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disputes

AI LIABILITY DIRECTIVE AND MODERNISED PRODUCT LIABILITY DIRECTIVE

REPRINTED FROM:
CORPORATE DISPUTES MAGAZINE
APR-JUN 2023 ISSUE



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HOT TOPIC

AI LIABILITY DIRECTIVE AND MODERNISED PRODUCT LIABILITY DIRECTIVE



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Vitor Castro is a dual-qualified attorney (England and Wales and Brazil) experienced in handling commercial disputes, class actions, mediation and domestic and international arbitration, in addition to advising clients on regulatory issues and internal investigations in Europe and Latin America.

CD: Could you provide an overview of why the European Commission (EC) is proposing to modernise its product liability rules? What key factors are driving this process?

Newstead: It is nearly 40 years since the first Product Liability Directive (PLD) was introduced in the European Union (EU). The range and complexity of products that are now on the market are a world away from those in the sights of legislators back in 1985. Consumers now have the choice of a myriad of technically advanced, digital products, which are often connected. Some even have artificial intelligence (AI) capabilities. Those drafting the 1985 Directive could not have foreseen the advancements in technology, nor envisioned how such products may cause new types of loss. Until recently, the PLD had stood the test of time. Courts across the EU have interpreted its provisions creatively as technology has advanced. However, with the significant change in the nature of products, global supply chains and sustainability concerns leading to growing product refurbishment, EU legislators recognise that effective consumer redress now necessitates a Directive refresh.

Fielding: A key factor behind the drive to modernise has been the need to address perceived shortcomings in the existing liability rules,

particularly uncertainty about what types of digital products, economic operators and types of harm might fall within the scope of these rules. This includes, for example, how the existing rules might apply to products such as software updates, and who should be liable if a business substantially modifies a product that is already on the market. As regards the Artificial Intelligence Liability Directive (AILD), key factors have been the perceived need to clarify the rules for businesses regarding the extent of their liability for damage caused by AI-enabled products and services, to harmonise the rules across Europe to prevent the emergence of fragmented national civil liability rules, and to reduce the obstacles faced by consumers in gathering evidence to prove liability in claims for damages involving AI systems.

Castro: The modernisation of product liability rules is also associated with the need to take into consideration the current circular economy model, in which the lifespan of products is extended by reselling used or refurbished products. The new rules fill a gap to regulate such situations and avoid circumstances in which consumers and manufacturers are left with no clear guidance on how they should proceed if a product has been modified or if damage has occurred after product refurbishment. Moreover, the new rules provide guidance in a digitally driven economy and bring

legal certainty to consumer transactions concluded digitally via electronic portals. The new rules pave the way to protect consumers who otherwise would have no solid grounds to pursue compensation for damage.

CD: What overarching issues do the proposed AI Liability Directive and the Product Liability Directive seek to address? To what extent do the two Directives complement each other?

Castro: The PLD and AILD set out a framework for excellence and trust in AI systems and software, ensuring that consumers can obtain compensation if they are victims of software or AI-related damage. The new rules also create an incentive for businesses that rely on AI to enhance their models and deliver state-of-the-art services and products that are safe for end-users. The safety of consumers includes protection against cyber security vulnerabilities and the leaking of personal data. The challenges posed by technology demand revised rules and not a mere adaptation – and this is the overarching issue for the proposed revised rules.

Newstead: Both Directives seek to provide clarity and address legal uncertainty in a more technologically complex world, where harm may be caused by digital and AI products and services, as

well as tangible goods. The new PLD aims to clarify which products will be covered by strict liability principles and who may be held liable for damage. It modifies existing evidential burdens when products are considered technically and scientifically complex and ensures that consumers have an adequate means of redress in relation to products supplied from outside the EU. The AILD complements existing liability regimes in the EU by providing a specific framework for damage caused by AI. By introducing specific rules on evidence and causation for harm caused by AI systems, those bringing fault-based AI claims should not be at a disadvantage when compared with those advancing claims concerning non-AI technologies.

Fielding: The Directives are closely linked and form part of a package of measures designed to support the uptake of new digital technologies, while also addressing the risks associated with some of their uses. Fundamentally, the new PLD and AILD deal with different types of liability: the new PLD covers claims for no-fault liability for damage caused by defective products, including software and AI systems. By contrast, the AILD covers claims under national fault-based liability rules – such as rules that require a claimant to prove that somebody's fault caused the harm they suffered – for damage caused by an AI system. The fact that they cover different but related types of liability is deliberate; they are

meant to complement each other in supporting the rollout of new digital technologies.

CD: Drilling down, how do the provisions of the AI Liability Directive aim to tackle some of the liability challenges arising in connection with artificial intelligence (AI)? How would you characterise the business community's reaction to the proposed revisions?

Fielding: AI systems have characteristics that make it difficult for consumers to identify a fault, and to prove a causal link between fault and damage. These include lack of transparency in the AI's decision making, its autonomous behaviour, continuous adaptation and limited predictability. The AILD tackles these challenges by easing the burden of proof for claimants, notably through rights of disclosure and rebuttable presumptions of causation. The AILD creates a rebuttable 'presumption of causation' if certain conditions are satisfied, thus potentially relieving the claimant of the burden of explaining how an AI system produced the result that it did. It also gives national courts the power to order disclosure of evidence about high-risk AI systems suspected of having caused damage. In consultations the business

community has generally been receptive to the use of disclosure and rebuttable presumptions on the basis that such tools already exist in many national legislative systems.

"In view of the complexity of AI systems, the main challenge in any AI-related dispute is to prove that damage has been caused by the system in question."

*Vitor Castro,
Shook Hardy & Bacon International LLP*

Newstead: AI systems can be incredibly complex. EU legislators identified that the cost of bringing an AI-related action could be prohibitive for many claimants. As a result, the AILD introduces certain measures in fault-based actions to facilitate claimants in bringing AI-related claims. Firstly, the AILD creates a rebuttable presumption of causation if several specific conditions are met. This presumption would not apply, however, if the defendant shows that the claimant can access sufficient evidence and expertise to prove the causal link in high-risk AI products or national courts do not

consider it excessively difficult for the claimant to prove the causal link between fault and damage in non-high-risk AI products. National courts are also given the power to order disclosure of evidence in cases where high-risk AI is alleged to have caused damage. This is a relatively new concept in some jurisdictions, particularly those where widespread disclosure is not customary.

Castro: In view of the complexity of AI systems, the main challenge in any AI-related dispute is to prove that damage has been caused by the system in question. Establishing causation poses a potentially significant burden on consumers. Accepting that causality can be presumed in certain cases provides a simplified procedural pathway to claimants, as it removes a potential barrier to accessing compensation. It will be interesting to see how the courts will apply this principle in order to avoid creating an unbalanced system for developers of new technologies.

CD: In terms of the Product Liability Directive proposal, how will the revised legislation adapt existing product liability rules to address new types of products and services, such as advanced software systems and advanced machinery?

Newstead: The existing PLD is seeing wholesale replacement, rather than revision. That said, the underlying strict liability principles will remain largely the same. Courts will still examine defect, causation and damage. However, the range of products and economic operators that fall within the scope of the PLD will widen. Both tangible and digital products will be covered by the new PLD, with hardware manufacturers, software producers and providers of digital services that effect how a product works now falling within its remit. Digital manufacturing files, firmware, computer programmes and apps will all be included, as will AI systems and AI-enabled products. Changes that are made to a product after it is placed on the market, such as software updates and machine learning, will also fall within the PLD's scope. Interestingly, where digital services affect the safety of a product, they will fall within the regime, even though the new PLD will not apply to other services.

Fielding: The test for determining whether a product is defective – that is, whether it provides the safety that the public at large is entitled to expect – remains substantially the same as under the existing rules. However, updates have been introduced to accommodate the use of technologically advanced products. The definition



of 'product' has been updated to include software and digital manufacturing files, such as those used for 3D printing. Certain attributes of digital products, such as interconnectedness and self-learning functions, have been added to the non-exhaustive list of factors to be considered by courts when examining defect. And defect and causation will be presumed in certain circumstances, including those where claimants would face excessive difficulties because of scientific or technical complexity.

Castro: In 1985, when the original PLD was enacted, the concept of liability was different from the liability defined in today's digitalised society. Furthermore, access by consumers to the global supply chain was significantly more limited. Changes since the original enactment mean that the new PLD has needed to expand in scope. In addition to the presumptions of defect and causation that have been widely applied in France, the new PLD extends its strict liability regime to online purchase platforms – with the aim of covering the more modern consumer relations between manufacturers, retailers, resellers and end-users. Moreover, damage to property now includes loss or compromise of data. This is in recognition of the status that data has acquired in the past decade

and an issue that was not regulated in the original Directive.

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Shook, Hardy & Bacon International LLP*

CD: To what extent will the EC's proposals create greater legal certainty for businesses in terms of planning for AI-related product liability? On the flipside, what potential unintended consequences may the proposed changes bring?

Castro: The intention of creating specific rules governing AI liability and harmonising targeted domestic legislation is to create more stability for business and legal certainty for the development and use of new technologies that have become part of everyone's daily lives. The rules also provide a roadmap for courts to recognise and understand the

rights of the players in the market, which should help to support confident investing. It is unclear, however, whether the presumptions set out in the PLD and the AILD are going to be excessively complex for courts to apply in practice. If the presumptions of causation are combined with the removal of other barriers to seeking compensation in court, the outcome might be a new wave of litigation against AI service providers, reducing the appetite for the development of new technologies and reducing new investment in this field.

Fielding: The AILD is expected to bring greater clarity about the types of products and economic operators within scope, and the conditions for liability. It is also likely to avoid an undesirable situation in which judges must interpret general rules that were not designed with AI in mind when adjudicating claims. Industry criticisms of the AILD have focused on the need to further clarify how liability will be allocated in practice. For example, concerns have been expressed that the AILD should take better account of the differing size and resources of the economic actors involved in supplying AI systems, by including rules to allocate liability across the value chain, for instance. Wider concerns have also been expressed that the AILD might ultimately constrain innovation and lead to unnecessarily increased insurance premiums.

Newstead: Courts across the EU have been interpreting existing principles in different ways in order to address liability for new technologies. Businesses therefore face legal uncertainty, as risk and liability exposure may differ across EU markets. The new PLD and AILD will bring greater consistency across the EU, allowing businesses to operate across the whole market with a clearer understanding of potential risks and liabilities. Consumers are likely to be more willing to take-up AI-enabled products if there is a clear liability regime, which would, in turn, create benefits for businesses. In its proposal for an AILD, the European Commission (EC) indicated that by easing the burden of proof for AI-related claims, having a targeted review of strict product liability and possibly introducing mandatory insurance for AI products, an increased AI market value of between €500m and €1.1bn would be created in 2025 across all 27 member states. Obtaining insurance for AI-related product issues may also be simplified, as insurers can offer coverage in a more certain environment.

CD: Following introduction of the proposals, what advice would you offer to companies on adapting their risk management and compliance frameworks accordingly? What considerations will they need to make with regard to their use of AI?

Newstead: The scope of potential defendants who could find themselves caught by the provisions of the PLD has widened. Defendants who would not previously have found themselves subject to the PLD's strict liability principles may now find themselves defending a claim. Traditionally, it has been manufacturers, importers, own branders and – in some circumstances – suppliers who have faced liability for defective products. Under the new PLD, this will be expanded to service providers, businesses that make substantial modifications to products and, if there is no importer into the EU, authorised representatives and fulfilment service providers. Ensuring product compliance at each stage of the supply chain will become increasingly important to ensure that risk is minimised. Post-market product update activities, as well as tracking and monitoring potential safety issues, will also be important. With the expanded scope of potential defendants and residual questions as to where liability may lie, parties should also be prepared for increased supply chain litigation.

Castro: One of the biggest challenges to the industry is ensuring that all operators in the supply chain maintain the same standards and preserve the necessary information to allow for a rebuttal of the presumption of causation and mitigate potential financial losses for businesses. It is fundamental that supply agreements contain a specific clause

to guarantee that all relevant information during a manufacturing process is documented and recorded in a verifiable way. Moreover, suppliers should consider negotiating clauses to limit their liability, if possible. Economic operators should consider how they would implement an emergency plan to update or replace an AI system if identified as potentially harmful. The industry must be prepared to adapt its plans to mitigate damage and inform the authorities when a risk is identified, avoiding significant waves of litigation and sanctions by the regulators.

Fielding: Industry should get ready for the AILD by putting in place enhanced documentation, training and incident response planning measures. Companies should begin by taking an inventory of their products that incorporate AI systems, including understanding to what extent they include third party systems, models or datasets. Given that a developer may rebut a presumption of causality by, for example, showing that its alleged fault could not have caused the damage, developers should maintain robust documentation recording the design, testing and validation of their systems. Preserving and retaining documentation will also be important for compliance with the new disclosure obligations. Additional training to employees may assist in spotting and mitigating potential issues before they arise. Development of a plan for swiftly identifying, escalating and responding to allegations

of harm caused by AI systems will be critical for assessing company readiness for defending litigation.

CD: In your opinion, are the proposed product liability rules sufficient to achieve their objectives? What are your predictions for the future of AI-related product liability in Europe?

Fielding: While the new PLD takes steps toward achieving many of its stated policy goals, it has arguably gone further than some expected in promoting a claimant-friendly regime, such as by adding psychological injury as a head of recoverable damage. In this respect at least, it remains to be seen whether the new PLD “strikes a careful balance between the interests of industry and consumers” as the EC originally intended. Furthermore, notwithstanding the AILD’s objective of harmonisation of rules across Europe, national civil liability rules governing AI systems may continue to diverge, as it is left to member states’ rules to determine certain key matters, such as the standard of proof necessary to establish breach of duty and the types of damage recoverable, which may ultimately lead to varying levels of protection for businesses from different member states.

Newstead: The new PLD will go a long way in clarifying which products fall within the strict liability regime and who may be held liable for damage caused by a defect. Technology is not static though and, inevitably, there is likely to be some continued debate as to whether new types of technology are covered by the PLD and where liability lies as between defendants. Nevertheless, under the new

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*Alison Newstead,
Shook Hardy & Bacon International LLP*

regime, consumers will have a much clearer picture of their routes of redress and new types of losses that may be recovered, such as those due to the loss, destruction or corruption of data. Changes in civil procedure will bring significant changes to some jurisdictions where disclosure is not currently commonplace. Access to justice concerns are also addressed in various ways. Of significant note under the new PLD is that the burden of proof will be

alleviated in some cases – for example where the claimant faces excessive difficulties in proving defect due to scientific or technical complexities.

Castro: The new PLD and AILD strengthen the protection of consumer rights. The new rules are designed in such a way that a high standard is demanded from businesses that develop and market sophisticated product technologies and AI systems. Although some of the rules as currently drafted appear to present an imbalance in the burden placed on companies defending claims and consumers bringing them, they intend to push businesses to create a framework of excellence in an area that is still under development. It is of note that criticisms were levied by the consumer industry when the original PLD was enacted, but time has proven that setting out the rules can be beneficial for both consumers and businesses. The domestic courts will continue to play a relevant role in defining how the application of these rules will assist in creating a safe environment for the deployment of new product technologies. Product liability has been developed by court rulings and the implementation of new rules is likely to follow the same path. 