

III Managing product liability risk in the Americas

BY CLAIRE SPENCER



In the current economic downturn, product liability has become difficult to manage and should now be high on the list of corporate priorities among companies in the Americas. Indeed, with balance sheets across many companies depleted, avoiding litigation is highly desirable, particularly in areas subject to mass tort and class action type litigations. Implementing a strong risk management strategy with a product liability focus can form a strong defence against such claims, provided appropriate dispute resolution procedures are built in. However, with the passage of various tort reform legislations and business-friendly court decisions during the past decade and a half, many companies have grown complacent. Nonetheless, the increase in class action should inspire companies, especially complex multiparty and multi-jurisdiction businesses, to make sure they are covered at a time when budgets are low and corporate tension is high.

Taken for granted

In most areas of risk management, areas which were essentially ignored during times of plenty have since risen to greater prominence in the financial crisis. In some areas of the Americas, this is also true of product liability risk, but in

others, it seems that the opposite is more the case. "As companies have found their existence threatened because of economic fundamentals, less time, attention and fewer resources have been devoted to managing product liability risk," observes James Stengel, the managing director of litigation practices at Orrick. "As an example, five years ago, product liability risk would have been a major item for the domestic US automakers. In addition, although probably not a material source of risk, they faced long-standing liability streams. Obviously, the market downturn and the events of the last two years have made those prior priorities minimal in comparison to the fundamental question of whether those companies would survive," he explains. Not all companies and sectors are in quite such a difficult bind as those in the automotive sector, but the actual fact of having insufficient resources, time and attention to do justice to product liability risk is becoming increasingly common among firms in the Americas.

Furthermore, as a separate issue, product liability is now a mature legal doctrine in the US, with a longstanding body of case law, and legislation which provides clear boundaries. As such, it no longer alarms the corporate hi-

erarchy in the manner that it did a few decades ago – they feel that they are well ahead of the game, and many feel that product liability lawsuits, when they occur, are just part of doing business. Indeed, the last 15 years or so has seen an almost perfect wave of favourable developments to product liability law. But this may soon cease, due to a combination of political and social change, which is set to erode those legal benefits. This will make product liability a more risky area, particularly for those companies which have not, for various reasons, made product liability risk a current priority. Furthermore, many small to medium-sized firms may no longer be able to absorb the impact of lawsuits, if indeed they could before. As such, companies must be prepared to wisely allocate resources, even if those resources amount to less than they would like. Part of this considered allocation should involve the examination of settled claims, so as to learn more about how suppliers' components are likely to fail to meet specifications.

Looking towards Latin America, it is the case that several of the larger economies have been increasingly influenced by the US approach to product liability, and as such may be facing similar, if not identical, issues. Júlio Bueno, a partner at Pinheiro Neto, notes that the level of so-called 'consumerism' in Brazil is particularly high. "Consumer protection in Brazil has the constitutional status of fundamental individual and collective right, and is a principle of the economic order. Consumer rights are set forth in the Consumer Defence Code. And with the effectiveness of the new Civil Code and the increasing awareness of consumers regarding their rights, and the effective acting of associations and non-governmental organisations for the defence of consumers, Brazil is likely to see an increase of litigation involving civil liability and products liability." However, he adds that companies are also more concerned with the quality of their products and services, and generally communicate more with consumers during product liability lawsuits than has historically been the case. This is an im- ►►

portant development – communication is key to not only the success of the case, but often to the continued survival of the product and the company itself.

However, the difficulties arising from the current environment are yet to engender product liability litigation. “The consequences of today’s risk management decisions may not be known for two or three years,” asserts William A. Worthington, of Strasburger & Price, L.L.P. “We are not a year into the recession, and most poor risk management decisions have a longer tail than that. If we look back to the early 1990s, we can find a number of cost-saving risk management decisions which had long-term consequences. Many lawyers stayed busy in the second half of the 1990s either taking advantage of or responding to cost-saving risk management decisions of the early 1990s,” he recalls. Nonetheless, companies would be well-advised to prepare for this manifestation now – particularly in light of the fact that typical product failures have a reasonably predictable and consistent profile. Firstly, potential problems should be highlighted, along with issues or failures pertaining to regulatory compliance. Then there are consumer complaints, followed by a handful of product liability cases. In many cases, these signs are ignored or misinterpreted, and when the litigation becomes a more serious matter, the company in question is unprepared.

This is a classic mass tort life cycle, but one of the other changes in the recent environment has been a dramatic acceleration of that life span, warns Mr Stengel. “What used to take five to 10 years to develop into a full-blown mass tort can now occur in 12 to 18 months, and that time period is becoming shorter and shorter. All that puts tremendous pressure on the internal risk management and legal staff of corporations because they can no longer deal with problems as they arise – they have to look into the future and try to identify the risks and manage around them.” He adds that this has also changed in terms of the legal risk management function – they should not be waiting for complaints to arrive and then reacting, but instead should be actively involved in supervising product testing, regulatory compliance, reporting and assessing the product lines of their respective companies to ensure that if there is a problem in terms of injury or harm to customers, they are aware of those developments and can accurately assess the risk.

The US system of asbestos litigation is a near-constant example of how the failure to properly manage and understand risk from product liability can play out. “There are a number of examples of poor risk management which can

be found in the asbestos product liability litigation,” notes Michael O’Donnell, the chairman of Wheeler Trigg O’Donnell LLP. “Some companies which were not ‘big dust’ defendants made the mistake of paying settlements to all plaintiffs rather than vigorously challenging the basis for liability and putting together appropriate defence strategies. As a result, some of these companies were targeted by the plaintiffs’ bar, and are now either in bankruptcy or struggling financially due to the overwhelming number of asbestos claims and lawsuits they face,” he says. And yet the problem remains – and an effective, reliable solution is yet to be found.

Ongoing challenges and risks

Clearly then, negotiating the mire that is product liability is far from a simple matter – even in countries like the US, which has relatively sophisticated legislation and a sturdy body of case law. “There is tremendous uncertainty surrounding potential product liability risk in the US,” says Mr Stengel. “In many product liability situations, the simple case of, say, a manufacturing defect in an automobile may be relatively simple because the time-frame is compressed. If there is going to be a problem, it will manifest itself fairly quickly; the causal link between the defect and potential harm is clear and the issue of whether or not the product is properly designed or properly manufactured is relatively clear. When you move from that situation to the more complex scenario of toxic substances or pharmaceutical products, where the defect is not obvious, if it even exists, the latency or lag periods between administration or exposure and manifestation of injury become protracted, in many cases involving the passage of decades,” he says. Further, where the alleged harm is no longer specifically caused by exposure to the product or substance, these layers of complexity make it difficult for those responsible for risk assessment to evaluate what is likely to happen – a problem which is undeniably exacerbated by reduced resources.

Furthermore, the nature of the product at issue and the manufacturing processes create major differences. In the US, the relevance of regulatory compliance has been a key factor, and there has been a significant amount of litigation addressing the issue of pre-emption. The conflict is thus: does a federal regulatory scheme like the Food and Drug Administration trump state tort law? “Pre-emption used to be a defence that was particularly viable for medical devices and some pharmaceuticals. Now, with the recent Supreme Court decision in *Wyeth v. Levine*, the possibility of pre-emption was

significantly reined in for a number of types of cases beyond just medical products. In addition, food, beverages, and a variety of other products, are susceptible to suits where federal legislative and regulatory requirements are insufficient to preclude state law claims,” warns Russell Jackson, a partner at Skadden, Arps, Slate, Meagher & Flom LLP. But on balance, the US court system has been unable to bring any real clarity to the issue. There have been defence-side victories, which recognise that the regulatory scheme does in fact pre-empt state tort law, but there are efforts under way at both federal and state level where appropriate to undo or limit the scope of those decisions.

Ultimately, each sector is going to face its own specific issues – for instance, challenges faced by the automotive sector are very different from those faced by the pharmaceuticals sector. “The Chrysler and General Motors bankruptcies present an immediate issue in the automotive industry,” asserts Mr Worthington. “Typically, responsibility for an alleged defective product is passed up the sales chain from the immediate seller to the manufacturer. However, to the extent the bankruptcies protect the new companies from liabilities of the old, dealers or other intermediaries may be left with responsibility both for tort and warranty claims. This same consequence may occur in other industries experiencing manufacturer failures,” he warns. Companies in the manufacturing industry should take this under advisement.

It is clear that product liability covers a wide swathe of factors, but more generally, a product is considered defective when it is not adequate for the purposes for which it is normally intended. This can be due to defects in its making, design, manufacturing, building, assembly, use of raw materials, presentation or storage, or because of insufficiency or inadequacy of information pertaining to its use and risks. Looking specifically at presentation, a significant element is how a product is advertised to the wider market. “Advertising is one of the means whereby the supplier provides consumers with information about its products and services, and in Brazil, the Consumer Defence Code prohibits misleading and abusive advertising,” explains Mr Bueno. “Therefore, the misleading character of any kind of advertising information or communication is present if it is false in whole or in part or, for any other reason, even owing to omission of essential data about the product or service that is capable of inducing the consumer to make a mistake regarding the nature, characteristics, quality, quantity, properties, origin, price or any other information about the

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products and services.” He adds that abusive advertising, on the other hand, is that which is considered to be discriminatory or that stimulates violence, exploits fear or superstition, exploits the lack of judgment and experience of children, disrespects environmental values, or that is capable of inducing the consumer to behave in a way that is harmful or dangerous to his health and safety.

There are also challenges associated with a company’s product liability insurance coverage, particularly in light of the fact that a number of substantial insurers have failed in recent months. “One of the primary challenges is understanding that merely buying insurance is not the end of risk management,” asserts Mr Jackson. “It requires an understanding of how your products have failed in the past, what types of consumers are going to use them, and how component suppliers may be tempted to skirt specifications to achieve cost savings in ways that may impact product performance,” he says. Companies should probe deeply into the depth and boundaries of any potential problems, and realistically consider what they will be able to do to address those problems. This will better enable companies to ensure that there is adequate insurance coverage, as far as is possible.

In addition, it is vital that key employees such as engineers, scientists and other relevant individuals are all well-versed on product liability risk. Furthermore, senior management need to create a working environment wherein safety and quality always come before profits. An intimate knowledge of the company’s product line and processes is also essential. “Managing product liability risk begins at product incep-

tion and runs through R&D, procurement, fabrication and marketing, and those areas too will be subject to elevated budgetary pressures and scrutiny. The big question is whether companies will forego perceived redundancies in those processes to reduce costs today. That, of course, will affect future risk,” adds Mr Worthington.

Keeping it real

While product liability may have been pushed to one side for now, the downturn, if nothing else, has served to help companies prepare themselves for future challenges by exposing their most critical weaknesses. “Downturns and recessions always expose weaknesses which are largely ignored during the good times. The best risk management occurs on the front end before and during the manufacturing process,” says Mr O’Donnell. Further, as the Americas emerge from the current downturn, it is likely that there will be a renewed emphasis on product liability issues. In an environment where most companies are challenged with fiscal issues, smart companies will have the ability to gain the upper hand by closely assessing the design and marketing of the relevant products, the reliability of the component suppliers, the legal and regulatory environments, the litigation history, and the availability and structure of their insurance, they can develop a risk management plan that accurately assesses product risks and allocates sufficient assets to address them.

Further, the legislation surrounding product liability is constantly being refined. Mr Bueno explains that in Brazil, the law surrounding product liability has been continually evol-

ing in terms of its rationales and grounds for liability – far more so than any other area of tort law. “Over the past 50 years, with developments in industrialisation and international trade, product liability has been a popular and dynamic legal issue in Brazil. Over time, several economic and social considerations have been taken into account in the formulation of product liability rules. Consumer protection ideas and striking a balance between the parties have emerged as the most effective factors in the policies of many jurisdictions,” he notes. As such, Brazilian companies have been facing the prospect of a substantial increase in civil responsibility and product liability cases.

Positive developments notwithstanding, companies need to be mindful of the legal and regulatory landscape. Indeed, in certain US states, class action suits for consumer fraud can be brought wherein no-one has to prove what representations were made, never mind proving those that actually influenced the purchase decision. They could be able to recover either statutory damages or actual damages, which in the individual case may be quite limited but which are substantial when aggregated by a class action. These sort of allowances make it almost impossible to accurately assess a product’s potential liability in these US states. Ultimately, there are few areas where compliance with regulation provides a safe harbour from product liability claims in the Americas. However, failure to comply will, in most cases, nearly always constitute negligence or liability. This is a risk that few companies can afford to take, and must therefore avoid at all costs. ■



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