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A BRUSH WITH DANGER

THE GROWING PRODUCT LIABILITY RISK POSED BY CHINESE IMPORTS

For better or for worse, the economies of the U.S. and China have become forever linked. So long as there is an economic incentive to do so, U.S. companies that import products from China will continue to be exposed to the risk of unpredictable downstream product liability recalls and related litigation. It is critical that any company outsourcing any part of its manufacturing to China recognize the real risks involved and install appropriate measures to effectively mitigate them.

THEN CAME THE LAWSUITS

From poisonous pet food to toxic toys and tainted toothpaste, the repercussions for the companies involved in those recalls over the past two years have been staggering. Retailers and distributors were forced to initiate expensive product recall programs to protect consumers. Revenues also took a hit from bad publicity. With respect to the lead paint recall, toy sales flattened for the companies involved, causing their stock price to drop. Then came the lawsuits. The pet food recall alone resulted in over 65 separate lawsuits, which were subsequently consolidated into a product liability multidistrict litigation (“MDL”) action venued in the United States District Court for the

District of New Jersey entitled *In re Pet Foods Products Liability Litigation*. On May 22, 2008, the pet food manufacturer announced that it had reached a \$24 million settlement with the plaintiffs in the pet food MDL, which likely did not include the attorneys’ fees it had spent on defending the case to that point.

Criminal proceedings are also a possible consequence, as some U.S. companies have learned. In March 2008, California prosecutors filed state charges against top executives of the U.S. companies responsible for importing tainted toothpaste from China, alleging a total of 16 counts of receiving, selling and delivering adulterated drugs and products. The FDA’s Office of Criminal Investigations also recently indicted executives involved in the pet food recall; if convicted, the defendants face up to seven years in federal prison and fines exceeding millions of dollars. In addition, some legal scholars have argued that the concept of “crimtorts” — civil torts that also constitute criminal conduct — should be expanded to include U.S. companies and their executives whose failure to conduct due diligence in overseas factories injures U.S. consumers.

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2008 RECALLS

SEPTEMBER:

A U.S. candy distributor issued a recall of all Chinese-manufactured candy after testing confirmed it contained dangerous levels of melamine.

MARCH:

Manufacturers of heparin, a blood thinner made from raw materials imported from China, issued recalls after it allegedly caused 19 deaths in the U.S.

2007 RECALLS

NOVEMBER:

A major U.S. toy manufacturer recalled over a million Chinese-made toys that had been coated with lead-based paint.

JUNE:

A New York company recalled imported children's snack food from China that caused 60 salmonella cases, mostly in toddlers from 19 different states.

JUNE:

Over 450,000 Chinese truck tires were recalled because of a defect that could cause dangerous tread separation.

JUNE:

The USDA warned consumers to cease using toothpaste because of diethylene glycol, a chemical used to make antifreeze.

MARCH:

60 million packages of pet food recalled after discovery of melamine contamination.

AVOIDING THE "UNTHINKABLE"

What can companies do to make sure they never become involved in the China-import recall crisis? Companies must closely analyze their supply chains by obtaining as much information as possible about their Chinese suppliers, as well as their suppliers' suppliers.

At a minimum, direct visits, reference checks and similar quality controls are basic due diligence steps that should be performed before anything is purchased. Some larger U.S. companies have even instituted formal audit programs that verify their Chinese partners are meeting manufacturing and product quality standards.

Companies can likewise minimize their exposure through indemnification agreements with other players in the supply chain as to how any damages and litigation costs from recalls associated with imported goods will be shared. When doing so, companies should keep in mind that only arbitration awards are enforceable in China, thus raising the need for arbitration provisions in their agreements with Chinese trading partners. Companies should also closely review their insurance coverage to determine if they are sufficiently protected from a product recall through supply chain insurance coverage, such as all-risk, goods-in-transit, ocean cargo or stock throughput policies.

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