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MANAGING PRODUCT LIABILITY IN THE AUTOMOTIVE AND MANUFACTURING SECTORS

REPRINTED FROM:
CORPORATE DISPUTES MAGAZINE
APR-JUN 2015 ISSUE



www.corporatedisputesmagazine.com

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Bird & Bird

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MINI-ROUNDTABLE

MANAGING PRODUCT LIABILITY IN THE AUTOMOTIVE AND MANUFACTURING SECTORS



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Ryan A. Polkowski is Senior Products Counsel at Harley-Davidson Motor Company. His legal career has been devoted to working with world-class engineers to help make automobiles and motorcycles safe, resolving product-related claims and lawsuits with customers and/or their counsel, and setting up internal systems to drive safety and encourage quality from lessons learned through customer experience and interaction with top internal and outside experts nationwide.

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'Mickey' Pohl is a litigation partner at Jones Day. He has litigated product liability cases for almost 40 years and was the head of Jones Day's Product Liability and its Business and Tort Litigation practices. He has counselled clients around the world on such matters and has tried cases across the country. He is a Fellow of the American College of Trial Lawyers and is listed in 'Best Lawyers' in America in four categories, including 'Bet-the-Company' litigation.

CD: What are some of the key trends in product liability that have affected the automotive and manufacturing sectors over the last 12-18 months?

Dickerson: In 2014, there were a record number of automotive recalls – 64 million, more than double the previous record. Most of the recalls were initiated by the manufacturers. One reason for the record number of recalls is likely the potential for hefty fines, as last year both the NHTSA and the Justice Department were aggressive in levying fines on auto manufacturers for issues related to recalls. In 2014, the NHTSA issued over \$126m in civil penalties, setting a record high. The Department of Justice also stepped into the fray, imposing the largest penalty ever imposed on an automotive company. The threat of fines, coupled with the multitude of class-action lawsuits against manufacturers, has created an environment marked by heightened litigation exposure and regulatory concerns. Understandably, manufacturers are taking the initiative to remediate issues seriously.

Kessel: Certainly in the automotive industry, the numbers of recalls are increasing all the time. In addition, there are a number of silent recalls or field actions that take place but which the consumer and mostly the press do not become aware of. This development is due to the pressure of the market,

but is ultimately, therefore, self-inflicted, to develop and sell ever more new or different vehicle models and model permutations at even shorter time intervals. This results simultaneously in continuously less time available for the development and testing of both such vehicle models and their relevant serial production parts. Notably, even test programs agreed with car manufacturers are shortened or skipped entirely from time to time. In addition, the more electronics and software based parts are in the car, the greater the danger of faults.

Polkowski: There were an unprecedented number of automotive sector recalls in 2014, NHTSA penalties, and Congressional involvement in product-defect related issues. Recalls cause manufacturers to receive more claims and lawsuits and affect the public's perception of automotive safety culture. Certain manufacturers have set up settlement funds to handle a huge influx of claims. Others have had to stipulate that certain incriminating facts are allowed to be introduced in product liability cases, as part of a settlement with the Department of Justice. As a result, many product liability cases have been settled for higher amounts, resulting in greater settlement demands and expectations for others.

Pohl: The biggest trend is the change in public awareness of recall issues because of vast media coverage of recalls recently, especially in the automotive sector. There have not been hugely

significant changes in the relevant laws and regulations, but there have been significant changes in public perceptions, fuelled by extensive media coverage of recall-related product problems and attempts by plaintiffs' lawyers and politicians to profit financially or politically from the handling of recalls. Juries will likely be tougher on manufacturers. What also has become ever clearer is that a recall decision, or a botched decision not to recall, by a manufacturer carries potentially huge consequences on many fronts. What had been a significant but manageable decision for a manufacturer has become a huge, many-headed monster in too many cases. The recall has become more of a "damned if you do, and damned if you don't" decision than ever before.

CD: Have there been any recent legal or regulatory developments in this area? If so, what are the implications for companies?

Polkowski: There is proposed legislation to increase to \$300m the civil penalty cap for manufacturers that fail to timely report vehicle safety defects or EWR data to NHTSA. As part of its settlement with manufacturers, NHTSA has started to include requirements that instruct well-established automotive companies on how to handle

issues that may be safety related. This results in the federal government having a significant influence on the hiring decisions and organisational structure of these companies.

"In 2014, there were a record number of automotive recalls – 64 million, more than double the previous record. Most of the recalls were initiated by the manufacturers."

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Alston & Bird LLP*

Pohl: There have not been major changes in the law or regulations relating to recalls *per se*. The main legal issues that are percolating have been whether juries can consider in a personal injury case that a particular product has been recalled and, also, the extent to which persons can recover for claimed economic losses caused by a mere purchase of a product that later is recalled. There are also cases on investments in the stock of a company that then had a recall.

Kessel: 'Classic' product liability is quite established, both in terms of legislation and case law, and rather needs to be applied to the actual

circumstances of the cases – and in these respects case law is becoming more and more fine-tuned and specific; new legislative developments are rather to be expected with regard to disruptive technologies. A good example in the latter respect is the trend toward automated driving where first the Vienna Convention of 1968 needs to be amended followed by national legislation in order to allow for ‘driverless’ cars. Whereas currently only about 1 percent of all car traffic accidents are due to technical failures, and about 90 percent are due to human deficiencies, this percentage of technical or product liability fault will likely increase substantially in any automated driving scenario.

Dickerson: We have already seen legislators and regulators sound the alarm for more safety regulations as recalls increase. One example has been the Obama Administration’s transportation reauthorization proposal – The Grow America Act – which seeks to increase the NHTSA’s congressionally established limit for civil penalties from \$35m to \$300m. The proposal would give the NHTSA more leverage to ensure that companies act expeditiously and proactively to detect and remedy defects. A bipartisan group of US Senators has also introduced legislation to encourage automotive sector employees to report safety problems. The Motor Vehicle Safety Whistleblower Act gives the Department of Transportation discretion to award whistleblowers up to 30 percent of the total

monetary penalties resulting from a successful administrative or judicial enforcement action that leads to monetary sanctions exceeding \$1m. Companies should ensure that employees are made aware of the internal channels for reporting safety concerns.

CD: How important is it for automotive and manufacturing companies to plan in advance for the possibility of a product recall? What aspects should such a plan entail?

Kessel: Automotive and manufacturing companies should have a clear emergency plan for the moment when accidents caused by their cars, products or their parts occur or increase significantly and reveal a safety issue, or when defects or safety risks are notified by customers or consumers to them in increasing numbers. A team consisting of the relevant development engineers, quality officers, finance people and certainly legal advisers – either in-house or external – should always be on standby and be involved from the beginning. They should map out a clear strategy of reacting according to a pre-established plan or manual and apply that to circumstances of the individual case. The plan should entail a timely reaction without admitting liability, undertaking the necessary investigations and tests, reviewing of the applicable contractual documents and technical specifications and, if the matter is or



becomes publicly known, involving the company's own or external PR-specialists.

Dickerson: There is no doubt that recalls can have a huge impact on consumer confidence, product supply and distribution, and can invite regulatory scrutiny. It is therefore vital that companies develop a detailed strategy for handling recalls well in advance of an actual product recall. Such a strategy should address all significant business functions through each stage of a recall, including the initial assessment, implementation,

and the recovery. While there is certainly no one-size-fits-all approach, a company's recall strategy should generally include the following: a strategy for the assessment of the overall scope of the recall response; a strategy for communications, both the initial announcement and periodic communications with employees, distributors, and dealers; a strategy for field response relating to an intake of defective products, tracking of replacements or repairs, and so on.; a strategy for the reintroduction of the product into the marketplace; and finally, a strategy for the auditing of the recall.

Pohl: It is critically important for manufacturers to have plans in place in advance in case a recall becomes necessary. Our advice to manufacturers is to be proactive and do a simulation or rehearsal for handling a major recall-related crisis. Companies regularly have building evacuation drills or hazmat response contingency plans, but few plan in advance about what to do if a major recall may be necessary. It is a useful exercise to put together a multi-disciplinary team within a company and have it work through a simulation based on a hypothetical, major product safety problem. This will lead to advance planning that covers how to notify an agency, the public and dealers. It will identify legal, technical, scientific and media consultants. It may include handling practical details of setting up toll-free call centres and international notifications.

Polkowski: Automotive recalls are complex. There should be a clear plan for deciding and then handling issues that may be safety related. The plan should include a single point of contact for safety related issues, a clear process for safety defect decision making, upper management buy in and accountability, and a group that can effectively execute the recall.

CD: If a product recall is deemed necessary, how should companies go about managing the crisis to avoid some of the common pitfalls?

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Pohl: Companies that have best handled difficult product problems usually have a corporate culture where the safety of its products is recognised as a key component of a long-term product quality, and profitability, strategy. They also have a well designed and consistently applied set of policies and practices regarding when to initiate a product recall. This has to include, at the very least, a process for analysing data which it receives from claims, cases and complaints about product performance. The best companies make recall decisions based on known data measured against the regulations,

safety standards or moral principles involved. Their decisions are not driven by financial impact. Finally, outside experts and special legal counsel should be involved very early in the decision process.

Polkowski: Most of the time, a product recall is not a crisis. It is a well-thought out and planned event. People that handle communications, technical service and customer service coordination should be made aware of reported safety recalls and be prepared for media and customer enquiries. Preparing a quick reference guide to help ensure the company's message is kept consistent is helpful.

Dickerson: If a recall is deemed necessary, a company should manage the crisis by demonstrating that it is accountable, transparent, cooperative and responsive. By demonstrating these qualities, a company can mitigate and restore any consumer confidence potentially lost due to the recall announcement and bolster its credibility. Companies can also take steps to ameliorate the crisis before it even starts by implementing protocols that will help limit the scope of a recall. Companies can, and should, implement track-and-trace systems that link component parts with unique identifiers that are in turn linked to the identification number of the vehicle in which they are installed. If a defect is found, the manufacturer can readily trace the defective part to the VINs of all affected cars. Using data in this way

reduces the scope of a recall and ensures that every defect is not escalated into a 'crisis'.

Kessel: Any unwise statements which could later be interpreted as an acknowledgment of liability or admission of fault must be avoided. In particular, suppliers of parts which allegedly cause the reason for the recall should issue a letter to the manufacturer of the end product stating that any communications and assistance are rendered without acknowledgment of liability or admission of fault and are purely made as gesture of goodwill in a reasonable amount only. Product liability scenarios often start almost unnoticeably with one or two instances of defective parts but they may precede an avalanche. The potential for a major recall is often grossly underestimated at such early stages. In particular, a company should regularly brief its employees to consider these risks and pitfalls before the emergency plan is activated and the emergency team takes charge and control of the situation.

CD: What additional challenges apply if a product recall is necessary across borders, in multiple jurisdictions?

Dickerson: The primary issue for dealing with a multiple-jurisdiction recall is making sure that a company has a strategy in place for dealing with country-specific regulators. Companies should apprise themselves of both the legal requirements

and the common procedures and practices for recalls in the jurisdictions where their products are sold. To gain such an understanding, local counsel in each jurisdiction can assist with developing a strategy for notification and compliance. In addition, the burden of managing a global recall can be quite complex, so companies should pre-emptively create a plan for handling a recall, and identify key internal and external personnel to manage their global recall efforts. In many cases, it may be necessary to retain third parties to assist with the logistics of a global recall in order to ensure that the process is conducted properly and with little damage to the company's reputation as a global contributor of consumer goods.

Pohl: Recalls have global implications for manufacturers now. The manufacturer who recalls a product in one country must decide whether it can, or will, recall the same products sold in other countries. The communications and notification issues can be very challenging.

Kessel: Technically and commercially, cross-border recalls are not that particularly impactful except for in those jurisdictions which demonstrate cultural differences in dealing with such cases. Legally, however, the key issue may well be that different legal systems have different rules in dealing with product liability cases, both with regard to the issuing of recalls for a safety relevant defect, but also

with regard to the later assessment and allocation of liability and damages along the supply chain. Here, issues of the applicable law are most relevant. These need to be analysed carefully – ideally at the stage of concluding supply contracts, but at the latest, if there is a product liability case.

Polkowski: Each jurisdiction has unique and sometimes significantly different rules for product recalls. Brazil, for example, requires advertising. Also, some jurisdictions do not have formal product recall rules and it is difficult to find experts on the governing regulations. Lastly, some jurisdictions may treat an issue differently than others and the smaller jurisdictions may become the catalyst for a worldwide recall.

CD: Are potential class actions arising from product liability a major risk for automotive and manufacturing companies? What steps can companies take to mitigate this risk?

Pohl: Recalls generate class actions. Generally, personal injury cases are not appropriate for class action treatment because facts of the cases and damages differ from case-to-case. There can be economic loss cases that may have classes certified. Large numbers of individual cases are often aggregated in federal multi-district litigation (MDL) proceedings.

Dickerson: Product liability class actions are certainly a major risk to automotive and manufacturing companies. For example, just a few months ago, Honda was hit with a class action lawsuit in which the plaintiffs allege that millions of Honda vehicles are equipped with faulty airbag inflators. There are a number of ways that companies can mitigate class action risk. First, companies should limit the possibility of defects entering into the marketplace through careful design and thorough product testing. Companies should also ensure that they are in compliance with all applicable product safety regulations. Compliance helps eliminate risks already identified by regulatory bodies and eliminates any argument that failure to adhere to regulations is a *per se* product defect. Finally, companies can mitigate the cost of class actions by purchasing insurance or self-insuring.

Polkowski: In our experience, potential class actions have not been a major risk. However, other companies have been the subject of a significant number of class actions stemming from product liability cases recently. In the context of personal injury product liability matters, class actions are not a real risk because the individual issues surrounding causation and damages generally precludes class

certification. Rather, to the extent class actions pose a risk, it would be in the 'diminution of value' rubric.

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*Ryan A. Polkowski,
Harley-Davidson Motor Company*

Kessel: Class actions 'North-American style' are of course a major risk in those jurisdictions that allow such class actions at all. This is, by and large, not yet the case in Europe.

CD: How can product liability insurance help? What should a company consider when choosing the right policy to meet its needs?

Polkowski: A high self-insured retention keeps control of the case in the manufacturer's hands. In cases we have participated in where the manufacturer has dollar-one insurance, insurers have shown little regard for the insured's product,

brand reputation or potential for pattern litigation. In litigation involving dealerships with insurance, for example, the dealer itself is often not consulted about whether to take a case to trial or settle. The insurers focused only on the financials of the case at hand, which is perfectly sensible from the insurer's perspective.

Kessel: Product liability insurance can, of course, not avoid the safety issues and the product liability case at all, but it can help to alleviate the financial consequences. Product liability insurance should certainly cover any recall situation for safety risks but also any silent recall or field action for serial damages which, from a legal point of view, is more of a warranty matter. In some jurisdictions product liability recall insurance, particularly for the automotive market, is easily available, in particular with worldwide cover for any product liability causes occurring in other countries. In some jurisdictions such comprehensive insurance is far less available. Particular issues often arise in relation to the coverage for software and electronics related product liability scenarios. For these there are often no or very few standard product liability offerings available and each case needs to be looked at separately and negotiated and agreed with the insurer.

Dickerson: Insurance coverage is a primary mechanism to defray the costs of product liability class actions and product recalls. General liability insurance policies typically provide coverage for defence costs and amounts paid to settle or satisfy a

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Bird & Bird LLP*

judgment stemming from product liability claims and lawsuits. In purchasing general liability insurance, companies should be aware that the coverage limits of a single general liability insurance policy may be insufficient to provide adequate protection against liability for companies with significant product liability exposure. Such companies should strongly consider purchasing excess liability insurance policies which kick in after the limits of a primary liability policy have been exhausted. In order to keep premiums manageable, especially in the situation where a company purchases both primary and excess liability insurance, companies can retain higher deductibles or retentions so that insurance

coverage is generally available only for large losses. It is also important to note that coverage for costs related to recalls is generally not included in general liability insurance. Product-recall insurance is, however, offered as a separate insurance product by many carriers. Product-recall insurance typically provides reimbursement for reasonable and necessary costs related to a product recall such as the costs of notifying the public, costs related to shipping the product, and costs related to hiring outside experts to assist with the recall.

Pohl: There is a multiplicity of views about whether to carry product liability insurance and in what amounts. Depending on the size of the company and the nature of the products sold, it seems that a prudent company will have some excess coverage for catastrophic events but, at the same time, the presence of insurance and the amount is generally discoverable and, where insurance exists, it sometimes seems to attract more claims and cases.

CD: What final advice can you offer to automotive and manufacturing companies on managing product liability?

Kessel: Consider carefully in which jurisdictions you are active and the laws of which country govern the contract. The manufacturer of products sold to consumers does not have a choice here, as the

laws of the country in which the consumer lives normally apply. However, suppliers further along the supply chain, delivering parts for the manufacturer's final product, may well have a choice. In particular, jurisdictions of high risk like the US, or lower risk like Germany, need to be identified at the stage of entering into the supply contracts. Suppliers should seek to make their contractual arrangement subject to the laws of a low risk jurisdiction. For example, under the very strict law on standard terms in Germany, many clauses in the car manufacturers' purchase terms are invalid, most notably those clauses that do not reflect the principle that payment of damages requires that the supplier was at least negligent.

Pohl: Where recalls have turned into costly debacles, certain themes seem to appear too frequently. A person, faction or division within a company stubbornly defends the product for too long, often in the face of mounting credible data, which, when viewed objectively, indicates that there is a problem. Those charged with making a recall decision should consult with, but be separate from, those who may be emotionally involved because they designed, approved or otherwise defended the product. Finally, documents, and especially emails, should be carefully worded and limited to the facts. Stupid emails can be very costly in litigation.

Polkowski: In my career, I have not seen very many product liability cases with merit. If a case with merit arises, I recommend a cards-up, reasonable attempt to resolve the case or claim and then ensure that the issue is reviewed by the people in the organisation who review issues that may be safety related. If the case does not have merit, we recommend hiring good trial counsel and taking a strong position on not settling meritless claims and cases. Develop a reputation for doing so.

Dickerson: Companies need to be prepared. There are a number of unique liability risks facing automotive and manufacturing companies. Such risks run the gamut from personal injury claims to class actions alleging breach of warranty and consumer fraud. By carefully mapping out a strategy for handling recalls and using insurance and other mechanisms to defray the costs associated with product liability claims and recalls, companies can minimise the impact of product recalls and manage consumer confidence. 

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Bird & Bird is an international law firm with in-depth knowledge of client's industry sectors. We have a strong reputation in the automotive sector, providing a full range of legal services in Europe and Asia to suppliers, manufacturers, investors, distributors and dealers. Our product liability team helps clients to navigate the legal implications of the various safety standards in the automotive sector and to assess their impact in terms of product liability risks. The team has extensive experience in handling product liability disputes and non-contentious matters both on a national and multi-jurisdictional basis.

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