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## **ADDRESSING THE CHALLENGES OF PRODUCT LIABILITY**

### **THE ISSUE**

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Let the *seller* beware. That, in a nutshell, is the problem facing general merchandise distributors and retailers as more and more plaintiffs in product liability cases train their sights not only on the manufacturers of injurious products but also on companies that sell or distribute them.

The reason? Retailers and distributors with strong roots in their communities can be far easier targets for fat judgments than small, fly-by-night manufacturers that produce shoddy and potentially hazardous goods, often overseas, and then disappear or go belly up when multimillion-dollar judgments are issued against them.

Moreover, retailers and wholesalers today are more prominent than in the past. And they have deeper pockets. In 1964, not a single retailer or wholesaler was among the top 40 Fortune 500 companies. Last year, eight retailers and three wholesalers were in the top 40, including the No. 1 company, Wal-Mart. Through their success, retailers and wholesalers have clearly painted a bigger bull's-eye on themselves for potential litigants.

However, by playing it smart, as this White Paper will show, retailers and distributors can avoid nasty liability surprises or at least protect themselves financially when a product they distribute turns out to be defective and causes serious harm to a customer.

### **THE BACKGROUND**

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Retailers and distributors haven't always been a prime target. Once, manufacturers were the ones held to account when a substantial product defect resulted in serious injuries or deaths. But in 1997 a restatement of the American Law Institute's "Third of Torts," which relates to product liability, shifted part of the burden to retailers and wholesalers. The restatement has since been adopted, in whole or in part, by various courts and state legislatures throughout the United States.

The ALI's landmark revision states in part: "When joining the manufacturer in the tort action presents the plaintiff with procedural difficulties, local retailers can pay damages to the victims and then seek indemnity from manufacturers. Finally, holding retailers and wholesalers strictly liable creates incentives for them to deal only with reputable, financially responsible manufacturers and distributors, thereby helping to protect the interests of users and consumers."

The change encouraged plaintiffs' attorneys to go after retailers and wholesalers as well as manufacturers, often in state courts where they typically have an easier time winning judgments than in federal courts. In fact, plaintiffs seeking damages from a manufacturer or supplier in a different state often choose to sue product sellers or distributors in their own home state courts specifically to avoid more rigorous federal court rules. The practice is called "defeating diversity," which means, simply, getting around the rule that gives federal courts jurisdiction when plaintiffs and defendants are from different states.

Federal and state courts are not the only venue for product liability actions. The U.S. Consumer Product Safety Commission (CPSC) is another active arena. The commission looks on manufacturers, importers, retailers and wholesalers as equal partners in product safety. Under the Consumer Product Safety Act, they are all required to immediately report any information about serious product defects to the CPSC. Failure to do often results in hefty civil penalties.

In 2003, for example, Wal-Mart agreed to pay \$750,000 to settle a CPSC action in federal court in connection with defective exercise equipment manufactured by a Utah company and sold in the company's Wal-Mart and Sam's Club outlets. The government alleged that the Bentonville, Arkansas, retailer did not immediately report a series of injuries that resulted when the seats on the exercise machines unexpectedly disconnected because of a faulty mounting. In settling, Wal-Mart did not admit to any of the contested issues in the government's complaint or to liability for any of the alleged violations.

In another complaint, the CPSC alleged that Sears Roebuck and Company failed to immediately report defective fuel tanks on rear-engine riding lawnmowers manufactured by a Tennessee company and sold under Sears' Craftsman label. The tanks tended to rupture and spill fuel, raising the risk of fire and substantial injury or death to people mowing their lawns. In 2004, Sears agreed to pay \$500,000 to settle the case. Like Wal-Mart it did not admit to any violation of law or liability in any cases arising out of the defective machines.

In a CPSC case involving product lines handled by many general merchandise distributors and retailers, Hamilton Beach/Proctor Silex agreed to pay a \$1.2 million civil penalty for late reporting of hazards involving several imported products. Toasters failed to turn off after their contents had popped, causing a potential fire hazard. Juicers had strainer baskets that sometimes broke apart, posing a risk to the person operating the product. Imported slow cookers came with defective handles that sometimes broke off when lifted. CPSC said several consumers using the product required medical attention for burns from hot food. The company was held liable even after reporting the defective products and recalling them. In settling, the company denied any wrongdoing.

A wide range of products are at risk for similar government actions as well as for private lawsuits. CPSC complaints in the past have been leveled against the manufacturers of coffee-making machines with defective electric connections; of improperly installed basketball hoops that caused severe lacerations; and of soap-making kits that risked serious burns. The list goes on and on.

One of the most litigation-prone product categories is lighters. Almost a billion lighters are sold in the United States each year, of which 700 million are imported, according to the CPSC. It isn't clear how many of these are poorly manufactured and unsafe, but the commission estimates that between 1997 and 2002, more than 3,000 people went to hospital emergency rooms with injuries caused by lighter malfunctions. Most of the injuries involved hand and facial burns. During the same period, CPSC received reports of three deaths and six serious injuries due to lighter failures.

While deaths from fires caused by children playing with lighters fell sharply after July 1994 when a new standard for child-resistant lighters became mandatory, in 1998 there were still 6,100 residential fires and 130 deaths that resulted from kids fooling with lighters. Children under five accounted for 40 of the deaths. It's obvious that child-resistant does not mean child-proof, and CPSC emphasizes the importance of keeping lighters out of reach of tots.

## **PUBLIC DEVELOPMENTS**

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Although there are voluntary standards for safe lighter design, it is clear that many imported lighters fail to comply. Because of that, CPSC is considering a mandatory standard for all lighters. Several options are currently being weighed, but the commission appears likely to adopt one similar to that of the American Society for Testing and Materials (ASTM), which regulates flame height, flame extinguishment, fill rates, and drop tests, among other safety design measures.

Even with a new mandatory safety standard on the way, retailers and distributors need to adopt additional measures to defend themselves against potentially devastating product liability judgments. In one recent case, for example, the attorneys for a plaintiff who was awarded more than \$20 million in a lawsuit

against Cli-Claque Co. Ltd., a Hong Kong lighter manufacturer, went after the product sellers to satisfy the judgment when the manufacturer defaulted.

## **SOLUTIONS**

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To avoid liability exposure, the best business practice is to deal only with reputable, financially responsible manufacturers and suppliers. One of the first steps for retailers and distributors is to open up a dialogue with their vendors and begin to ask tough questions. How long, for example, has the manufacturer been making a particular product? Have there been any issues with the government agency or agencies that oversee the industry?

Are product test data available? In many cases, manufacturers test products internally to insure that they meet government or industry standards. (The latter can be even more stringent than those set by a government regulatory body.) Retailers and distributors should ask to see the copies of the results. At the very least, a vendor should be willing to provide a statement attesting that the product has passed tests and no violations are pending. If a government agency is doing the testing, copies of that data should also be scrutinized for potential hazards.

It is also important to understand that product safety is overseen by scores of federal and state agencies, so retailers and distributors should find out which ones cover their particular product lines. For example, an imported pen that causes harm may come under the regulatory spotlight of the Consumer Product Safety Commission. But the chemical dyes that make up the ink may be covered by import restrictions enforced by U.S. Customs and Border Protection. Customs is also responsible for intellectual property rights. An imported product that violates a patent or trademark can bring treble damages to the seller.

In short, exercising due diligence is paramount. At the very least, it will provide a defense in a future lawsuit or government action and may help to limit damages.

The same diligence should also be applied to insurance. Companies may think they are protected when a vendor assures them that it has \$5 million or even \$10 million in general liability insurance. But those amounts can be eaten up in a single lawsuit, leaving nothing for future actions. So it is crucial to dig into the quality of the insurance. Is the insurer highly rated by an independent rating company like Standard & Poors, meaning that it has the wherewithal to withstand protracted litigations and damage awards, as happened with asbestos cases? Financial strength ratings are based on a wide range of risk factors that could have an impact on an insurer's long-term survival, including competitive forces or changing fundamentals in their marketplaces.

In addition, what is the nature of the insurance? Is it measured on a year-to-year basis, or is it tied to a particular date and has to last for many decades? The latter is important in litigations involving children. A young person potentially has more than two decades to bring a lawsuit—up to the age of 21 plus whatever is allowed under the statute of limitations. For a retailer or distributor, that can add up to as much as 25 years of potential exposure to a product liability lawsuit.

So, understanding the full breadth of coverage is critical. And if the retailer or distributor is unhappy with the answers they receive from vendors, they should consider looking elsewhere or checking their own liability insurance to see if there is a provision for coverage in the event that the vendor's policy falls short.

In summary, at a time when litigants may skip manufacturers and go straight to product sellers to seek damages, it is vital for retailers and distributors to cover all bases. Deal with reputable suppliers. Don't accept anyone's word that a product is safe; do your own digging to establish safety. And finally, make certain the vendor's insurance, or your own, is adequate to meet any future bombshells.

## **RESOURCES**

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For further information, you can access the website of the U.S. Consumer Product Safety Commission, [www.cpsc.gov](http://www.cpsc.gov).

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