Westlaw Journal
AUTOMOTIVE
Litigation News and Analysis • Legislation • Regulation • Expert Commentary
VOLUME 34, ISSUE 19 / MARCH 23, 2015

EXPERT ANALYSIS

Reducing Risk with Contracts, Warranties and Safety Programs

By Mark A. Aiello, Esq., Vanessa L. Miller, Esq., Jeffrey A. Soble, Esq., and Lauren M. Loew, Esq.
Foley & Lardner

Over the next year, the automotive industry can expect continued focus on product recalls, warranty issues and safety procedures.

As the National Highway Traffic Safety Administration and original equipment manufacturers waded through numerous recalls in 2014, OEMs stepped up their efforts to seek contributions or shift responsibilities to suppliers.

This renewed focus on the contracts and warranties between suppliers and OEMs is also a good opportunity for companies to revisit their standard warranties and negotiation and contracting practices. As recalls and warranty issues continue to dominate the industry in 2015, automotive companies should seek to mitigate future product liabilities and claims by reviewing and updating their corporate product safety programs.

REDUCING SUPPLIER EXPOSURE TO RECALL AND WARRANTY CLAIMS

In 2014, NHTSA pursued recalls against component manufacturers, rather than merely focusing on the OEMs. These recalls include multibillion-dollar recalls, spanning multiple vehicle manufacturers, which promise to stretch into 2015, exposing suppliers and component manufacturers to signifi cant liability.

In addition, contracts between suppliers and OEMs often include provisions whereby the manufacturer of the defective component part bears responsibility, or a portion of responsibility, for the costs of a recall. Suppliers can expect to face increased pressure from OEMs to contribute to recalls.

Automotive companies should take steps to mitigate their exposure in the event of a recall implicating their product.

These include comprehensively documenting the product development process, including design- and testing-level responsibilities. Design options and proposals can be of major importance, along with part- and component-level testing responsibilities. Moreover, the procedures for determining fault and responsibility for defects should be reviewed, including the limitations and disclaimers contained in the warranty and risk allocation provisions.

Finally, suppliers should strongly consider implementing a corporate product safety program.

HANDLING WARRANTY ISSUES

Contract negotiations and disputes in the automotive supply chain often involve questions concerning warranties, warranty disclaimers, limitations on remedies and limitations on damages. Understanding the basics of warranty law is critical to managing and litigating these negotiations and disputes.

Companies should take steps to mitigate their exposure in the event of a recall implicating their product.

The starting point in most commercial disputes is analyzing the warranty the seller gave the buyer when supplying automotive components. These include both express warranties and implied warranties under the Uniform Commercial Code.

Express warranties arise from affirmations of fact by the seller and may be created by oral statements, advertisements, specifications, drawings, samples or models. Implied warranties under the UCC include the implied warranty of merchantability and the implied warranty of fitness for a particular purpose.

The parties should consider any warranty disclaimers, modifications or other limitations that are part of the parties' contract to determine potential exposure in the event of a breach-of-warranty dispute.

By contract, the parties may agree to disclaim certain implied warranties and to fix or limit certain remedies or damages. Any contractual provision that limits remedies must leave minimum adequate remedies for the aggrieved party and must not be unconscionable.

In particular, a supplier should expressly address design, part integration and system-level testing responsibilities. General implied warranties should be replaced or limited, when possible, with carefully drafted express warranties that specify the design, part integration and system-level testing responsibilities, criteria and performance specifications.

In addition to understanding the contractual language and any disclaimers or limitations, a party must clear two timing hurdles in order to bring a claim for breach of warranty: warranty eligibility, meaning the claim falls within the applicable warranty period, and timeliness under the UCC's four-year limitations period.

The expiration of either the warranty period or the four-year limitations period is an absolute bar to a breach-of-warranty claim.

Both buyers and sellers should consult the following checklist:

- Draft clear and concise express warranties concerning the goods being sold. Rather than relying solely on vague phrases ("free from defect"), include precise, objective performance criteria for the goods ("product will meet objective specifications").
- As a seller, disclaim the implied warranties and all other express warranties not specifically given in the contract. As a buyer, focus on negotiating the proper express warranties rather than relying on implied warranties.
- Sellers will want to limit the buyers' remedies, such as to repair or replace. Buyers should resist. If the seller has the leverage and a limitation on remedy is accepted, the buyer should negotiate for tight deadlines and specific activity relative to compliance by the seller with the limited remedy ("machine shall be rendered fully operational within 24 hours of notice").
- Buyers should fight against damage limitations. If the leverage means a seller wins on this point, the buyer should look to add carve-outs for certain circumstances (intentional acts, gross negligence and so forth). Additionally, argue for excluding certain types of claims from the disclaimer (intellectual property infringement, indemnity claims, etc.).
- Whether a buyer or seller, make sure that the warranties/disclaimers that you give upstream are the same that you get downstream. Failure to do so may lead to gaps that your company will have to cover.

Finally, the most important focus of any commercial contract should be capturing all aspects of the parties' commercial relationship in the written agreement. Uncertainty breeds disputes and litigation.

Conversely, a well-drafted, comprehensive agreement will serve as a roadmap for the parties' commercial dealings. With respect to indemnities, the devil is in the details.

While many contracts contain boilerplate indemnification clauses, companies should consider some specifics that are often overlooked.

For example, is there a duty to defend and pay for a defense in the indemnity? If so, who picks counsel and controls the defense? If that defense leads to meaningful settlement discussions — as it almost always does — which party controls the terms of that settlement?

As far as insurance, there are many options and types to hedge against the inherent risks of your business, such as comprehensive general liability, excess, umbrella and recall.

Further, contracting parties can help to protect each other by asking to be named "additional insureds" on each other's policies.

IMPLEMENTING CORPORATE PRODUCT SAFETY PROGRAMS TO MITIGATE RISK

In light of the business, litigation and reputational risks automotive companies face from recalls and warranty claims, companies more than ever are proactively reviewing (or for the first time implementing) their corporate product safety programs.

These programs promote a culture of safety and can identify warranty and recall issues well before they become a multimillion-dollar (or greater) exposure for the company. However, a corporate product safety program is effective at mitigating risk only if the company implements the program in a meaningful way.

Key components of an effective program include:

- A written product safety policy.
- A product safety committee, led by a product safety manager.
- Audits and audit programs for both manufacturing policies and warranty issues.

A written product safety policy is one of the first steps in establishing a culture of safety at a company.

An effective policy contains a mission statement, details a management and accountability structure for the program, establishes goals that are both measurable and ascertainable, empowers employees to raise safety or defect issues, and is widely disseminated within the company.

The product safety committee also is an integral part of a corporate product safety program. The committee is a working group of legal and operational leaders that establishes criteria, best practices and procedures to support the written product safety policy. The committee gathers information about product defect events, establishes guidelines and criteria for product warnings and product advertising, and handles regulatory reporting.

An effective product safety manager should lead the product safety committee and report directly to a member of the company's management team.

Through the product safety committee, the company should also initiate an audit program to cover its manufacturing policies and warranty claims. Audits are designed to identify potential defects before they reach consumers and to identify problems in the field before they turn into claims.

Finally, companies that implement a corporate product safety program must take steps to protect the attorney-client privilege and work product doctrine when legal counsel is involved.

Although the application of these privileges varies among jurisdictions, companies can increase the likelihood of protecting the privileges by implementing the following:

- Legal counsel (in-house or outside) should be involved with and guide any investigation.
- Product safety committee documents and communications should clearly indicate when the committee is seeking or receiving legal advice.

Suppliers must address design, part integration and system-level testing responsibilities.

Corporate product safety programs can identify warranty and recall issues well before they become a multimillion-dollar exposure for the company.

- Information should be disseminated only to necessary individuals.

A company that implements a corporate product safety program is not immune from liability for recalls and warranty claims, but companies that take these steps are taking action toward mitigating their future liabilities.




(L-R) **Mark A. Aiello** is a partner and litigation attorney with **Foley & Lardner** in Detroit, where he focuses on business transactions and commercial litigation, including business transfer, supply-chain and warranty litigation, and product development and protection. He is co-chair of the firm's automotive industry team, and can be reached at maiello@foley.com. **Vanessa L. Miller** is a partner and litigation lawyer with the firm in Detroit. Her practice focuses on a wide array of bet-the-company litigation, including manufacturing, contract and warranty disputes, and automotive supply-chain disputes. She has written several publications and presentations on these issues, and can be reached at vmiller@foley.com. **Jeffrey A. Soble**, a partner and member of the firm's business litigation and dispute resolution practice in Chicago, is co-editor of Dashboard Insights, the Foley & Lardner automotive industry team's blog. His practice focuses on supply-chain management and contract enforcement, class action defense, product liability, and general contract and tort law. He can be reached at jsoble@foley.com. **Lauren M. Loew** is senior counsel and a litigation lawyer with the firm in Chicago. She is a member of the business litigation and dispute resolution practice team, and the automotive industry team. She represents clients on matters including product liability defense; commercial contract, general contract and warranty disputes; and post-acquisition disputes. She can be reached at lloew@foley.com.