

III Managing product liability risk in Europe

BY PAULINE RENAUD



The growth of world trade, combined with the ongoing effects of the financial crisis, has reinforced that the threat of product liability is still present for many companies. Furthermore, avoiding litigation has become a priority, as companies can no longer afford to risk the potential impact that prolonged legal action can have on a business. But in Europe, the issue of product liability risk has been particularly acute, as countries have to deal with two levels of regulation, national and supra-national. In addition, developments to laws and regulations have been ongoing during the last few years, and companies should take this into account in their risk management structure if they want to limit claims. In general, identifying such issues and overcoming challenges is key, as liability threats are expected to continue to increase, going forward.

Growing threat of product liability

The impact of the crisis on product liability risk has been notable in all EU countries, and has required companies to adapt quickly in order to mitigate issues. Some manufacturing companies, for example, have reacted by updating and reinforcing their quality controls. They have also renewed withdrawal procedures for their products, and reviewed the adequacy of certain user manuals to limit the risk of litigation. But,

just as importantly, the crisis has highlighted the strengths and weakness in the liability laws of certain European countries. “French liability law is, for example, one of the riskiest in the European Union, given the fact that it is not necessary for the claimant to prove there has been a fault,” points out Florian Endrös, a partner at Endrös-Baum Associés. “Indeed, the claimant usually only needs to bring evidence that the product, or plan, purchased did not accord with the contractual specifications. The claimant can therefore claim all the damages, including financial damages and consequential damages for loss of production. The result is that more and more companies have been seeking to stop commercialising their products in France, or at least minimise risk in a contractual way,” he says. And it is not only foreign businesses that fall prey to the ‘liability without fault’ trap – an increasing number of French companies have required the help of advisers to limit their product liability risk amid the nuances of French law.

Seeking professional advice is particularly important, judging by a recent spate of high-profile cases, notably in the construction sector, where product liability and poor risk management have been instrumental. In France, for example, a section of a terminal collapsed at Charles-de-Gaulle airport in 2004, killing four

people. In this case, several companies had been working on the design and construction of the terminal but no real overview of the project existed, which ultimately led to disaster. Indeed, experts highlight that the gap that can exist between a project and its execution is often at the source of many problems and accidents, and is therefore a primary cause of litigation. Other sectors vulnerable to product liability risks include the food and drink sector. Last December, the Irish government had to recall all pork products made in the country since September 2008, when laboratory tests found the presence of dioxins in animal feed and pork fat samples. In this situation, good risk management, such as quickly determining the root of the contamination and tracing it accurately through the distribution chain, may have helped to limit the impact of the contamination.

Indeed, Shuna Mason, head of regulatory at CMS Cameron McKenna LLP, believes that good risk management procedures are fundamental to the success of any product recall. “Generally, the types of risk management issues that companies dealing with defective products should consider are: warranty terms and contractual risk allocation mechanisms, including provisions regarding who should bear the burden of shouldering recall costs and handling customer complaints; good traceability mechanisms for tracing the location of faulty products and identifying end purchasers; and procedures for repairing or replacing sold/installed products,” she explains. In addition, to generally avoid product failures, companies are advised to know their own suppliers, to regularly check that those suppliers are supplying safe and lawful products, to check what regulations may apply to the product and ensure compliance to those regulations and, finally, to determine available insurance cover for liability or recall costs to include proper geographic coverage. Importantly, companies should learn from their previous risk liabilities experience in order to avoid repeating the same mistakes again. For example, businesses should keep records of all product complaints, complete with details of action or changes and ►►

improvements made, which will make a recall easier. Furthermore, it is also useful to have a prepared procedure for effective action in case of a claim, and to know which agencies may require immediate notification in the event of a material claim, such as stock exchanges, food standards agencies, or as required under the revised European Product Liability Directive.

Dealing with sector-specific issues

Good risk management is essential in order to address the nuances of product liability risk, but there are numerous challenges associated with the implementation of a product liability risk strategy. For example, establishing a clear division of responsibility between manufacturers and distributors on notifying customers can prove difficult. It is also challenging to determine how costs will be allocated between contracting parties, as well as agreeing procedures for dealing with faulty products and recovery of costs, and allocating responsibility for harm caused to customers, explains Ms Mason. "In addition, companies in financial difficulty may be tempted to cut corners to save costs, thereby giving rise to a greater risk of product liability claims. Also, the temptation to outsource to save costs can lead to the implementation of less rigorous testing and other quality control procedures, and potentially a decrease in product quality and therefore safety," she warns.

There are also sector-specific issues that companies should be aware of, particularly when outsourcing the manufacturing of their products. With the financial crisis squeezing margins, manufacturers and suppliers may be tempted to use lower-quality materials, which in turn may increase the threat of a product liability claim, particularly in the construction and food and drink sectors. "Therefore, before

purchasing products or components, finished product manufacturers or retailers should perform additional due diligence to ensure that companies are not cutting corners in their manufacturing processes," advises Ms Mason. "Special attention should be paid to companies moving into new business areas, out of their core competency, in an attempt to escape or mitigate the effects of the recession. Even though retailers may be able to pass claims back up the supply chain, their quality standing may be damaged by the association with recalls of dangerous products." This is of a particular concern for product liability insurers and companies importing their products from countries severely hit by the current financial crisis. For such businesses, Ms Mason recommends the incorporation of carefully-worded warranty and dispute resolution clauses into their trade agreements to ensure that they have the greatest chance of recovering losses or costs directly from their trading partners.

In addition, specific laws enforced in certain sectors may also increase the liability risk, particularly when companies are not familiar with certain regulatory requirements. "In France, specific legislation applies to certain sectors, such as the industrial, medical and construction industries. For example, in the construction industry, a product specifically designed for a building can come under a 10-year guarantee, therefore creating potential liability for the manufacturer," explains Mr Endrös. As a result, many companies based in, or with subsidiaries in France have special insurance coverage to deal with those issues. But for foreign companies seeking to commercialise their products in France, such insurance coverage is much more difficult to obtain. Worse still, most are unaware of those specific risks not covered by a normal non-French insur-

ance policy. "But in some specific cases, you can try to make the buyer accept the risks in the contract. As a result, in case of a product default, it is not possible for the buyer to make a claim on the risks contractually accepted," continues Mr Endrös, adding, however, that such procedures only tend to happen in limited circumstances.

Going forward, product liability risk is expected to continue increasing, given the current downturn and the inclination of many companies to turn to cheaper, lower-quality materials in order to cut costs. Also, given that businesses are dealing with bigger issues at the moment, risk management strategies may be considered secondary and an unnecessary expense. But this is unwise, since recent legal and regulatory changes may also impact the liability threat for many companies. "Under French legislation, it is now possible for a claimant to make a claim directly against a producer in a foreign company, based on tort liability" explains Mr Endrös. "This new jurisprudence, enforced in 2006, set the principle of violation of a contractual obligation by a co-contracting party. It is considered a tort when a third party has suffered damages or prejudice from a contractual violation between two other parties," he says. Furthermore, there is a growing claim culture in many European countries, as it is sometimes easier to earn money through claims rather than by selling products, further exacerbating the risk. However, it is also true that the financial crisis has had a positive impact on companies by increasing their awareness of the need to implement efficient risk management strategies. Provided that they then act on this awareness, this may, in some cases, limit potential product liability disasters and diminish the threat of litigation. ■



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Following a full double university degree at Munich University and Paris 1 Panthéon-Sorbonne University, Dr. Florian Endrös completed his training as an avocat of the Paris Chamber of Lawyers. After passing the examination to be admitted as a German Rechtsanwalt, Florian Endrös completed his doctorate on European product liability law, with an emphasis on French law. He is admitted as a Rechtsanwalt in Munich and as an avocat in Paris.

Dr. Endrös practised in an international commercial law firm for several years. He was the founding partner and for ten years practised at a law firm specialising in industrial risk, before he founded the new firm Endrös-Baum Associés / EBA together with his team of lawyers. He also worked for ten years as an assistant professor at Cergy-Pontoise University (Paris). Here he was in charge of a European university project that enabled French lawyers to study German law. The main emphasis of his practice is on complex

international cases and proceedings, particularly in the fields of industrial risk, plant construction, product liability and product safety, and also on general contract and commercial law. Dr. Endrös has many years of experience of French expedited expert report proceedings in a wide variety of industrial risk cases, and he is also the author of a number of books, essays and other publications on this subject. Dr. Florian Endrös's working languages are German, French and English.