

PREVENTING FOREIGN PRODUCTS LIABILITY

Elements of a Product Liability Risk Control Program for Wholesalers and Distributors

BACKGROUND

Wholesalers and distributors are an integral part of the product marketing process and generally have limited products liability exposure if no design, private labeling, modification, assembly, or packaging of products is done. Nevertheless, there is still vulnerability in today's global marketplace when wholesalers and distributors bring products manufactured overseas into this country. It is almost impossible to recoup product liability losses from overseas manufacturers, especially the costs of recalling a foreign made product, and wholesalers and distributors must therefore take an aggressive approach in protecting their assets from product liability actions.

With this in mind, wholesalers and distributors should develop and implement a Product Liability Risk Control Program to minimize product liability claims and strengthen their defensive posture in case a claim is made against them.

PROGRAM ELEMENTS

Purchasing

Wholesalers and distributors should purchase safe, quality products, with appropriate warnings and labels, from reputable manufacturers who exercise good management controls (i.e., consider safety, comply with mandatory, and voluntary standards, avoid making exaggerated claims in advertisements, and provide adequate manuals and instruction material). These are key elements in minimizing product liability lawsuits, as the wholesaler or distributor typically has no design input, does not manufacture the products, and is not in a good position to adopt better warnings or instructions, but does have control over the line of products sold or distributed.

When considering a new product line, the wholesaler or distributor should determine if the product could be hazardous to the user. They should avoid products that are inherently dangerous and discontinue selling products that generate complaints. Judging the quality and safety of distributed products is very important, and cannot be over-emphasized.

To help clients, a number of hazard analysis guides and checklists are available on www.cna.com/riskcontrol. There are also a number of consulting firms who specialize in product hazard analysis and lawyers who can help analyze the results and help you make a well-reasoned decision.

Manufacturing Issues

Wholesalers and distributors should investigate the type of quality assurance testing program the overseas manufacturer has. Do they do full, partial, or random testing? When does the testing occur? What do they consider a product that meets specifications? Do they believe that "close enough" is acceptable? What records that might be necessary for product liability defense do they keep? How accessible are they?

Still, that may not be enough depending upon the nature of the products you are importing. Should you do full, partial, or random inspection testing of the incoming product or component part? Do you confirm that the foreign manufacturer has not changed the raw material in the part or product they sell you after you have approved or the certifying agency has approved? There are many horror stories of "quality fade" in foreign manufacturers. Should you have full-time people at the plant in the foreign country monitoring their manufacturing and quality control processes? Can you use third parties to confirm conformance to manufacturing standards?

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Warnings and Instructions

Wholesalers and distributors should review the warnings and instructions provided by the foreign manufacturer and require them to provide clear and direct warnings and instructions in correct, plain English.

The U.S. based firm should not generally undertake the rewriting of the warnings and instructions of a supplier, U.S. or foreign. Doing that makes them more potentially liable. It is better to require the foreign manufacturer to utilize competent people, including experienced safety attorneys, to assist them. And it is acceptable for you to recommend whom they should use. They know their products best and should be required to provide you a component part or finished product that is safe in its design, manufacture, and warnings and instructions.

Sales and Advertising

Liability for an injury associated with the use of a product can result from inaccurate statements regarding product capabilities or performance. Statements can be oral or written, and can appear in printed advertising or in sales presentations and demonstrations.

Sales literature and advertising should be reviewed by an attorney versed in product liability law to ensure that all material clearly represents the intended use and true capabilities of the product. Terms such as "absolutely safe", "shock proof", and "fire proof", etc., should be avoided. Your sales personnel should be trained to accurately describe the capabilities and performance of the products they sell or distribute.

Packaging and Shipping

Products should be adequately packaged to prevent damage in shipment. When a product is released to the customer:

- The product should conform to purchase order requirements
- Warnings and instructions should be with the package

- Shipping papers, parts lists, manuals, warranty, certification and other required data should be included in the shipment.
- Shipping records and identification data should be kept on file for the life of the product.

Contractual Risk Transfer

Wholesalers and distributors should request product manufacturers to purchase vendors liability coverage. The manufacturer's insurer will then protect the wholesaler or distributor as an additional insured. The wholesaler or distributor should request appropriate certificates of insurance from the product manufacturer or its insurer at least annually. The certificates will indicate if coverage applies, to whom it applies, the type(s) of coverage, the limits of liability, and the policy period.

U.S. wholesalers, dealers and retailers should have more detailed contracts and specifications when dealing with foreign suppliers. Most contracts and specifications for U.S. and foreign suppliers are inadequate when dealing with some safety issues, such as recalls. With foreign manufacturers who have no assets in the U.S., and therefore no jurisdiction to be sued, it is harder to enforce contracts in general and certainly harder to deal with issues not explicitly set forth in the contract.

Some of the issues that could be included in such contracts and specifications involve required certifications or other safety and quality testing, the documentation that must be sent to the U.S. in English to support the certifications and testing, and confirmation of the foreign manufacturer's understanding of U.S. regulatory or safety issues and when must they tell you about a post-sale safety or quality issue.

U.S. wholesalers and distributors should be sure to include in the contract acceptable remedy and damage provisions. For example, you may not want the foreign manufacturer to disclaim consequential damages or to provide that repair or replacement is the only remedy.

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Of course, the foreign manufacturer should indemnify you and hold you harmless in the event of a product liability claim or lawsuit. However, do you really want them defending the case, or do you want to make it clear that you control the defense or at least are able to participate in it, even if their insurance applies? Their insurance company should be U.S. based and be financially capable of responding in the future. And, you should require a relatively low self-insured retention.

You should think about how you are going to enforce this contract if necessary. Will you have to sue in China? Or, do they agree to jurisdiction in the U.S.? And, is the foreign company financially capable of paying for any recall or any deductible in an insured matter?

If the company goes bankrupt or closes its doors, the insurance premium is not paid and there is no one other than the U.S. firm to pay for the recall. Maybe the foreign manufacturer should be required to post some type of bond with provisions for when the U.S. manufacturer can access the proceeds of the bond. And the foreign manufacturer needs to agree to cooperate with the U.S. manufacturer in all respects in the production process, in any product liability dispute, and in any government inquiry. The foreign manufacturer must agree to provide in a timely manner relevant, translated documents and/or personnel who can appear, if necessary, in a U.S. court or other forum to explain why its product was reasonably safe.

A separate purchase order agreement with the manufacturer should contain a hold harmless agreement, which is favorable to the wholesaler/distributor. However, this will not prevent a party injured by a product from suing everyone in the distribution chain.

Warranty Disclaimers

Since parties to sales contracts are free to contract in any lawful manner they choose, contracts can attempt to disclaim any warranties and specify that the buyer takes the goods at its "own risk". However, due to the harsh effect of such disclaimers, they are usually not favored in

the law and generally must meet very specific requirements to be upheld. Wholesalers and distributors attempting to disclaim warranties to purchasers of their goods should consult their legal counsel to ensure that their disclaimers will be effective in all appropriate jurisdictions.

Field Monitoring

The most important action a wholesaler or distributor can take to limit its product liability exposure is to implement a returned goods policy. Detailed reports should be made explaining why a product is returned. These reports should be passed on to the supplier and manufacturer if possible.

Customer complaints, incidents, and accidents should be recorded, investigated and reviewed by management. Corrective action can then be taken to prevent future loss.

The wholesaler or distributor should discuss its role in the product recall with the manufacturer. The following elements are generally needed for recall of a product:

- Recall policy with established responsibilities
- Product traceability system
- Recordkeeping system to monitor for effectiveness

Legal and Contractual

A firm may choose to have legal counsel on a retainer basis or employ its own in-house legal department. Legal counsel provides consultation and guidance for compliance with laws and regulations.

All contracts, warranties, purchase orders, warning labels, instruction manuals, and advertising should be reviewed by legal counsel versed in product liability law.

CONCLUSION

The techniques and concerns mentioned above are also important for U.S. based suppliers. However, it is even more important to go the extra mile with foreign suppliers.

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Ultimately, the wholesaler or distributor makes a business decision on whom to buy from and what to require them to do. Since it may be impossible to get a foreign manufacturer to do all of these things, the company will need to decide what is most important and what preventive techniques are priorities. In that way, the distributor or wholesaler will be better prepared to make a rational business decision and assume the future risk that it deems acceptable.

An organization's vulnerability to product liability in today's litigious society can be strengthened by responding to the Elements of a Product Liability Risk Control Program.

For assistance with your Product Liability Risk Control Program, contact your CNA Risk Control Department.

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