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Talking Point: Managing product liability risk

FW moderates a discussion between ***Árpád Geréd*** *at BMA Brandstätter Rechtsanwälte GmbH,* ***Florian Endrös*** *at Endrös-Baum Associés and* ***Terence Lee*** *at Smith & Partners, on how companies should manage product liability risk.*

FW: In your opinion, are business leaders demonstrating sufficient awareness of the risks to their company posed by product liability?

Geréd: Awareness in Austria is generally very high, with a notable increase in lines of business which have not been traditionally prone to product liability risks. There, risk awareness was low or focused on very specific issues. However, the news as well as the Austrian courts have shown that product liability is not reserved to medical products or cars but may be caused by each and every product. As a result, many companies that previously have not shown much interest in product liability are now actively seeking legal and technical advice on the subject.

Endrös: Business leaders do not often demonstrate a sufficient awareness of the risks to their company posed by product liability. Instead they focus too much on cost efficiency in production and on business turnover. They do not integrate sufficiently the potential risks and the higher costs of claim-handling linked to cost reduction in the design of their products or to other cost saving measures (such as modification of raw materials) due to cost or environmental considerations. Furthermore, and if management is aware of product liability risks, they often try to handle this risk on a purely contractual basis with their technical partners and sub suppliers, ignoring that they can not always operate a sufficient recourse against their partners if the producer of the final product is directly sued by the victim or a third party. The risks created by outsourcing development or design services are rarely integrated in the overall cost plan, and seem under-evaluated by business leaders.

Lee: In this increasingly competitive industrial environment, business leaders are focusing more of their attention and resources on business expansion than risk management. They are busy with considering the reduction of manufacturing cost, researching and developing new technologies, marketing, mergers and acquisitions. Generally, I would say there is insufficient awareness of product liability risks among business leaders. This is especially so when product liability risks in most countries are increasing, in particular rising and developing markets such as China and India. Generally, many believe that these developing countries have low product liability risks as they generally have a low level of technology, undeveloped consumer protection law and low consumer rights awareness. However, this is no longer the case. Things have changed, and product liability is becoming a real issue in many countries.

FW: What key trends have you seen affecting product liability in the market?

Endrös: Product liability risk increases in France due to a very victim oriented jurisprudence. This orientation does not distinguish in practice between the quality of the actors as professionals or consumers, even if it is clear that special regulations favour the claims of consumers. Nevertheless, the indemnifications paid to consumers are not particularly important compared to the huge loss of profit or of pure immaterial damage which can be claimed by victims of defective products. The product is defective under French law if it does not comply with the contractual specification, is not fit for normal use or has a lack of safety in the sense of the EU Directive for Product Safety. Furthermore, foreign business leaders are often unaware of the risk of French employer liability. The employer has an absolute safety duty to his employees. In the case of an accident at work, the employer can be held liable to indemnify French healthcare for all medical treatment. The risk of a serious accident involving a healthy 20 year old person can be up to €3-4m.

Lee: I would say the most distinct trend is the rise of consumer protection which is profoundly affecting the development of product liability concepts and laws worldwide. On the one hand, consumers require safe goods and services free from any and all defect, damage and danger. On the other hand, it requires business operators to undertake strict liability for any claim of product defect. In addition, governments are placing more and more controls over manufacturers and production by imposing numerous requirements including technical standards and other safety regulations. Companies are required to comply with prerequisite standards in all stages of the manufacturing and distribution process. Another key armoury of most governments is product recalls which have played an increasingly important role in enforcing product responsibility. In this internet savvy world, most information is readily available on the internet and accessible worldwide. All these aspects mean product liability is becoming one of the most important factors affecting business consideration and operations in the market.

Geréd: The most remarkable trend in Austria is a notable increase in litigation and a decrease in time spent trying to reach an out of court settlement. While it is hard to tell what exactly caused this trend, the current mass tort litigations in the wake of the financial crisis definitely helped to raise public awareness of lawsuits as a viable means of enforcing one's claims. The consequence for businesses is that they have less time to collect and analyse the relevant legal and technical data to decide whether or not to settle a case, demanding a high degree of organisation and preparation.

FW: Can you outline any recent high profile cases involving product liability, and their significance?

Lee: The Toyota 'unintended acceleration' cases which have led to the recall of millions of Toyota auto products worldwide is a good lesson on product liability management to business leaders. Triggered by a series of vehicle accidents in the US and escalated by poor communication and bad risk management, Toyota has experienced tough public scrutiny, worldwide recalls, numerous class litigations, government investigations, public confidence crisis, destruction of brand image, etc. Toyota's crisis is the result of multiple factors, in particular insufficient product liability management, bad crisis management and poor communication. The initial cases and problems were ignored and downplayed without systematic risk evaluations and a defence strategy. When the crisis escalated, there was no coordinated, uniform and simultaneous action, and there is no rapid, coordinated and proactive communication with the public and relevant governments, which are essential for any good management of a product liability crisis.

Geréd: The two most significant cases recently decided by the Austrian Supreme Court dealt with organisation and testing respectively. In the first case, circuit breakers were assembled by a single employee who did not perform a particular check that would have prevented the fault but would have required a second employee. The Supreme Court considered this a breach of duty to take care. In the second case, the reason for a water bottle exploding was discovered by the court appointed expert only after extensive and original research. The Supreme Court ruled that the producer would still need to prove that it could not have discovered the fault. These decisions increase the pressure on businesses to analyse whether organisational measures or additional research could identify and prevent product faults.

Endrös: Council Directive 85/374/EEC of 25 July 1985 transposed in French law with the Product Liability Act of 18 May 1998 governs defective product liability. In the medical field and in terms of evidence, article 1386-9 of the French Civil Code allows complete compensation for damage if an injured person can prove the damage, the defect and the causal relationship between defect and damage. Thus, the complete burden of proof rests on the victim. In these circumstances, the Court of Cassation overcomes this difficulty by judging that a default of information on medical effects constitutes a default of safety. Indeed, to measure the legitimate level of security expected, judges apply an advantages-disadvantages test and a lack of information about side effects makes the product defective. Further, the Court of Cassation admits that even if there is a serious scientific uncertainty, evidence of a product's capacity to damage a consumer may be brought by presumptions said to be "serious, specific and corroborating". Moreover, evidence that a product puts consumers at risk can be compensated regardless of any other reasons explaining the damage. The kindness of the French Supreme Court for victims of a defective product has as corollary that a default of conformity cannot proceed from a simple implication of the product in the causal relationship. To prove that the defective product is among the reasons for the damage is not enough to characterise the dangerousness of an item. In particular, an expert has to demonstrate that defectiveness of a product is the only explanation for damage, to involve producer liability.

FW: Have there been any notable changes to product liability laws?

Geréd: Austria's Product Liability Act from 1988 has remained remarkably static, the last amendment due to the change from the Austrian Shilling to the Euro. Other, more specialised laws and regulations, however, have seen many significant amendments, usually due to the regulations and directives of the European Union, of which Austria is a member state. Currently the European Union is planning to revise the General Product Safety Directive from 2001. One of its intended goals is the harmonisation of diverging safety evaluations in the member states. Should this goal be attained, the resulting directive could prove one the most significant in recent years.

Endrös: Defective product liability is a specific legal basis on which to obtain compensation for damage. In accordance with defective product liability settlement, a claim resulting from a safety default bans conforming to a very new decision of May 2010 any other legal action based on common contractual liability or tort liability (except for admission of legal action on the basis of liability for civil wrong or latent defect warranty). More specifically, in compliance with the European Court of Justice decision dated 4 June 2009, the Court of Cassation decided that compensation for damage to an item of property intended for professional use and employed for that use is not covered by the scope of application of Directive 85/374/EEC. In these circumstances, common law about defective product liability will be applicable and a claim for damages can be reached.

Lee: Product liability laws in Asia are experiencing substantial changes in the underlying ideology, basic rules and forms. One of the most notable changes in the last decade is that product liability is changing from tort law to consumer protection law. This fundamental change is underlined by the traditional fault-based liability ideology to a kind of social responsibility based ideology based on strict liability principle. The types of defects that are regulated by product liability laws are also developing from the traditional manufacturing defect to include design defect, warning defect, distribution defect, etc. Punitive damage and defective product recall regime are also widely introduced into product liability legislation to force business operators to take their product safety responsibility seriously. In China, the new tort law promulgated recently introduces punitive damage and consumer's right of initiating a recall request for product liability. China is also in the last stages of introducing a new recall legislation. In South Korea, The Framework Act for Product Safety will become effective on 5 February 2011. Also in South Korea, a legislative bill is being considered by the National Assembly to amend the Product Liability Act which will shift the burden of proof to the manufacturer in product liability cases.

FW: To what extent are companies under increased pressure to enhance their product knowledge and testing methods? Has this reached an extreme level, and if so, how will it impact businesses going forward?

Endrös: Several EU-regulations put pressure on companies to enhance their product knowledge. In particular, the REACH-regulation creates duties that are difficult for smaller companies to handle, in part due to the national interoperation of these European regulations. Compliance with this regulation has to be proven in every European country separately, and it is not certain that even certified compliance with an external official organisation in one country ensures safe marketing in another country. The increasing absolute safety duties and the extreme level of revaluation is encouraging companies, especially smaller or middle size companies, to cease business in France.

Lee: Rising consumer awareness and protection mean that most consumers demand safe goods and service free from any and all defect, damage and danger. This awareness has fundamentally influenced consumer's social expectations and government's interpretation of product safety. Consumers request and demand the safety of products and services almost to an absolute extent. On the other hand, influenced by the idea of unequal power between consumers and business operators, the judiciary of most countries is increasingly putting strict liability on business operators for product liability claims in an attempt to level the playing field. Accordingly, product liability litigations and product defect recalls have been increasing worldwide in recent years and have been one of the toughest issues for business operators to consider and deal with. All these trends invariably increase the operating costs of companies, so it is a definite yes that companies are under increasing pressure to enhance their product knowledge and testing methods. However, I do not see it reaching an extreme level that will have a severe detrimental impact on businesses. What is more important however, is for business leaders to quickly realise the worth and necessity of adjusting their management structures, and to set up product liability risk management processes to deal with product liability issues systematically.

Geréd: Apart from ever increasing and more demanding obligations from laws and regulations, recent Austrian court decisions have also highlighted organisational measures and testing. Court decisions have raised the bar very high. This is alarming considering that Austrian law considers economic feasibility in the case of organisational measures but not in the case of testing. Therefore, a producer could be liable if he could have discovered and prevented product faults by additional, albeit economically unfeasible, research. In the end, businesses will need to conduct thorough cost-benefit analysis to decide whether they prefer taking the risk, including media exposure, or making additional investments.

FW: What action can management take to reduce product liability risk?

Lee: It is essential that management should set up a systematic risk control and management system to cope with product liability issues and manage potential crisis. The system should include at least the following components: a product quality control system for ensuring the quality of products in the materials design, supply, production and distribution process; an early warning system for indentifying any potential product liability risk; and a product liability case management system for handling existing product liability matters in a coordinated, proactive and professional way. It is essential that there is a central PL department which has the necessary resources and authority to coordinate the operation of the product liability risk management system globally. The PL team should include people from at least the technical, legal and public relation departments, the head of which should preferably be a senior officer under direct leadership of the chief executive officer.

Geréd: Possible measures vary greatly depending on the product and the business involved. In general, the first step is to know your options from a legal as well as from a technical point of view. Key questions are: In what circumstances could my business become liable for its product? What measures could be taken to avoid or mitigate the risks? Only by knowing all this and the costs involved will management be able to make an educated decision on the measures to take. The next important step is to keep informed, since requirements, options and costs will change over time. Monitoring of jurisprudence and the relevant market are key aspects, since it is good to learn from your own mistakes but it's better to learn from those of others.

Endrös: One very important action to reduce product liability risk is to create a clear, long term brochure covering the total production process, starting from the initial contractual specification, the first sample reports, the commercial agreements, the technical modifications and approval on one hand, as well as production data and measures, proceedings and results of the quality insurance program on the other hand.

FW: Once a product liability dispute does arise, what general steps should companies take to resolve the issue?

Geréd: While each case is unique, as a general rule, not restricted to product liability issues, a business will first need to decide, based on gathered data and analysis of the same, whether it prefers to continue or settle the dispute. Once litigation has started, in Austria a business will usually want the court to appoint an expert as soon as possible to clarify the existence of a technical product fault. In the case of an affirmative finding, the producer still has the possibility of avoiding liability, while a negative finding will more often than not lead to the withdrawal of the claim.

Lee: The company should set up and maintain an effective PL early warning and coordinating system. When a product liability issue arises, the first step is to ascertain the nature of the issue and to carry out a detailed analysis of the potential risk and exposure of the matter. Steps have to be taken to collate as much evidence as possible and as early as possible by conducting a technical inspection and communicating with the consumer to understand how the incident occurred and what the concerns of the consumer are. Once the company has all this information, it is in a position to make a proper and considered evaluation of how the matter should be handled. Whilst to most companies, settlement and amicable resolution remains the most convenient and preferred resolution method, experience tells us that this is only the beginning of more problems for the company. The word will spread that the company is an easy target and it will be faced with more and more settlement pressure.

Endrös: In the case of a civil product liability dispute in France, the first step for a producer is to create a task force charged with handling the case in terms of communication, technical analysis and gathering internal functioning and existing data. It is therefore necessary to save immediately all commercial, contractual and technical information as well as any current exchanges. Moreover, it is essential to inform the insurance company of judicial issues and to appoint (together with the

insurance company) an external private expert who should be fluent in French. He or she will assist with the preservation of files about technical data and specifications. Thus the scope of the insurance policy may be brightened, especially with regard to the coverage of claims of damages. Seeking advice from a lawyer is also crucial. The most important advice is to prohibit passing on information about manufacturing facts outside the company walls. All discussions must be internal. Technical files should be passed onto to a private expert who will give his opinion about the product's qualities. An expertise report may provide some arguments for the defendant in the litigation process. Contrary to the disclosure proceedings in other legal systems, French law does not foresee any duty for a party to disclose negative information in civil or commercial proceedings. The French lawyer may even be held liable as a professional if he discloses elements negative for his client.

FW: How important is it to prepare for litigation but also to explore alternative dispute resolution options?

Lee: It is very important that each and every matter should be handled as if it will end in litigation. From the perspective of business and social effects, litigation is definitely the most unfavourable method for solving a product liability matter and should only be used as the last resort. After a thorough fact finding process, the company has to evaluate its strengths and risks and decide how best to resolve the matter with the least damage to the company. Based on our experience, many disputes with consumers can be easily defused if handled properly and swiftly from the beginning. Communication with the consumer is key, as most disputes arise due to the consumer's misunderstanding of the functions of the product and the relevant technologies. A company should always explore alternative dispute resolution options but not at the expense of not preparing for litigation properly.

Endrös: In product liability cases, alternative resolution options are rare in practice. In low profile cases, French insurance experts often try to handle the case and to adjust the claims. In more important cases with more than two parties, victims or their insurance companies systematically ask a Court to appoint a technical expert. This court appointed expert will clarify the technical situation. Therefore, it is necessary to try to influence the Court appointed expert through an appointed task force. The Court appointed expert needs the input of the parties. Although these common proceedings are very long and expensive, alternatives are rarely used by French parties. Sometimes foreign parties facing a problem in France will appoint on a contractual basis an external institute and settle the case on test results. French parties are nevertheless very hostile towards this kind of dispute resolution.

Geréd: Since the first step of being prepared for litigation is to know whether you prefer litigation or another form of dispute resolution, providing for the necessary organisation to quickly and easily retrieve and analyse the required data is not an option but a basic and important requirement. However, since the plaintiffs are usually consumers with whom no contractual relation exists, on the one hand Austrian law limits the possible options for dispute resolution to litigation or settlement. Even in the case of a contractual relation, Austrian law places significant constraints on what can be legally agreed upon between businesses and consumers. On the other hand, these restrictions allow for faster, though not always easier, decisions on which option to choose.

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