

Preempting and Mitigating Product Liability Claims

JEFFREY A. SOBLE, FOLEY & LARDNER LLP, WITH PRACTICAL LAW COMMERCIAL

A Practice Note describing steps that product manufacturers can take to avoid or mitigate consumer and other product liability claims. This Note gives a basic overview of the nature and types of product liability claims and describes the various benefits a company can receive by avoiding these claims. This Note explains the elements of an effective product safety program, supplier due diligence and product warranties, and explains key contractual risk allocation provisions to be included in supply contracts. It also describes important steps a party can take to help defend itself against a potential claim, including regarding document retention, insurance and retaining expert consultants.

Defending litigation or settling product liability claims can materially drain a company's resources. For example, when faced with a product liability claim, a company often must do one or more of the following:

- Investigate, test products and assess risk.
- Hire attorneys and other expert consultants.
- Comply with regulatory requirements.
- Institute a product recall.
- Develop and disseminate product warnings.
- Redirect employee time away from profitable work to investigate or mitigate the claim.

For this reason, the costs to prevent or quickly address product liability claims are almost always worthwhile. This Note covers product liability claim preemption and mitigation, focusing on the following areas:

- Understanding product liability claims.
- The use of safety programs and procedures.
- Business practices such as avoiding poor relationships, proper documentation and corrective actions.
- Early intervention in the defense of potential claims.

WHAT IS PRODUCT LIABILITY?

Product liability is the area of the law dealing with claims arising from nearly any product defect, including:

- A product's manufacturing defects (see *Manufacturing Defects*).
- A product's design defects (see *Design Defects*).
- The manufacturer's failure to warn (see *Failure to Warn*).
- Product-related warranties (see *Warranty*).
- Repairs or service failures relating to the product (see *Repair or Service Failures*).

Plaintiffs typically make these claims to seek remuneration for alleged personal injury, property damage or economic harm. For more information on the definition of product defect, see *Practice Note, Product Liability Claims, Defenses and Remedies* (<http://us.practicallaw.com/2-504-1711>).

MANUFACTURING DEFECTS

Manufacturing defects are:

- Caused by a failure in the manufacturing process.
- Unique to the individual product manufactured.

Although unique to the individual product manufactured, a failure on the manufacturing line could lead to the same defect appearing in multiple individual products.

DESIGN DEFECTS

Design defects:

- Are common to each product of the same design.
- Exist before the product is even manufactured, though usually unknown to the manufacturer.



Every product manufactured from this design is likely (though not certain) to contain this defect.

FAILURE TO WARN

Failure to warn claims:

- Are based on the product's foreseeable uses and misuses.
- Assert that the defendant failed to forewarn the user of potential harms.

WARRANTY

Although attorneys rarely consider claims for breach of warranty as product liability claims, defects in workmanship or materials often give rise to claims based on breaches of either:

- A written express warranty (see *Practice Note, UCC Article 2 Express Warranties* (<http://us.practicallaw.com/8-519-5098>)).
- A warranty implied by law (see *Practice Note, UCC Article 2 Implied Warranties* (<http://us.practicallaw.com/1-521-1351>)).

REPAIR OR SERVICE FAILURES

Aftermarket parts installed by repair or service providers can lead to product liability claims, which:

- Can result in product defects based on:
 - a defect in the service provided;
 - a defect in an aftermarket part; or
 - the interaction of the aftermarket and original parts or materials.
- The claimant can bring against either or both the product manufacturer or the service provider.
- Can lead the product manufacturer as defendant to plead third-party claims against the service provider. Types of Plaintiffs and Lawsuits.

Any downstream entity within the supply chain who uses or could be harmed by the product is a potential product liability claimant, including:

- End users who are business entities.
- Distributors and resellers.
- Consumers.

(See *Practice Note, Supply Chain Overview* (<http://us.practicallaw.com/0-523-6390>)).

Plaintiffs can bring a variety of types of product liability lawsuits, including:

- Single plaintiff lawsuits seeking damages for personal injuries or property damage.
- Class actions where the defect is common to the entire class, such as an automobile recall based on a design defect (see *Practice Note, Class Actions: Overview* (<http://us.practicallaw.com/2-529-7368>)).
- Existing defendants who make indemnification or third-party product liability claims against their suppliers.

BENEFITS OF AVOIDING PRODUCT LIABILITY CLAIMS

Manufacturers should seek to avoid product liability claims for many reasons, including:

- Ethical standards (see *Ethical Standards*).

- Consumer sentiment and brand protection (see *Reputation, Brand and Competitive Advantages*).
- Costs and expenses relating to:
 - legal fees, including attorneys' fees;
 - damages not covered by insurance;
 - insurance fees; and
 - lost time and productivity of employees supporting the defense of claims.

(See *Enhanced Profit through Lawsuit Cost Avoidance*.)

ETHICAL STANDARDS

Companies may be obligated to their customers and the public to make products that do not cause injury or damage under ethical standards (commonly called occupational morality). When a company adopts ethical policies and practices, its planning and decision-making reflect the potential impact of its corporate actions on various stakeholders and constituencies. Companies sometimes choose to ignore or marginalize ethical considerations based on a belief that they are:

- Subjective or voluntary.
- Not required under the law.
- Inconsistent with the common corporate goal of maximizing shareholder profit.

However, behaving ethically can positively impact a company in the long term by enhancing the company's:

- Social structure and worker morale.
- Reputation (see *Reputation, Brand and Competitive Advantages*).

Therefore, a manufacturer seeking long-term profitability should consider cultivating a corporate culture that values ethical decision-making.

REPUTATION, BRAND AND COMPETITIVE ADVANTAGES

A company that avoids product liability claims can:

- Protect and enhance its brand, culture and corporate identity.
- Maintain corporate goodwill.
- Maintain consumer loyalty.
- Maintain employee morale and commitment.
- Aid its business development. Investors and partners are often less likely to partner with or invest in companies that have a history of product liability claims.

For example, in 2011, Toyota recalled a record number of automobiles due to allegedly lethal product defects. In 2014, General Motors recalled an even greater number of vehicles based on similarly damaging allegations. These product liability events have posed a significant threat to these companies' brands, corporate goodwill and consumer loyalty.

ENHANCED PROFIT THROUGH LAWSUIT COST AVOIDANCE

Product liability lawsuits can lead to:

- Expensive and time-consuming legal defenses that distract company employees from their more profitable work.
- Higher insurance premiums.

- Judgments.

Therefore, avoiding costly product liability lawsuits can help preserve a company's bottom line.

CORPORATE PRODUCT SAFETY PROGRAM

Product manufacturers that have corporate product safety procedures, processes and training are more likely to have a corporate culture of safety that decreases product liability risks by avoiding or mitigating product liability claims.

WRITTEN PRODUCT SAFETY POLICIES

Each consumer product manufacturer should have a written product safety policy that establishes a culture of safety and increases the company's odds of limiting claims. Effective policies:

- Are shaped by legal requirements, corporate values, market, industry and societal norms, and the commercial context in which the company operates.
- Take into consideration resources, management and accountability structures.
- Contain a mission statement.
- Establish ambitious goals that are both measurable and attainable.
- Empower every employee to raise safety or defect issues.
- Are widely disseminated, for example, the company publishes them online and in company publications, training programs and employee handbooks.

PRODUCT SAFETY COMMITTEE

To ensure that a company's product safety policy is meaningful, the company must form a working group of the appropriate legal and operational leaders (commonly called a product safety committee) to:

- Establish criteria, best practices and procedures to support the product safety policy, including regarding enforcement.
- Gather information from prior product defect events and apply lessons learned to future situations.
- Establish guidelines and criteria for product warnings and product advertising.
- Handle regulatory reporting, especially related to safety.

Effective committees are cross-departmental and often include representatives (typically key employees or executives) from:

- Engineering.
- Legal.
- Compliance.
- Service.
- Risk management.
- Sales.
- Operations.

PRODUCT SAFETY MANAGER

Effective product safety committees are led by a competent and empowered product safety manager. Product safety managers are most

effective when:

- The manager reports directly to a member of the company's executive management team and not a specific department.
- Each department implicated by product safety reports, either directly or indirectly, to this manager.
- The manager is respected by and works well with all other departments.

AUDITS AND AUDIT PROGRAMS

Companies typically design audit programs to cover the company's:

- **Manufacturing policies.** Manufacturing audits can identify potential defects before they reach customers.
- **Warranty claims.** Warranty audits can identify products suffering problems in the field before those problems turn into claims.

The product safety committee typically initiates and oversees the audit. When a company has an audit program and institutes regular audits, it can:

- Encourage and enforce ongoing compliance with product safety rules and policies.
- Understand the company's product liability risks.
- Stop product defects from becoming defect claims.

PROTECT ATTORNEY-CLIENT PRIVILEGE AND THE WORK PRODUCT DOCTRINE

Once the company knows about any actual or potential product liability claim, the product liability committee usually initiates and oversees an internal investigation to understand the nature and scope of the issue. Before and during any product safety investigation, the company should identify and protect the attorney-client privilege and the work product doctrine by ensuring that:

- In-house counsel leads and guides the product safety team and other investigators.
- The investigation has a specific legal purpose, which can help persuade a court to apply the attorney-client privilege to investigation-related communications. For example, where the investigating team expressly states in an internal document that it is seeking legal advice regarding the nature and scope of the potential product liability claim.
- The investigation's legal purpose is made clear to the investigators. The more that counsel provides substantive legal comments or advice, the more likely that a privilege applies.
- Legal comments and advice are restricted to necessary recipients. The attorney-client privilege is likely to be compromised if information is widely disseminated, especially when many recipients do not represent the company in a legal capacity.

Courts usually presume that communications between a client and outside counsel or requests for legal advice are privileged. For more information on the attorney-client privilege and the work product doctrine, see *Attorney-Client Privilege and Work Product Doctrine Toolkit* (<http://us.practicallaw.com/0-501-1475>).

MANAGE SUPPLIER RISKS

Companies frequently pick suppliers based exclusively on cost without performing adequate due diligence regarding the suppliers' quality or reputation. Although more cost effective in the short term, this approach may cause a company to overlook an issue that later gives rise to a product liability claim. Therefore, companies should:

- Perform due diligence before awarding a bid.
- Ensure that supply contracts are adequately protective (see *Mitigate Supply Contract Risks*).

MITIGATE SUPPLY CONTRACT RISKS

After carefully selecting the supplier, the company should further mitigate its risks by negotiating a fair and favorable supply contract, paying particular attention to provisions governing:

- The indemnification and defense of third-party claims (see *Standard Clauses, General Contract Clauses: Indemnification* (<http://us.practicallaw.com/5-507-8048>)).
- Insurance (see *Standard Clauses, General Contract Clauses: Insurance Covenant (Sale of Goods)* (<http://us.practicallaw.com/7-524-9426>)).
- Product warranties (see *Standard Clauses, General Contract Clauses: Product Warranty and Disclaimers* (<http://us.practicallaw.com/4-521-5263>)).
- Credit support, such as guaranties and letters of credit (see *Practice Note, Credit Support in Sale of Goods Transactions* (<http://us.practicallaw.com/4-523-3894>) and *Comparing Types of Credit Support in Sale of Goods Transactions Checklist* (<http://us.practicallaw.com/0-524-0392>)). Credit support can help a party ensure that its suppliers, especially foreign suppliers, have adequate assets in the US to support their contractual risks and obligations, including indemnification obligations.

For more information about key provisions in sale of goods agreements, see *Practice Note, Sale of Goods Agreements: Avoiding Common Pitfalls* (<http://us.practicallaw.com/5-525-2962>).

PRODUCT WARRANTIES AND OTHER DOCUMENTATION

A product is less likely to be the subject of a liability claim if it is:

- Covered by appropriately limited warranties and disclaimers (see *Standard Clauses, General Contract Clauses: Product Warranty and Disclaimers* (<http://us.practicallaw.com/4-521-5263>)). For example, the manufacturer could:
 - limit warranties to those express warranties provided under UCC § 2-313;
 - exclude all other warranties, express or implied; or
 - specifically exclude the implied warranties of merchantability and fitness for particular purpose (UCC §§ 2-314 and 2-315).
- Subject to meaningful remedy limitations (see *Standard Clauses, General Contract Clauses: Limitation of Liability* (<http://us.practicallaw.com/7-507-5628>)). The UCC permits the contractual limitation of remedies available to the buyer in a breach of warranty under UCC § 2-719. Therefore, the manufacturer could:
 - specifically define the available remedies as limited or exclusive; or

- limit or exclude consequential damages (see *Legal Update, Understanding Damages Waivers: Consequential, Incidental, Lost Profits and More* (<http://us.practicallaw.com/3-571-4285>)).
- Accompanied by comprehensive warnings that are:
 - written in plain language and understandable to the average user; and
 - conspicuous, prominent and large enough compared to other copy to alert a reasonably prudent person.

(See *Practice Note, Product Labeling: Warnings, Cautions and Other Requirements* (<http://us.practicallaw.com/3-553-8065>)).

ADDRESS ISSUES BEFORE THEY BECOME CLAIMS

Although product defects are common, many companies prepare to defend against a product liability claim only after receiving formal notice of the claim. However, product manufacturers are more likely to successfully defend a product liability claim when they treat all product failures as potential claims and plan for and react quickly to product liability issues when they arise by:

- Frequently assessing risk to identify issues before they become claims.
- Issuing post-sale warnings to end users so that they can avoid uses that increase the potential for injuries or damages.
- Self-reporting defects to regulators, especially if a corrective action is in place already.
- Comprehensively documenting all replacement parts and design or manufacturing changes by:
 - stating why the change was needed;
 - describing all technical aspects of the change;
 - describing how the change is intended to eliminate the defect at issue;
 - assigning new part numbers to new designs; and
 - rendering new drawings.

For information about addressing and defending product liability issues when they develop into claims, see *Practice Note, Product Liability Claims, Defenses and Remedies* (<http://us.practicallaw.com/2-504-1711>).

NOTIFY THE INSURANCE CARRIER EARLY

A variety of types of insurance are available to protect product manufacturers, including:

- Comprehensive general liability insurance.
- Product liability insurance.
- Recall insurance.
- Excess liability insurance.
- Umbrella liability insurance.

For more information on insurance coverage and policies, see *Insurance Policies and Coverage Toolkit* (<http://us.practicallaw.com/4-506-1171>).

Regardless of type, almost all insurance policies require the company to notify the carrier of any actual or potential claim. The failure to provide timely notice can cause the insurer to:

- Deny insurance coverage.

- Delay defending or indemnifying the claim because an insurer's obligation to defend or indemnify typically begins on receipt of notice.

Therefore, the product manufacturer should notify its insurer as soon as it knows of an actual or potential claim as a matter of formal processes.

IDENTIFYING AND RETAINING EXPERT CONSULTANTS

A company facing a potential product liability claim could benefit from retaining a variety of types of experts, including:

- Technical advisers, both within the company and as outside expert consultants. Companies facing potential product liability claims often hire various types of engineers, such as electrical, chemical or mechanical.
- Outside counsel.
- Public relations agencies.
- Call centers to field consumer inquiries.

A company should retain expert consultants as soon as the company knows of an actual or potential claim because:

- Early retention helps ensure that the company reserves the appropriate support in defending the claim, which is especially important where:
 - only a few qualified expert consultants exist; or
 - the company makes unique products with few competitors.
- Consultants can offer low-cost advice during the claim's initial investigation.
- Experts typically charge nothing or very little to be retained.

For more information regarding locating and retaining an expert, see *Practice Note, Experts: Locating and Retaining an Expert* (<http://us.practicallaw.com/7-566-2595>).

INVESTIGATING THE PRODUCT OR SCENE

When faced with a potential claim, the manufacturer should assemble a team to thoroughly investigate the facts and options. The team should consist of a small group of people who are not directly involved in the design, manufacture or sale of the relevant product and who understand the company's business, such as:

- Product safety committee members (see *Product Safety Committee*).
- Expert consultants (see *Identifying and Retaining Expert Consultants*).
- The company's insurance carrier (see *Notify the Insurance Carrier Early*).
- Outside counsel.

Once assembled, the team should:

- Inspect and perform a technical analysis of the product and, if relevant, the immediate and surrounding scene of its failure. For example, if the product is believed to have caused a fire, the team should inspect both the product and the scene of the fire.
- Analyze important factual information that helps assess the failure, such as:
 - a technical analysis and other documents;
 - photographs; and
 - eyewitness statements.

- Spot check existing products in the company's possession, the distribution chain and in the field.

By timely and thoroughly investigating a potential product liability issue, the company obtains all relevant facts and information needed to defend against a claim before a formal claim is made.

PRESERVE ALL PHYSICAL ITEMS

To the extent possible, the manufacturer's investigating team should carefully preserve:

- The product believed to be defective.
- Any other item that was or may have been involved in the product's failure or the related loss, including the environment in which the product is believed to have malfunctioned or caused a loss.

The manufacturer should also consider inviting all interested persons to conduct the same inspection to help prevent any party from later alleging spoliation of any evidence related to the loss, which can give rise to both adverse inferences and cost sanctions.

For information on the various standards used by US federal courts to determine spoliation duties and sanctions, see *Article, Spoliation Sanctions by Circuit Chart* (<http://us.practicallaw.com/1-505-7509>).

PRESERVE DOCUMENTS AND INFORMATION

Most large or sophisticated companies have a document retention policy that establishes and describes how the company expects its employees to manage company information (whether in electronic files, hard copies or other formats) from creation through destruction, according to applicable laws and the company's particular needs. For a sample document retention policy, see *Standard Document, Document Retention Policy* (<http://us.practicallaw.com/0-503-1765>).

Document retention policies often require employees to routinely destroy or delete documents, which helps minimize the expense of preserving a large volume of documents in connection with a litigation hold. However, if the company faces a potential product liability claim, it should consider suspending the document retention policy to be able to:

- Gather all related information as soon as possible to:
 - identify and retain all information (including electronically stored information) necessary for an effective defense; and
 - avoid spoliation claims.
- Institute an effective litigation hold if necessary. For more information, see:
 - *Practice Note, Implementing a Litigation Hold* (<http://us.practicallaw.com/8-502-9481>);
 - *Litigation Hold Checklist* (<http://us.practicallaw.com/9-548-9255>); and
 - *First Steps for Identifying and Preserving Electronic Information Checklist* (<http://us.practicallaw.com/0-501-1791>).

MAKE AN INITIAL MATTER ASSESSMENT

As soon as it is assembled, the investigative team should assess the product liability concern to determine the viability of a claim and the extent of the related liability. For example, the investigative team should:

- Confirm that the company's product is the focus of the potential claim. Many products may look similar, especially those incorporated into larger applications.
- Determine whether the product was:
 - properly installed;
 - properly used or applied;
 - properly maintained; or
 - altered or modified.
- Establish whether the product met the required specifications.
- Ensure the product complies with key internal product documents, such as:
 - design drawings;
 - quality control documents; and
 - manufacturing line reports or confirmation documents.
- Determine conformance with any applicable regulatory requirements. Even if the product was designed to meet regulatory requirements, it may fail those requirements in practice.
- Identify any alternative designs that could have prevented the product failure and understand why these alternative designs were not used.

For more information on pre-litigation claim assessment, see *Practice Note, Case Assessment and Evaluation* (<http://us.practicallaw.com/4-525-8907>).

ABOUT PRACTICAL LAW

Practical Law provides legal know-how that gives lawyers a better starting point. Our expert team of attorney editors creates and maintains thousands of up-to-date, practical resources across all major practice areas. We go beyond primary law and traditional legal research to give you the resources needed to practice more efficiently, improve client service and add more value.

If you are not currently a subscriber, we invite you to take a trial of our online services at practicallaw.com. For more information or to schedule training, call **888. 529. 6397** or e-mail ustraining@practicallaw.com.