, and (5) benefited financially from the arrangement.

In light of these relationships, the court felt that the trial court should have found as a matter of law that Remington was an integral part of the enterprise that placed the defective shell in the stream of commerce. The court went on to discuss the development of product liability in California jurisprudence. First the court noted that strict liability was appropriate in *Kasel* since that type of liability should be imposed upon the overall enterprise responsible for placing defective products in the stream of commerce. The court then acknowledged that strict liability actions had typically involved a downstream retailer,[4] and that strict liability had not previously been applied upstream to a franchisor (i.e. to a licensor permitting the licensee to use its trademark and business methods).

After examining the relationship of the defendant to the manufacturer and the benefits accruing to the defendant from this relationship, the court concluded that strict liability was appropriate in this case where Remington had been an active participant in the enterprise bringing the product to market, and as such had been more involved than a typical downstream retailer who could be held strictly liable.

The expansive stream-of-commerce form of enterprise liability was applied again by the California court of appeal in *Fortman v. HEMCO*, 211 Cal. App. 3d 241 (1989). *Fortman* was an action on behalf of a three-year-old girl who was permanently injured after being ejected from a moving jeep and struck by another vehicle. The girl had inadvertently opened the door of the jeep, which was part of a fiberglass jeep top.

The plaintiff argued that the door was defective due to its rear-hinged and front opening design and exposed door handles. The plaintiff had settled with all parties but HEMCO, and the court of appeals affirmed the determination in the lower court that HEMCO was 25% responsible for the injuries and upheld the accompanying jury award of $23,742,620.

The jeep top had been designed and actually produced by other parties. HEMCO was paid $2,500 to produce the fiberglass mold for the top from a prototype built by another party and cast two tops (neither of which were involved in this accident). HEMCO's bid to manufacture the top had been related to the door but Hill was not consulted on the placement of the door hinge. Meetings attended by Hill, the inventor and the person building the wooden prototype were held to discuss the construction of the prototype. The top involved in the accident had been cast from the mold produced by HEMCO.

◄ Reaffirms ►

The court in *Fortman* reaffirmed the stream-of-commerce approach

* *Rosenblum, Parish & Bacigalupi, P.C., San Francisco and San Jose, California.*
** *J.D. candidate, May 1991, Stanford University.*

to enterprise product liability after noting the loss and risk-spreading rational for strict liability. The court held that entities deemed to be in the stream of commerce were not limited to readily identifiable designers, manufacturers, or vendors, and that participation, not control, is the determinative factor in assessing liability. Therefore, HEMCO's defenses — asserting no control on its part and that it was not responsible for placing the top in the stream of commerce — were rejected.

The court viewed the production of the mold as an essential step in brining the defective door to the market. In dicta, the court indicated that a defendant could possibly avoid liability by showing that it was not in the business of selling or leasing the defective product. In the instant case the court ruled that this defense was unavailable to HEMCO, since it was in the business of making fiberglass molds and products cast from such molds. It seems that this defense would be available in very few situations, given the court's willingness to impose liability on HEMCO, which did not sell or lease an injury-causing product.

The Court of Appeals for the Ninth Circuit also applied a broad enterprise liability, with a focus on the control involved, in *Torres v. Goodyear Tire and Rubber Co.*, 901 F.2d 750 (9th Cir. 1990), *opinion by* Arizona Supreme Court at 163 Ariz. 88 (1990). In that case, the federal court certified the following question to the Arizona Supreme Court and received an affirmative response: Is strict liability appropriate for a trademark licensor significantly involved in the overall process by which the product reaches consumers? The action was for injuries resulting from an accident caused by tread separation on a Goodyear tire that had been designed and manufactured by foreign subsidiaries of Goodyear. The licensing contract provided that the tires must be manufactured in accordance with formulas and specifications given by Goodyear, produced from materials provided by Goodyear, and labeled, marketed, packaged, and advertised according to Goodyear instructions.

The Arizona Supreme Court rejected any reliance on the definition of manufacturer or seller provided in Restatement of Torts Second §402A, and instead looked at the ability of Goodyear to control production and design of the tires. The reservation of the ability to control provided a basis for liability, and the court found it unnecessary to look for a showing of actual exercise of control. After quoting Prosser and Keaton on the Law of Torts §100 (5th ed. 1984) on patent licensors, the court indicated in dicta that strict liability may be inappropriate for a "mere licensor" of a trademark or patent. Since this question was not before the court, it declined to decide that question or to provide any definitions or guidelines. Finally, the court noted that recognizing a distinction between Goodyear and its foreign subsidiary when a tire is labeled Goodyear would surprise consumers.

In a similar situation involving personal injuries resulting from tire failure, the Supreme Court of Illinois based the imposition of strict liability on the trademark relationship itself. *Connelly v. Uniroyal, Inc.*, 75 Ill. 2d 393 (1979). In *Connelly*, the plaintiff brought suit against Uniroyal for damages caused by a tire manufactured in Belgium by a wholly-owned subsidiary of Uniroyal. The court rejected both vicarious liability premised on the ownership and control by Uniroyal, as used in *Torres*, and the recharacterization of Uniroyal as a seller as basis for imposing strict liability. Rather, the Supreme Court of Illinois, quoting *Kasel*, ruled that strict liability was appropriate in this case since the tire bore the trademark of Uniroyal. The court also endorsed the public policy rational of strict liability for trademark licensors given in *Kasel*.[3]

◄ Trademark Licensor ►

The issue of strict liability for a trademark licensor also arose in *Carter v. Joseph Bancroft & Sons Co.*, 360 F.Supp. 1103 (E.D. Pa. 1973). *Carter* involved a motion by the defendant for judgment notwithstanding the verdict following a finding of liability for personal injuries sustained by the plaintiff when her dress caught fire. The defendant here prescribed and controlled specifications and quality standards for the dress that bore its trademark, which had been manufactured by another company. A tag in the dress stated this fact. The court found unpersuasive the arguments by the defendant that it was a mere licensor, and not a "seller" for purposes of imposing strict liability under the laws of Pennsylvania. The court held that the defendant was sufficiently involved in the manufacturing process to be deemed a seller and thus subject to strict liability. The opinion does not discuss the degree of control actually exercised by the defendant, but does note that the tag, available to the plaintiff (consumer), indicated that control was exercised. This representation could have induced reliance on the part of the plaintiff and provides support for the imposition of strict liability.

These three cases, *Torres, Connelly* and *Carter*, illustrate the three theories commonly used to impose strict liability in a trademark licensing situation. *Torres* used vicarious liability based on control. *Connelly* based the imposition of strict liability on the trademark licensing. Finally, the characterization of the licensor as a "seller" was involved in *Carter*.

Another federal court interpreting state (Kentucky) law imposed strict liability for a failure to warn on a defendant that was neither a seller nor a manufacturer in *Taylor v. General Motors*, 537 F.Supp. 952 (E.D. Ky. 1982).[4] In that case, an action was brought by the widow of a plaintiff who had been killed by an engine blade that had detached from a running motor and struck the plaintiff in the chest.[5] The plaintiff's cause of action was based on defective design and a failure to warn. The court of appeals granted the plaintiff's motion for new trial following a jury verdict for General Motors (GM) because the trial court had refused to give an instruction on strict liability.

In *Taylor* no precise legal relationship existed between GM and the manufacturer of the blade, and the blade bore no markings linking it to

GM. Furthermore, there was no proof that the actual injury-causing blade had passed through GM's hands. The blades were manufactured by Hayes-Albion (H-A) and sold to GM (99%) and Checker Motor Company (1%). Based on the following, the court declared that GM was "intimately involved" with the manufacture of the blades: (1) GM had given the manufacturer a sketch of the blade it wanted produced; (2) GM approved the manufacturer's actual design before any blades were produced; (3) in 1986, GM redesigned the blade; (4) GM decided when production should be discontinued; and (5) GM had suggested that the manufacturer sell the blades to the only other user, Checker Cab.

The court decided that this relationship was a type of franchise without the use of a tradename, and that GM had controlled design and testing and was therefore an integral part of putting the blade in the stream of commerce. The court went on to rule that GM had the duties of a seller in this case and therefore had a duty to warn. This liability was imposed despite the fact that GM's tradename was not used on the blade, and that consumer reliance and expectations were lacking. The plaintiff in *Taylor* mixed and matched parts in cars for which the part was not tested; there is no discussion by the court of whether this action by the plaintiff was intervening negligence or foreseeable use.

The Supreme Court of Connecticut reached the opposite conclusion in an analogous situation involving a third-party suit for indemnification. *Burkert v. Petrol Plus*, 216 Conn. 65 (1990). *Burkett* was an action by Petrol Plus for third-party indemnification from General Motors (GM) for damages allegedly caused by defective transmission fluid that had been licensed under GM's trademark, Dexron SM II. As phrased by the court, the issue on appeal was, "must a licensor of a trademark indemnify the distributor when the licensor did not participate in production, marketing or distribution?" After discussing GM's involvement with Dexron (the product) and Petrol's various theories of GM's liability, the court ruled that GM was not liable for indemnification.

The court started with a discussion of GM's "unusually limited" role as licensor. GM licensed its trademarks for products formulated by other companies; these products were required to meet an initial qualification performance test but were not subject to any continued testing or control by GM. Furthermore, GM received no royalties or financial benefit from this arrangement. GM's stated rational for this set-up, one apparently believed by the court, was that GM wanted to ensure a supply of quality transmission fluid. Throughout the opinion the court emphasizes that GM had no control over the formulations used, production, labeling or distribution.

Although not discussed in the court's opinion, several unique facts may have influenced the outcome in this case. First, this case does not involve a product that was unsafe or defective in a way that was unknowable. Rather, the defect was precipitated by a wrongful act committed by Atlantic.[8] This intervening tortuous conduct may have relieved GM of responsibility. Next, GM was not alerted by Petrol when complaints first surfaced. Petrol sent the fluid to be analyzed at a lab that was not a GM-approved testing lab. This lab, in the first analysis, erroneously determined the fluid was "satisfactory for use." Again, this action by Petrol deprived GM of notice of possible problems and a chance to take any corrective action. Finally, the fact that GM licensed a trademark for formulations developed by others may have been a strong indication that GM had neither a product nor an invention to sell or license.

In an analogous situation, the Court of Appeals of Arizona ruled that a broker who exercised no control over a product was not strictly liable under the enterprise theory. *Dillard v. Associated Merchandising Corporation*, 782 P.2d 1191 (1989). In *Dillard*, the defendant was a broker who had been set up by a group of department stores to provide buying services and merchandise management. Associated Merchandising Corporation was awarded summary judgment in an indemnity action brought by Dillard after a consumer injured by a defective piece of luggage had filed a claim against Dillard. While the broker did bring together buyers and sellers, it lacked the attributes of a traditional retailer. For example, the broker did not sell, manufacture, distribute or license the product. Furthermore, the broker never owned or controlled the product, and in fact, never made a profit from the arrangement.

After examining this relationship to determine the degree of control exercised by the defendant, the court ruled that the broker was in the stream of commerce but lacked the "participatory connection" required for liability. The court noted that enterprise liability should be used when an entity receives an economic benefit or to encourage an entity in the position to take preventative or remedial action to do so. In *Dillard*, the broker had no opportunity or ability to affect the design or specifications or to inspect the product. While not mentioned in the court's opinion, there were other parties, such as the department stores, which were in control and better situated to perform these functions. Finally, the actions or involvement of the broker induced no consumer reliance or expectations.

While no clear standard for the degree of involvement that triggers the imposition of strict liability under the enterprise theory can be gleaned from this case law, some common factors in these cases provide an indication of what types of behavior and licensing agreements will result in liability. These factors include the following:

1. The relationship of the defendant to the product causing injury, i.e. the role of defendant in putting product in "stream of commerce."
2. The stated rational for imposing strict liability.
3. The type of defect and defendant's action relative to the defect.
4. Intervening acts of other parties.
4. Consumer expectations.

No single factor is determinative of liability. While present in most cases where liability is imposed, a

monetary or financial benefit to the defendant from the licensing arrangement is not a prerequisite to liability. *Taylor,* 537 F. Supp. 952 (E.D. Ky. 1982). Furthermore, all factors are not present in each case and the factors do not appear to be weighted equally. For example, cases involving a recognized trademark and the accompanying consumer expectations and reliance have uniformly imposed liablity while the trademark relationship alone has not been determinative. *Burkert,* 216 Conn. 65 (1990), *Kasel,* 24 Cal. App. 3d 711 (1972). *Torres,* 901 F.2d 750 (9th Cir. 1990). *Carter,* 360 F.Supp. 1103 (E.D. Pa. 1973). These cases may also be classified by the focus of the court's inquiry on participation or control by the defendant. Courts focusing on participation in the stream of commerce consistently imposed liability. *Kasel,* 24 Cal. App. 3d 711 (1972). *Fortman,* 211 Cal. App. 3d 241 (1989). *Taylor,* 537 F.Supp. 952 (E.D. Ky. 1982). *Connelly,* 75 Ill. 2d 393 (1979). Courts looking for control have both imposed liability, *Torres,* 901 F.2d 750 (9th Cir. 1990), and exonerated the defendant, *Dillard,* 782 P.2d 1191 (1989).

UNIVERSITY LICENSING

Under the Dole-Bayh Act[9] universities have been granted the right to retain title to and license federally-financed inventions, which covers a very large percentage of all university technology licensing. This act was adopted in the hope that universities could establish licensing programs that would benefit domestic industry by facilitating the commercialization of advanced technology created through government-sponsored research and generate royalty income to support further research by the university.[10] Small business firms are viewed as most successful at developing new products and creating employment. Therefore, this right to retain title was coupled with a requirement that the universities and other nonprofit organizations give preference to small businesses as licensees.[11]

The combination of the preference for small business licensees and the current unclear state of product liability law[12] places the university in a difficult, uncomfortable, and untenable position when it attempts to license an invention in compliance with the mandate in the amendments to the Dole-Bayh Act and the rules adopted thereunder[13] without exposing the university to liability as a deep-pocket. The likelihood of the imposition of strict liability on the university is unclear under the present law, and since small businesses often lack the financial resources to secure an indemnification agreement or to obtain product liability insurance, universities have been reluctant to license inventions to them.[14] As a result, product development has been slowed and U.S. competitiveness impaired.[15]

The university must endeavor to determine its exposure by applying the factors and tests from the case law as discussed above. Unfortunately, the typical university licensing arrangement incorporates relationships and factors that cut both for and against liability. For example, all of the following characteristics, which are analogous to university licensing, have been used to support a finding of liability in the case law: (1) the licensing royalties received by the licensor; (2) the initial investigation and continual monitoring of the licensee by the licensor;[16] (3) the probable overlapping personnel between the licensor and the licensee;[17] (4) the possibility of a long-term relationship between the licensor and the licensee; (5) any advice from or consultation with licensor personnel by the licensee; (6) the view that the licensor's invention is an indispensable part of the overall enterprise bringing a product to market.

On the other hand, other characteristics of university licensing weigh against liability: (1) the intervening acts of the licensee; (2) the absence of consumer expectation or reliance on a licensor (university) name or trademark; (3) the lack of control on the part of the university;[18] (4) the socially desirable nature of technology transfer and the beneficial products that result from this activity.[19]

Likewise, the public policy arguments that have been made could both support and oppose the imposition of strict liability on a university licensor. For example, the fact that the university could serve as an additional source of risk and loss spreading, and the ability of the university to deter commercialization of hazardous inventions support strict liability. But, strict liability could have a chilling effect on the vital transfer of technology from universities to their commercial licensees. Such transfer of basic technology has resulted in commercial development of socially desirable products, not likely to have been otherwise developed in the more applications oriented industrial environment. Furthermore, academic freedom and American industrial competitiveness could be compromised through the inhibition on research and subsequent development.[20]

A LEGISLATIVE SOLUTION

The product liability uncertainties and risks that impede university licensing result from the clash of two public policies — the policy of protecting consumers against product defects and the policy of advancing national competitiveness through the commercialization of university research. Courts may be ill-equipped to resolve this conflict in the timely and comprehensive manner required for university technology managers to obtain a reasonable level of comfort, particularly in dealing with small companies. This is a classic case for legislative intervention. To be effective, such legislation needs to establish uniform national standards of liability.[21]

The most recently proposed federal product liability reform legislation does not address the issue of standards for licensor liability.[22] Although revision of this bill is one possible approach, it does not seem particularly promising. The bill deals with a multitude of other issues and has been pending in various forms for several years. Another alternative that could be of immediate benefit to universities is an amendment of the Dole-Bayh Act.[23] Such an amendment could limit university liability to the tradi-

tional negligence standard and could clarify that standard by specifying those limited circumstances in which it is reasonable to require universities to provide warnings or instructions regarding product dangers.[24] Universities can be protected in this regard by a "checklist" procedure at the time the technology is transferred to a commercial licensee.

It seem inevitable, in the years ahead, that legislators as well as technology managers must come to grips with the paralyzing effects of product liability exposure.

FOOTNOTES

1. Previous discussions are found in Schwartz, *Licensing and Products Liability*, 20 *les Nouvelles*, Licensing Executives Soc'y 41 (1985); Goldman, *Strict Liability and Intellectual Property Licensors - Keeping Closed a Can of Worms*, 66 J. PAT. OFF. SOC'Y 630 (1984); Cowan, *Tort Liability of Patentee Licensors*, 64 J. PAT. OFF. SOC'Y 87 (1982); Scola, *Licensor Liability in U.S.*, 15 *les Nouvelles*, Licensing Executives Soc'y 166 (1980).

2. Pub. L. No. 96-517, 94 Stat. 3015 (1980).

3. The first contract was a trademark license that gave the defendant the right to inspect and control the product on which its trademark was used. The second agreement was a contract for sale of technical information whereby the defendant sold the manufacturer information about the scientific process relating to the production of ammunition. The third agreement was a technical services contract under which the defendant agreed to train and provide personnel for the manufacturer (licensee).

4. *E.g., McClaflin v. Bayshore Equipment Rental Co.*, 274 Cal. App. 2d 446 (1969) (lessor); *Garcia v. Halsett*, 3 Cal. App. 3d 319 (1970) (licensee); *Vandermark v. Ford Motor Co.*, 61 Cal. 2d 256 (1964) (retailer).

5. "A licensor is an integral part of the marketing enterprise, and its participation in the profits reaped by placing a defective product in the stream of commerce presents the same public policy reasons for the applicability of strict liability which supported the imposition of such liability on wholesalers, retailers and lessors." 24 Cal. App. 3d 724.

6. Although not mentioned in the opinion, the situation in *Taylor* was similar to the market share cases involving DES. The court could have reasoned that since GM sold 99% of the blades, it should be held liable. This could explain the slant of the opinion and the outcome.

7. The actual source of the blade was unknown. It could have been a GM or Checker Cab part.

8. Atlantic was supplying fluid that was in reality dyed base oil.

9. Publ. L. No. 96-517, *supra* note 2.

10. H.R. Rep. No. 1307, 96th Cong., 2d Sess. 2 (1980).

11. This preference was added in the amendments to the Dole-Bayh Act found in Pub. L. No. 98-620, 98 Stat. 3335, 3366 (1984), 35 U.S.C. §202(c)(7).

12. The development of product liability law and the doctrine of strict liability, as evidenced by case law, indicates that the current trend is to expand liability both up and down the chain of production and distribution. See *supra* note 5.

13. 37 C.F.R. §401.7 (1990).

14. Statement of Robert Mosbacher, Secretary of Commerce, Before the Consumer Subcommittee of the Senate Committee on Commerce, Science and Transportation, (Apr. 5, 1990) cited in S. Rep. No. 356, 101st Cong., 2d Sess. 10, at note 50 (1990). *See also* Testimony of John Preston, Director of Technology Licensing at MIT, and Niels Reimers, Director of Technology Licensing at Stanford, Hearings on Product Liability Law Reform Before the Consumer Subcommittee of the Senate Committee on Commerce, Science and Transportation, (May 20, 1986) (Legal advisors now are recommending that universities not license any U.S. firm which has limited assets or is unable to provide adequate product liability insurance. Yet, it is exactly these small companies which have been most effective in contributing to technology transfer and job creation.)

15. Statement of Robert Mosbacher, *supra* note 14.

16. Universities (and other non-profit agencies) performing federally-funded research agree to submit periodic reports on the utilization of the results of this research by the university or its licensees. 37 C.F.R.§401.14(h) (1990). Indeed, failure to carefully select and monitor licensees may result in licensor liability under the traditional negligence theory. *Cf. Hixon v. Sherwin-Williams Co.*, 671 F.2d 1005 (7th Cir. 1982) (principal liable for failure to select a competent contractor).

17. University professors and researchers often possess expertise requested or required as part of the license by the company attempting to commercialize the technology. This type of overlap was present and noted by the court in *Kasel*.

18. The university and the federal agency that sponsored the original research retain "march-in" rights to help ensure the development of inventions but lacks any substantive control over the decisions made during the commercialization by the licensee. These rights allow the university to grant another license to a different user. The federal agency may require this if the original licensee is not effectively achieving practical application of the research. 37 C.F.R. §401.14(j) (1990).

19. Special products, such as prescription drugs, are subject to different standards based on their social utility. In *Brown v. Superior Court*, 44 Cal. 3d 1049, 245 Cal. Rptr. 412 (1988), the court distinguished prescription drugs from other products in determining the appropriate standards of liability in accord with Restatement of Torts, §402A, comment k. The public interest in providing incentive to develop technologically advanced products with possible unknown risks on an affordable basis warrants the use of the negligence-based, rather than strict liability, standard.

20. S. Rep. 356, *supra* note 14, at 10.

21. See S. Rep. 356, *supra* note 14, at note 95 for a discussion of the constitutional basis of Congressional legislation that preempts state liability laws.

22. S. 1400 *reprinted in* S. Rep. 356, *supra* note 14.

23. Pub. L. No. 96-517, *supra* note 2.

24. A bill containing such provisions is presented in Rosenblum, *Product Liability Risks of University Technology Licensing*, paper presented to Association of University Technology Managers, 1991 Annual Meeting, to be published in THE DELPHIAN, J. RISK MGMT. FOR HIGHER EDUC. (Tillinghast Publications).