PREVENTING LIABILITY FOR COMPONENT PART SUPPLIERS AND THEIR OEMS

An Important and Perplexing Subject

One of the more perplexing areas involving product safety and product liability concerns the liability of the original equipment or finished product manufacturer (usually referred to as the OEM) as well as the liability of component part and raw material suppliers to OEMs. This is especially important for manufacturers of finished electrical products and for suppliers of the many electrical component parts that they utilize.

Making a finished product reasonably safe is especially difficult when it is comprised of many safety-critical component parts and there are multiple tiers of suppliers. In addition, in the event of an accident and lawsuit, the plaintiff will always sue the OEM because the OEMs name is on the product but will rarely sue a component supplier. Sometimes, the OEM will sue the supplier if they believe or have proof that the component caused the problem.

If multiple parties are in the case, determining who is primarily responsible is a complex analysis of the actions and inactions of everyone in the chain of production and distribution.

Involving component suppliers as named parties in litigation can significantly increase the cost of the litigation and can result in damaging evidence being created since multiple defendants will tend to point fingers at each other. As a result, these disputes are very fact intensive and cannot easily be resolved early in the case.

Therefore, manufacturers of finished products and their suppliers need to consider ways in which they can work together to produce a reasonably safe product and how, if accidents occur, they and others in the chain of production can work together to defend themselves. Or, if one party appears to be the

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most culpable, then that party needs to defend the case and protect the other parties.

BASIC LAW INVOLVING COMPONENT SUPPLIERS

The law generally says that, if the component is defective and the defect in the component causes harm, the component supplier is liable if they are a defendant in the case. However, the supplier can also be liable if the seller substantially participates in the integration of the component into the design of the product, the integration causes the product to be defective, and the defect causes harm.

In both situations, it seems fair to hold the supplier responsible. However, many times the comparative responsibility of various suppliers, the OEM, and possibly the distributor of the component or finished product can make a fair apportionment very difficult.

Where the component is not defective and the supplier did not participate in the selection or integration of the component into the final product, the law generally would hold the supplier not liable. This is based on the premise that the OEM is the expert in the design and manufacture of the finished product and is a "sophisticated purchaser," as opposed to the supplier who may or may not know how its components or material are being used.

IS THE COMPONENT DEFECTIVE?

It is difficult enough with final products to determine whether they are defective. With components, it can be even harder. Components can be designed for many applications. And, there are some components that have different levels of function.

Most components do not function unless integrated into other products. There are some components, such as motors, that can function on their own but still may be incorporated into another product. The law may treat these differently, especially when considering the knowledge of the various parties when selecting and installing the component.

Usually, the OEM selects the product from a catalog or after discussion with personnel from the component manufacturer or their distributor. If the OEM did not consult the component supplier and selected the wrong component for the application, the product is not itself defective and the component manufacturer should not be liable. However, the OEM can still try to blame the supplier who they would argue provided incorrect or unclear information in the catalog that served as the basis for their selecting the wrong product.

In addition, the component itself can have manufacturing and design defects and defects in warnings and instructions. Liability of the component manufacturer under these theories would be based on the same law as that for OEMs.

Similarly, raw materials can be defective if they are contaminated or have the wrong formulation. These are manufacturing defects. While raw materials cannot be defectively designed, the supplier can fail to warn. If the OEM or component supplier uses the wrong raw material, it may be because the raw material supplier did not warn against such use. In addition, the raw material supplier may have failed to warn about some hazard involving the use of the raw material or failed to instruct about how to use the raw material in the manufacture of the component or product. Or, maybe the OEM didn't ask and made certain assumptions or incorrect interpretations of sales literature or instructions.

On the other hand, the OEM or component supplier can fail to warn the user and, in that case, it may be

their responsibility and not that of the raw material supplier. However, it may be the responsibility of the raw material supplier to warn or instruct the OEM or component supplier about any hazards that exist during foreseeable use of the component or final product made from the raw material.

SUBSTANTIAL PARTICIPATION

The component supplier can be liable if they are substantially involved in the integration of their component into a final product, and the integration causes a defect and harm. Of course, the OEM could also be responsible.

Determining substantial participation is a very difficult factual and legal issue. In addition, it places the various parties in a quandary when the product is being designed and manufactured. The more involved the supplier is, the more liable they can be. As a result, the law discourages the component or raw material supplier from substantially participating in the selection or integration of their product into a finished product. This may not be helpful for the OEM but certainly is understandable. Unfortunately, the lack of participation may create a problem in the final product and result in safety problems, incidents and lawsuits which would be a problem for both the OEM and the supplier.

While the component supplier has an interest in having its products installed and used safely and correctly, it does not want to increase its potential liability by offering advice that may or may not be correct. Despite that, if there are any questions by the purchaser concerning selection, installation, use and maintenance of the component, the supplier should provide assistance if they have all of the required application information and feel competent to do so.

There is some case law that says that merely designing a component to a manufacturer's specifications does not necessarily constitute substantial participation. Also, providing technical services or advice concerning the use of a component part does not, by itself, constitute substantial participation. However, if a jury believes that the supplier knew or should have known of a problem with the OEMs use of their component and didn't say anything, then they may want to try to keep them in the case based on negligent omission rather than substantial participation.

Again, the possible fact scenarios are plentiful and can become very complex as the number of possible culpable parties increase. As these parties try to blame each other, the plaintiff's attorney can sit back and have the defendants make their case.

HOW TO MINIMIZE LIABILITY

From the supplier's side, you want to deal with OEMs who seem to be careful about the selection of components and knowledgeable about the uses to which their products will be subjected. If the OEM asks questions, it is incumbent on the supplier to be as helpful as it can to assist the OEM in selecting the correct component and installing it correctly. While this will fall over the line into "substantial participation," hopefully problems are minimized or prevented and the issue of who is liable never needs to be addressed.

The supplier should also try to deal with OEMs who know how to correctly install the component and OEMs who adequately warn and instruct the final product user or maintenance personnel on how to install, use, and maintain the final product and its components.

For OEMs, I think they should buy components from suppliers who are willing to be of assistance to the extent it is necessary. If the supplier, usually on the advice of counsel, takes the position that it gives no advice on proper product selection other than what is contained in the sales literature, and the OEM must make the final decision, then maybe the OEM should consider using another supplier. The decision on whether to change suppliers should be based, in part, on the OEMs comfort with making the final selection of the component or raw material.

In addition, the OEM wants to purchase from a supplier who manufactures the product correctly and in compliance with specifications, and who supplies to the OEM all warnings and instructions necessary for the proper installation of the component and for the proper and safe use and maintenance of the component.

In the post-sale area, OEMs want to be sure that the suppliers will inform the OEM if there are any problems with the component as used by other OEMs. And the supplier wants to confirm that the OEM has a good post-sale monitoring system and will quickly inform the supplier if there is a problem that is

potentially being caused by the component. Of course, the OEM would like to have the component supplier agree in the contract to pay for any recall caused by a defect in the component.

If some problems do occur, the parties will need to reconstruct what advice was given by each party and the basis of that advice. Unfortunately, memories can fade over time and documentation of the sale or design process could be unclear, especially since most problems arise many years after design.

The best way for the respective parties to deal with this issue is to have clear and documented communications on what is being supplied, who selected the part, and what was the basis of the selection. If the component part supplier suggested the part, there should be documentation on what information was used by the supplier to make the recommendation. Similarly, if the OEM makes the final decision, they should clearly document the basis for the decision. And, one or more parties need to keep this documentation long enough to use in the defense of litigation.

Each party must evaluate whether their actions and decisions are justified and how critical of a problem might arise if there has been a mistake. Selling the wrong shade of paint can be a big financial problem, but safety problems are unlikely to result. Selling the wrong plastic, engine, valve, switch, or chemical can create big problems in many situations.

It is difficult for the purchase order terms and conditions or sales documentation to deal with all potential issues in this area. At a minimum, the contracts could contain mutual indemnification provisions which provide that the responsible party will indemnify the non-responsible party to the extent they are responsible. That, at least, raises the

possibility that, if culpability is determined, the responsible party will protect the blameless party in the event of a claim or litigation or some other problem such as a recall.

In addition, the contract could require that the component supplier protect the OEM through its insurance policy. Unfortunately, this is not acceptable to many OEMs. The supplier's insurance company, if they accept coverage, will defend the case in a way that protects its interests. And these may be different from the best interests of the OEM. The OEM has more to lose from a defect in its components and resulting claims and litigation. Their name is on the product and their reputation and goodwill among distributors, retailers, and the consuming public can suffer by a wrong decision on settlement or trial.

The worst result is that the supplier goes to trial, the plaintiff's verdict is in the name of the OEM, and the supplier goes bankrupt as a result of a bad legal outcome. In that case, the OEMs name and reputation are tarnished and the responsible supplier no longer can defend any future cases and cannot provide insurance which has been cancelled because they stopped paying the insurance premiums.

Lastly, culpability is usually in dispute and these contractual provisions, if they come into play, may not work until the litigation is almost over. That makes it difficult for all parties to decide on the strategy to take when defending a claim. No one wants to take a chance that the jury will say the finished product or its component is defective. Not only does that impact the current case and commercial situation, but it also affects future products that have been sold or will be sold. Does the product now have to recalled, does the current design have to be changed, does the OEM have to report to the government? These are all consequences of a case that should have been settled and not tried.

All the preventive measures described above are seriously complicated if the component supplier is based in a foreign country. This makes it more difficult to get contractual or insurance protection, confirm that the component is being manufactured correctly, and ensure that English-language documentation and English-speaking personnel are available to help defend the OEM and the supplier. These potential problems need to be considered and anticipated when buying a component from a foreign supplier that could create a safety issue if it is defective.

Buying from financially marginal suppliers, whether in the U.S. or in a foreign country, is risky and is part of the business decision that must be made for all components and raw materials purchased outside the company. If it is necessary, the OEM needs to enhance its inspection and quality procedures to be sure that there are no defects in any received components, and to qualify an alternative supplier who can instantly start production in case the component in the finished product proves to be defective and can't easily be fixed by the original supplier.

A FEW EXAMPLES

Describing a few real cases or situations will help to illustrate the points discussed above. The first case involves the manufacturer of Velcro who sold their product to hot air balloon manufacturers. The Velcro was used to attach something important to the hot air balloon. When Velcro learned that hot air balloon manufacturers were doing this, it issued a warning to all such manufacturers and buyers of such hot air balloons, asking them to stop using the Velcro in this way.

When an accident occurred, Velcro was able to use the post-sale warning to defend themselves. However, they should not have been in this situation in the first place. Velcro knew or should have known what was being manufactured by the company to which they sold the material. As a result, it was hard for them to argue that the OEM misused the component since they sold it to this company and did not tell them not to use it to attach anything critical to the hot air balloon.

So, the preventive measure here is that component suppliers should know, to the extent possible, to whom they are selling their products and what they will use the product for. And they should have in their promotional literature a general list of appropriate as well as inappropriate applications.

The next case involves a raw material supplier who sold their raw material to a start-up manufacturer who wanted to use the raw material in a way that had never been used before. The supplier told the OEM that they should do adequate testing to confirm that the raw

material would be appropriate for that use. The OEM contractually indemnified the supplier and named them as an additional insured under their insurance policy.

The testing may or may not have been done or done adequately and the supplier did not confirm that the OEM tested the raw material and did not ask to review the test results. It turned out that the raw material was not appropriate for that use and end customers suffered injury. The OEM and the supplier, as well as others, were sued.

In the first lawsuit, the plaintiff obtained a verdict against the OEM and not against the supplier. The supplier had asked the OEM to do the testing and the fact that the raw material was incorrect was not the supplier's fault, it was the OEM's. So, is this a happy ending for the supplier? No.

After the first verdict, the OEM went bankrupt which negated any protection for the supplier under the contract and presumably under the insurance policy which was cancelled due to non-payment. Therefore, the raw material supplier had to defend all future cases, which they won, because they didn't do anything wrong. The raw material was not defective. It was the use of that raw material in that application that created the problem. The cost to defend these cases was many multiples of the profit that the supplier made by selling the raw material in the first case.

In the last example, a manufacturer of an electronic control for a coffeemaker was informed by a coffeemaker manufacturer that its control wasn't working properly. The result is that the coffeemaker kept running and resulted in house fires. Upon investigation, it was clear that the control was installed incorrectly.

The control manufacturer blamed the OEM for incorrectly installing the control. And the OEM blamed the control manufacturer for not providing adequate instructions. To prevent such problems, the supplier needs to determine whether its customers need warnings and instructions concerning installation and even use, and to supply this information even if most OEMs already should know it. Or, the sales personnel should observe the installation of the component at the OEMs plant to be sure it is being used in an appropriate application and is being installed correctly.

And a component supplier who provides the OEM warnings and instructions intended for the consumer should confirm that these warnings and instructions will be supplied to the customer or incorporated into the OEM's instructions and warnings attached to the product.

CONCLUSION

It is important for all parties to be proactive and to consider the potential consequences of bad decisions. Each of the parties should do what they can to prevent themselves and someone else from making bad decisions and they should not just rely on the law or an indemnification agreement to protect them. Such protection may not work and innocent product users may suffer. Working together to prevent safety problems in products will benefit all parties in the chain of production and distribution.