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What are the legal options for product component manufacturers when other manufacturers' components fail and the final product is not recalled? In this Analysis & Perspective, attorney Daniel W. Whitney explores strategies and risk management options for the manufacturer of a properly working component ''stuck in a bad product.'' Whitney focuses on the issues stemming from a hypothetical decision by government safety officials not to recall the final product, and the likely fallout on manufacturers who play by the rules but must deal with costly product liability litigation and additional product failures.

The Defective Household Product Not Recalled: Implications for the Component Manufacturer

BY DANIEL W. WHITNEY

The typical household product consists of component parts. Some of the component parts may be designed and manufactured by companies other than the company assembling and selling the final product under its own label. The product may fail and cause property damage and/or bodily injury. The failure may be the result of a defect in design or manufacture of the product unrelated to a specific component, or may result from the product being accompanied by an absent or inadequate warning. This article explores defense strategies and risk management options for the manufacturer of a good component stuck in a bad product — more specifically, where the product should be recalled but is not, and claims and lawsuits have ensued, and many more failures are expected to occur. What is the component manufacturer to do?

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Stuck in a Bad Product

The mere presence of a failed component in a product that has caused property damage and/or bodily injury due to failure of a separate part of the product is at times enough to implicate the innocent component manufacturer in a claim or lawsuit. This may occur even when the component manufacturer had no involvement in overall product design, premarket testing or assembly of the final product.[1] If the product has been in use for an extended period, the component at issue may be non-functioning without contributing to the failure. The component may have an operational life expectancy — set by the finished product manufacturer — and may cease to function once the design life is exceeded. Depending on the failure mechanism and presence or absence of overall design safeguards, such a failure might impair product performance but not cause or contribute to consequential property damages and/or bodily injury.

A component that ceases to function beyond its operational life expectancy cannot, by definition, be considered to have prematurely failed. Courts have recognized that products are not expected to last forever, and failure due to expected wear and tear is not a product defect.[2] Nevertheless, the innocent component manufacturer can be drawn into mass litigation that a timely product recall would have foreclosed or greatly diminished.

Avoidance of Recall

There is no generally recognized common law duty to recall a defective product.[3] A product recall may result either from government mandate or voluntary action by the product manufacturer. A company that decides not to voluntarily recall or issue a post-sale warning may be required to institute a recall if the product poses a substantial hazard *or* creates an unreasonable risk of serious injury or death.[4] In either instance, there is a common law duty to *reasonably* conduct the recall.[5] Although a common law duty to recall is not generally recognized, some states impose a post-sale duty to warn in various situations.[6]

Under federal law, a manufacturer must notify the Consumer Product Safety Commission within 24 hours of obtaining information that reasonably indicates that a product contains a defect that could create a substantial hazard.[7] Manufacturers are charged with knowledge of such information when it has been received by an official or employee who may reasonably be expected to be capable of appreciating the significance of the information.[8] For instance, the claims manager or head of corporate insurance of a major corporation should understand the significance of a reported product failure accompanied by a claim of bodily injury. ''Most defects could present a substantial product hazard if the public is exposed to significant numbers of defective products or if the possible injury is serious or likely to occur.''[9] Even if there are no reports of a potential for or an actual death or grievous bodily injury, other information may indicate a reportable defect.[10]

Should the manufacturer fail to report product-related injuries, the CPSC may investigate information from other sources suggesting that a product failure creates a risk of serious bodily injury or death. In the course of its investigation, the CPSC may require the manufacturer to provide information bearing on whether the product should be recalled. The CPSC's preliminary inquiry is whether the product is defective.[11] The manufacturer is required to explain the nature of the product failure, and disclose how many products have reportedly failed, reports of personal injury, how many products remain in use and other pertinent information.[12] Supporting documentation including internal failure analysis and reports of claims and lawsuits must be produced.[13] A single defective product can form the basis of a substantial hazard determination.[14] The CPSC may conclude that a product presents a substantial hazard even if not a single injury has yet occurred.[15]

Under the Consumer Product Safety Improvement Act (''CPSIA'') penalties may be imposed for violation of CPSC-administered statutes. Effective August 9, 2009, the available civil penalties include $100,000 for each knowing violation and $15 million maximum for a series of violations.[16] In addition to fines, criminal penalties may be imposed on a company for allowing a dangerous product to remain on the market.[17] Some hard-

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[1] The component part manufacturer who did not take part in design or assembly of the final product should not be held responsible in a product liability case if the part is made to the final product manufacturer's specifications. *Zaza v. Marquess & Nell, Inc.*, 675 A. 2d 620 (N.J. 1996); *See, e.g.*, *City of Cohoes v. Kestner Eng'rs, P.C.*, 640 N.Y.S. 2d 917 (N.Y. App. Div. 1996). In such situations, the component manufacturer generally owes no duty to warn the ultimate consumer. *See* Restatement (Third) of Torts: Products Liability § 5, cmt. 6 (1998).

[2] *See, e.g., Abdul-Warith v. Arthur G. McKee & Co.*, 488 F. Supp. 306 (E.D.Pa. 1980); *Micallef v. Miehle Co.*, 39 N.Y.2d 376 (N.Y. 1976); *Auld v. Sears, Roebuck & Co.*, 288 N.Y. 515 (N.Y. 1942), affirming 25 N.Y.S.2d 491 (N.Y. App. Div. 1941).

[3] *See, e.g., Patton v. Hutchinson Wil-Rich Mfg. Co.*, 861 P.2d 1299 (Kansas 1993); *Dion v. Ford Motor Co.*, 804 S.W.2d 302 (Tex. App. 1991).

[4] *15 U.S.C. § 2064(c)(1) & (d)(1)*. A ''substantial product hazard'' is defined as ''[a] product which, due to the pattern of defect, the number of defective products distributed in commerce, the severity of the risk, or otherwise, creates a substantial risk of injury to the public.'' *15 U.S.C. § 2064(a)*.

[5] Restatement (Third) of Torts: Products Liability § 11(a)(2)(b). Liability can be premised on an unreasonably conducted recall. For instance, a ''silent recall'' may feature an acknowledgement of the need to replace the product outside the warranty period, however, if no proactive steps are taken to notify customers in advance of product failure, such a recall would appear to be unreasonable.

[6] *Vasallo v. Baxter Healthcare Corp.*, 696 N.E. 2d 909 (Mass. 1988); *Cover v. Cohen*, 61 N.Y.2d 261 (N.Y. 1984); *See, e.g., Dixon v. Jacobsen Mfg. Co.*, 637 A. 2d 915 (N.J. Super. Ct. App. Div. 1994).

[7] *15 U.S.C. § 2064(b)(3); 16 C.F.R. § 1115.6(a)*.

[8] *16 C.F.R. §§ 1115.11(a), 1115.14(b)*.

[9] *16 C.F.R. § 1115.4*.

[10] *16 C.F.R. §§ 1115.6(a), 1115.12 (e)*.

[11] *16 C.F.R. § 1115.4*.

[12] *16 C.F.R. § 1115.6*.

[13] *16 C.F.R. § 1115.12(f)*.

[14] *16 C.F.R. § 1115.12(g)(1)(ii)*.

[15] *16 C.F.R. § 1115.6(a)*.

[16] *15 U.S.C. § 2069*.

[17] *15 U.S.C. § 2070*. ''Whoever knowingly and willfully falsifies, or conceals a material fact in a report under CPSA [Consumer Product Safety Act] and rules thereunder, is subject to criminal penalties under 18 U.S.C. 1001.'' *16 C.F.R.*

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ened companies may regard the threat of fines and criminal prosecution as remote possibilities, and through experience and political connections may calculate that all sanctions, including recall, can be avoided. Such companies may further find solace in the lack of a private right of action for violation of the reporting requirements mandated by the CPSA.[18] If the company under investigation provides incomplete or misleading information, and if the CPSC accepts at face value the response, the investigation may be closed with no action taken, other than reminding the company of its continued duty to supplement. The brazen manufacturer may actually attempt to use the closed investigation as evidence that it had no duty to recall.[19]

The finished product manufacturer may wish to avoid the cost of recalling a product whose sales are in the hundreds of thousands of units. It may wish to avoid the negative publicity which might impair a company's reputation for selling quality products. If the product has been in use for an extended time, the company may bet on some units being replaced by the consumer due to an upgrade or a breakdown not resulting in injury or damage. It may further calculate that costs can be shifted to the homeowners' insurers who may not subrogate, or may do so ineffectually and ultimately settle years later for a fraction of the claim's value.[20] It may further adopt an aggressive litigation posture and count on extracting contribution from the hapless component manufacturer who is powerless to recall the product. Ironically the company's professed ''core value'' of customer satisfaction is ignored as to those customers in possession of the product which ought to be recalled.

Investigation

Upon being drawn into the fray, the component manufacturer must conduct a thorough investigation. The component manufacturer must quickly learn if the product was the subject of prior litigation. Earlier suits against the finished product manufacturer may reveal deposition transcripts and documents. Counsel adverse to the product manufacturer in prior cases may be willing to share discovery materials. In this setting, third party investigation could yield invaluable information. In extreme cases, it may be learned that employees of the product manufacturer recognized the urgent need to recall the product but that the company failed to follow through, or that the product manufacturer had ''accepted responsibility'' for such failures over an extended period of years and had a recent change of strategy to pin the blame on the component manufacturer. Investigation may reveal that an economical retrofit/repair solution was available but was rejected by the product manufacturer. It may even turn out that the product never received a required listing, or obtained certification to an industry standard based on testing of early prototypes as opposed to actual production samples. If the product manufacturer had previously decided to discontinue production and distribution of the product, the formal decision to discontinue may be memorialized in internal company documents that acknowledges the product ''defect'' and need to replace due to the risk of both property damage and personal injury.

Information gleaned from prior suits may bear on whether the product poses a substantial product hazard and may include facts that would necessitate a recall. As a first step, the component manufacturer may choose to send a letter to the product manufacturer demanding a recall and post-sale warning. Predictably, if the manufacturer has already succeeded in avoiding a CPSC-ordered recall by virtue of a misleading or incomplete response to a CPSC investigation, it is likely that the component manufacturer's demand for recall will fall on deaf ears. The finished product manufacturer may actually agree that the product should be replaced, but might allege futility of a recall. The manufacturer may claim an inability to identify its customers.[21] For example, it may deny that warranty registration cards accompanied the product, or, if cards were provided to consumers, assert that it is unable to locate any completed cards that were in fact returned.

Notice to CPSC

Investigation of prior litigation and a Freedom of Information Act (''FOIA'') request,[22] may yield CPSC investigation materials, including correspondence between the CPSC and the manufacturer. This material may enable the component manufacturer to assess whether the information supplied to the CPSC was complete. If material information was not provided to the CPSC, the component manufacturer might itself supply the supplemental information in the hope that the CPSC will take action.[23]

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§ 1115.22(a). In August 2009, the maximum term of imprisonment was increased from one to five years. 15 U.S.C. § 2070 (a).

[18] The great weight of authority indicates that these requirements do not give rise to cognizable claim. *See, e.g., Kloepfer v. Honda Motor Co., Ltd.*, 898 F.2d 1452 (10th Cir. 1990); *Forbes v. General Motors Corp.*, Civil No. 08-172, 2008 WL 4527821 (D. Minn. Sept. 30, 2008) (citing *Drake v. Honeywell, Inc.*, 797 F.2d 603 (8th Cir. 1986). However, a minority of district courts have ruled that a private action does exist for a reporting violation. *See, e.g., Butcher v. Robertshaw Controls, Co.*, 550 F. Supp. 692 (D. Md. 1981). If the CPSC issues a Rule or Order regarding the product, and the manufacturer does not comply, then a private right of action may lie. *15 U.S.C. § 2073.*

[19] Any information related to the CPSC's failure to take action is not admissible evidence. *See* 15 U.S.C. § 2074(b); *Morales v. American Honda Motor Co., Inc.*, 151 F.3d 500 (6th Cir. 1998).

[20] As part of its ''silent recall,'' replacement may be conditioned on return of product to a distributor whose disposal of the product creates a spoliation defense to a later subrogation claim. Under such a bad faith scheme, claims may then be denied or settled for a pittance based on lack of evidence of defect.

[21] The CPSC rejects the notion that recalls are futile due to lack of means to reach consumers. The CPSIA specifies that a company is: ''[t]o give public notice of the defect or failure to comply, including posting clear and conspicuous notice on its Internet website, providing notice to any third party Internet website on which such manufacturer, retailer, distributor, or licensor has placed the product for sale, and announcements in languages other than English and on radio and television where the Commission determines that a substantial number of consumers to whom the recall is directed may not be reached by other notice.'' *U.S. C.P.S.C. Recall Handbook, http://www.cpsc.gov/BUSINFO/8002.html*.

[22] *5 U.S.C. § 552.*

[23] Additionally, upon being met with CPSC inaction, investigative reporters supplied with pertinent information may write an exposé seeking to shame the CPSC into action. *See*

To the dismay of the component manufacturer, even upon receipt of supplemental information, the CPSC, due to lack of resources or incompetence, may remain mute and take no action.[24] Moreover, the CPSC would consider any renewed investigation confidential,[25] and therefore not voluntarily divulge whether an investigation is proceeding. A follow-up FOIA request to find out if any action was taken, or to confirm that the supplemental letter from the component manufacturer was even in the file, may or may not bear fruit. If any documents within CPSC files are produced, the Commission will not disclose whether it is withholding other documents under a claim of confidentiality.[26]

Defense to Subrogation Action

If the product causes residential property damage, the consumer may make a claim under a homeowner's policy or claim directly against the manufacturer. If contacted by the consumer, the manufacturer may encourage the consumer to process the matter through the homeowner's policy. The homeowner's insurer, upon investigating and adjusting the claim, may assert subrogation rights against either the product or component manufacturer, or both. If not settled, suit may be filed against one or both manufacturers, and if only filed against the finished product manufacturer, the component manufacturer may be impleaded.

As early as is feasible, the component manufacturer should retain an engineer in the relevant field and become conversant with all pertinent design, manufacturing and quality assurance records. Any previous failure analysis by the insurer-subrogee should be secured. Then, working together with both the retained engineer and in-house experts, an inspection and testing protocol should be prepared. The failed product should be inspected and tested at the outset of discovery. If the component manufacturer becomes aware that the product manufacturer has never performed a failure analysis to determine the risk of bodily injury due to failure of other aspects of the product (not involving the component part), additional product exemplars should be obtained, and testing performed and videotaped to document the hazard. Such test results can then be served on the product manufacturer who should be encouraged to convey it to the CPSC, if warranted.

The component manufacturer of a defect-free part should make an effort to educate the insurer-subrogee. This is best done informally at the outset of the case. Prompt sharing of background evidence may be conditioned on the plaintiff keeping an open mind on providing a pre-answer voluntary dismissal of the component manufacturer. By providing background and a packet of corroborating deposition transcripts, party affidavits, expert reports, key documents, pertinent pleadings, and prior rulings, the component manufacturer may persuade the plaintiff to voluntarily dismiss the component manufacturer and focus attention on the true culprit -- the product manufacturer. Although there are major advantages to securing dismissal of plaintiff's case, the component manufacturer will most likely still have to contend with the cross-claim or third-party action by the product manufacturer.[27]

In this setting, although individual cases can be effectively defended, the specter of numerous future claims appears to place the component manufacturer at the mercy of the finished product manufacturer in terms of global risk management. If the product has a known defect that is expected to produce future mass failures, the best and only responsible way to control the risk is to institute a recall and issue a post-sale warning in an effort to allow consumers to take the product out of service before it causes property damage and/or personal injury. However, if the finished product manufacturer refuses to recall, this complicates matters.

Should the Component Be Recalled?

If the product manufacturer has refused to recall and the CPSC has failed to act, numerous future claims and suits will be asserted as long as the product remains in households. The risk management question then becomes: Regardless of lack of defect, should the component manufacturer attempt a recall of its own component that has remained in operation beyond its design life? There are many legal and logistical hurdles to this course of action.

A component recall is likely unworkable if the product manufacturer maintains the product should not be recalled. A focused attempt to reach the manufacturer's customers is not possible without the manufacturer's cooperation in supplying customer names and addresses. Without consent of the product manufacturer, a more generalized use of the media and Internet to broadcast the recall could lead to additional litigation, however ill-founded, based on theories of defamation and product disparagement.[28] Moreover, if consumers were successfully notified, it could lead to serious confusion given the disagreement over whether a recall has merit, ultimately diluting the effectiveness of a recall.

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generally "Sears Case Cited by Critics of Safety Panel," N.Y. Times, Feb. 20, 2008. However, a publicity-shy component manufacturer often declines to pursue this option.

[24] The CPSC has been labeled as understaffed and lacking in necessary resources, and has been accused of failing to thoroughly and properly investigate products that may warrant a recall or other form of corrective action. Adrienne Lewis, *Unsafe Products Overwhelm Emaciated Safety Agency*, USA Today Oct. 23, 2007. *See* Taylor Lincoln, et al, *Hazardous Waits: CPSC Lets Crucial Time Pass Before Warning Public About Dangerous Products*, Public Citizen report (January 2008) (available at http://www.citizen.org/documents/ HazardousWaits.pdf); *See also* Public Citizen, *Total Recall: The Need for CPSC Reform Now* (July 2008) available at http://www.citizen.org/documents/totalrecalljuly08.pdf). It remains to be seen whether the attempted revitalization of the CPSC under the new administration, will result in more effective enforcement of the CPSIA. *See BNA Product Safety & Liability Reporter*, May 11, 2009 pp. 540-41.

[25] *15 U.S.C. § 2055(b)(1); 16 C.F.R. § 1115.15.*

[26] The CPSIA mandates that, by August 14, 2011, the CPSC develop and implement a publicly searchable database. 15 U.S.C. § 2055A (a). Reports of harm and the company's response to an investigation will be posted on the database.

[27] For instance, although plaintiff may state a strict liability case against the component manufacturer, strict liability theory does not apply as between commercial entities. *See, e.g., Tokio Marine & Fire Ins. v. McDonnell Douglas Corp*., 617 F.2d 936, 939-40 (2d Cir. 1980); *Appalachian Ins. Co. v. McDonnell Douglas Corp.,* 262 Cal. Rptr. 716 (Cal. Ct. App. 1989).

[28] *See, e.g., Triton Ins. Underwriters, Inc., v. Committee on Chiropractic Welfare*, 43 Cal. Rptr. 504 (Cal. Dist. Ct. App. 1965); *Waste Distillation Tech., Inc. v. Blasland & Bouck Eng'rs, P.C.*, 523 N.Y.S. 2d 875 (N.Y. App. Div. 1988).

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Another point to consider is whether the product is susceptible to multiple failure modes. If one component part is replaced, it may actually have the deleterious effect of prolonging use of the product. Although consumers may expect a product to eventually wear out and cease functioning, a failure accompanied by consequential damages is likely unexpected. The longer period of use could increase the risk of property damage and/or bodily injury from another failed aspect of the product designed and manufactured by the finished product manufacturer. This may undermine the goal of getting the product out of service. As part of a ''silent recall,'' the product manufacturer may have decided to discontinue service parts so as not to perpetuate reliability issues. If not accompanied by proactive warnings, such a program will not succeed in getting the product out of service *prior* to failures accompanied by consequential damages, whether property or bodily injury.

Manufacturer's Own Quality Standards

The finished product manufacturer who refuses to recall may ironically have a world-class corporate Quality Manual with a specific mandatory recall process. Discovery efforts in any litigation matter should include all aspects of the product manufacturer's quality control programs, including whether the manufacturer is certified under any voluntary quality assurance scheme. If a company has a Quality Manual based on ISO 9001: 2000 (''ISO 9001''), there are specific measures bearing on whether a product recall should be undertaken. In order to obtain certification of its quality management systems under ISO 9001, the company must undergo comprehensive compliance assessment by an accredited third-party. Under ISO 9001, customer satisfaction is a key goal.[29] Customer feedback must be constantly monitored and corrective and preventive action systems must be established and implemented. ISO 9001 further requires that there be an effective means to communicate product information to customers.[30] In short, liability may be imposed using the finished product manufacturer's own Quality Manual to establish the pertinent standard of care.[31]

Settlement Option

The component manufacturer may consider settlement as an option. Even if the plaintiff abandons a direct claim against the component manufacturer, litigation between cross-defendants is likely to be expensive and protracted. If the product manufacturer has stonewalled the CPSC, it is likely that the same approach will be used in response to discovery. Document requests may be interpreted in a hair-splitting fashion, or responded to with semantic juggling to avoid production of documents. The product manufacturer may even deny the existence of certain documents that are known to exist. Lengthy boilerplate objections may be lodged to interrogatories and requests for production of documents, all with the intent to wear down the component manufacturer and increase the expense of litigation by forcing cumbersome discovery motions and eventually ''running out the discovery clock.'' The component manufacturer may also be served with onerous paper and e-discovery on irrelevant topics to further deliberately increase the costs of defense. Such tactics may require the appointment of a special discovery master by the court to deal with the avalanche of discovery motions. In the absence of a decisive, ''hands-on'' judge, both discovery and substantive rulings may be repeatedly ignored, denied, and challenged thereby further increasing costs. In time the scorched earth tactics may drive the component manufacturer to the settlement table.

In considering settlement, the component manufacturer must assess its future liability exposure. This may be hampered by the product manufacturer's refusal to provide access to internal records of failure rates, past payouts, remaining units in use and projected future failures. If the component manufacturer considers entering into a global settlement which includes all pending and future claims and lawsuits, any percentage allocation of responsibility must assess future exposure.[32] If future exposure is unknown, then the prudent component manufacturer must insist on capping its exposure once a certain payout level is reached and/or by agreeing to make payments for only a certain number of years into the future.

The attractiveness of the settlement option depends in part upon the magnitude of exposure. Settlement does not make sense if the short term savings in attorneys' fees and expenses is a mere fraction of future settlements. What if the nature of the exposure is primarily in the form of claimed property damage at anywhere from $5,000 to $1,500,000 per incident, where 100,000 units remain in use, and most are expected to fail, sooner or later? Moreover, what if the vast majority of claims and suits are for property damage, but a small number of significant bodily injuries have occurred in the past and can be expected to occur in the future due to defects in the finished product? Given the potential for an award of punitive damages in situations where the existence of a defect rising to the level of a substantial product hazard is known to the product manufacturer,[33] any settlement pact must factor in the possibility of punitive damages exposure through use of an ap-

[29] *See*, ISO 9001 § 5.2.

[30] ISO 9001 § 7.2.3.

[31] *See, e.g., Davis v. Johnson, 275 P.2d 563 (Cal. Dist. Ct. App. 1954).*

[32] This could be a straight buy-out or ongoing allocation on a case-by-case basis for future settlements or judgments.

[33] *See, e.g., White v. Ford Motor Co.*, 312 F.3d 998 (9th Cir. 2002); *Pesce v. General Motors Corp.*, 930 F. Supp. 160

propriate provision limiting the component manufacturer's responsibility to compensatory damages. If the nature and frequency of failure is beyond the control of the component manufacturer, any settlement must be approached with extreme caution. Any short-term reduction in attorneys' fees and costs must be carefully assessed against future liability payments that may dwarf any such savings.

Trial and Judgment

If settlement cannot be justified, and summary judgment has been denied, then the case must be tried. The component manufacturer should consider the benefits of a final judgment. As between the product manufacturer and component manufacturer, the judgment will give rise to *res judicata* and collateral estoppel defenses.[34] Thus, if the product is found to be defectively designed, and the component is exonerated, the component manufacturer will have good grounds in the next case for summary judgment based on a collateral estoppel bar. However, if the product manufacturer prevails, the component manufacturer may still have a basis to assert a claim for equitable indemnity due to the product manufacturer's breach of its ongoing duty to consumers to provide a post-sale warning.[35] It is the rare case today that gets tried to verdict. Obtaining a final judgment may even require enduring an appeal and retrial if the trial court renders erroneous evidentiary rulings.

Conclusion

When faced with an implacable foe in serial litigation, submission to an unfavorable settlement for the sake of a short-term savings in attorneys' fees is both shortsighted and unwise. To protect its interests, the component manufacturer may hope the CPSC does its job and orders corrective action, but if not, it must be prepared to litigate the matter until a final conclusion to obtain the best result.

(N.D.N.Y. 1996); *U.S. v. Hooker Chemicals & Plastics Corp.*, 850 F. Supp. 993 (W.D.N.Y. 1994).

[34] *See, e.g., Mycogen Corp. v. Monsanto Co.*, 28 Cal. 4th 888 (Cal. 2002); *Josey v. Goord*, 9 N.Y.3d 386 (N.Y. 2007).

[35] *See, e.g., Frank v. United Airlines, Inc., 216 F.3d 845 (9th Cir. 2000)*.

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