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Importing Products: Legal Risks and Defense Strategies

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THE YEAR 2007 may go down as the year of the recall. Companies recalled products ranging from tires to toothpaste to electrical products.[1] Recalls involving lead paint in children's toys garnered particular attention, due in large part to their emotional appeal. But the recalls were most memorable due to their frequency -- there were five times more recalls in 2007 than in the previous year.[2] For legal practitioners and clients, the alarm sounded loudly because the vast majority of these recalls involved products manufactured outside the United States. Given the increasing importance of foreign vendors, American manufacturers, importers and retailers need to consider the legal risks of importing products and strategies for minimizing these risks.

I. Legal Fallout

Product recalls invariably inspire litigation. The 2007 recalls were no exception. The significance, however, lies in the number of recalls and the fact that the legal ramifications have taken many paths. There have been relatively few traditional individual personal injury cases to date. The primary recourse has been via class actions (medical monitoring and consumer remedy), multi-district litigation, attorney general actions and shareholder litigation.

[1] For a complete list of the recalls that occurred in 2007, *see* Recalls.gov, Your Online Resource for Recalls, www.recall.gov (last visited June 17, 2008).

[2] This information was compiled using information from the Consumer Products Safety Commission's website. *See* CPSC.gov, U.S. Consumer Product Safety Commission, http://www.cpsc.gov (last visited June 17, 2008).

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A. Class Action Lawsuits

A class action was filed in California based on the toy recalls on behalf of consumers seeking a variety of remedies, including preventative medical screening and monitoring funds.[3] The claims alleged – strict product liability, negligence and violations of the unfair competition laws – are illustrative of those filed in other jurisdictions. Class actions have also been filed in Pennsylvania[4] and Illinois.[5] The unique challenge lies in teasing out the jurisdictional requirements for class certification from the standards of proof for medical monitoring, and from the burden of proof for establishing exposure, injury and damages. How will exposure to lead paint on toys be proven? How do you monitor for things like mental function, loss of I.Q. points, or developmental delay? If you can show change, how do you parcel out other causal exposures?

B. Multi-District Litigation

Another legal path has been coordinated proceedings and multi-district litigation. The pet food lawsuits against Menu Foods have been consolidated for pretrial proceedings in the District of New Jersey.[6] The approximately 100 cases relate to the recall of pet food products that were allegedly tainted by melamine in wheat gluten imported from China.

C. Attorney General Actions

The legal fallout has also extended to actions by the government. Recently, a federal grand jury in Kansas City indicted two Chinese businesses and a U.S.-based firm, as a result of the recall of the tainted pet food.[7] The allegations are that the companies knew of the problem and covered up, rather than remedied, the problem.

In addition, the California Attorney General has filed an action against Mattel based on the toy recalls.[8] In a creative twist, the complaint alleges violations of Proposition 65, which is California's Safe Drinking Water and Toxic Enforcement Act, violations of the Federal Consumer Product Safety Act (CPSA) and violations of the California Unfair Competition Law. The Attorney General is attempting to bootstrap alleged violations of Proposition 65 and the CPSA as "unlawful acts" under the Uniform Competition Law. An injunction and statutory damages of $2,500 per violation are sought. When millions of toys are involved, small incremental statutory violations can add up to millions, if not billions, of dollars. Companies need to be counseled regarding the political overlay that influences the course and resolution of AG actions. The putative role of the Attorney General is to protect the public, so their goal is often public awareness through headlines rather than money.. Recognition of this can assist clients in creative business solutions.

D. Shareholder Lawsuits

The legal fallout has also included shareholder lawsuits. Following the recall of millions of Mattel toys last summer, the

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[3] Powell v. Mattel, Inc., No. BC376231 (Cal. Super. Ct., Aug. 20, 2007); Gina Passarella, Class Action Suits Seeking Medical Monitoring Filed Over Recalled Toys, THE LEGAL INTELLIGENCER, Aug. 21, 2007, *available at* http://www.law.com/jsp/article.jsp?id=11876008315 16.

[4] *See* Monroe v. Mattel, Inc., No. 2:07-cv-03410 (E.D. Pa. Aug. 17, 2007), transferred to *In Re Mattel, Inc. Toy Lead* Paint *Products Liability Litigation*, No. 2:07-ml-01897 (C.D. Cal. Dec. 27, 2007).

[5] Hesse v. Learning Curve Brands, Inc., 1:07-cv-03514 (N.D. Ill. (June 22, 2007).

[6] In re Pet Food Products Liability Litigation, MDL-1850, No. 1:07-cv-02867-NLH-AMD (D.N.J. June 19, 2007).

[7] Mark Morris, Firms, *Officials Charged in Tainted Pet Food Case,* KANSAS CITY STAR, Feb. 7, 2008, at A1.

[8] People v. Mattel, Inc., No. RG07356892 (Cal. Super. Ct. Nov. 19, 2007).

shareholders filed a derivative suit, accusing the company of misleading investors by failing to report the alleged defects in a timely way.[9] They also accuse board members of insider trading, claiming they allegedly sold a substantial number of shares before the recall was announced. The action seeks compensatory damages, an order for the stock sellers to disgorge profits and, of course, attorneys and expert fees. The Mattel shareholder lawsuits are pending in Delaware.

II. Practical Considerations

There are several practical considerations, both unique and familiar, in recall litigation. The lawsuits involving toys imported from China resonate with potential jurors because they involve possible harm to children. Moreover, recalls may tarnish a company's reputation and that can, and often does, impact stock values.

Additionally, there are evidentiary implications to every recall. These include not only the when, what and how of the recalls, but also the statements or comments made by company executives to the press. The press conference held by the CEO of Mattel, in which he issued a formal apology to the Peoples' Republic of China,[10] prompted many practitioners to consider how they would deal with this type of evidence during a trial. The apology to China, however, highlights the reality many US suppliers and distributors face. They have to deal with both political and cultural considerations relating to foreign countries, as well as the legal issues involved in U.S. litigation. In the case of the Mattel toy recalls, approximately 90% of the recalls were reportedly the result of a design defect, rather than a manufacturing defect.[11] Mattel had to balance the impact on potential litigation of statements about the source of the problem with the importance of maintaining a valued relationship with its foreign supplier.

The fact that the manufacturer or supplier is foreign presents other practical problems. If litigation involves a foreign supplier, the attorney defending an outsourcing U.S. company should consider whether the supplier should be brought in as a party. Even if the supplier can be joined as a party, issues remain as to whether the foreign supplier can be successfully prosecuted or any judgment can be collected.

Collecting a judgment can be problematic because most Chinese manufacturers do not have facilities or even a substantial presence in the United States. On the other hand, litigating in China is fraught with difficulties. Chinese product liability law is very different from the law of the United States. It is more difficult to obtain a judgment and the amount of damages is usually far less than in the U.S. Once a judgment is entered in China, it can be very difficult to enforce the judgment. Among other challenges, there is no treaty regarding mutual recognition of judgments between the United States and China. Both countries, however, are signatories to the Hague Convention,[12] so one can seek enforcement through the Uniform Foreign Money Judgments Act.[13] That can be quite a

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[9] Sterling Heights Police & Fire Retirement System v. Eckert, No. CA3285-VCL (Del. Ch. Oct. 10, 2007).

[10] Jia Lynn Yang, "Mattel's CEO Recalls a Rough Summer," FORTUNE, Jan. 22, 2008, http://money.cnn.com/2008/01/21/news/companies/mattel.fortune/index.htm.

[11] Jyoti Thottam, "*Why Mattel Apologized to China*," TIME, Sept. 21, 2007, http://www.time.com/time/business/article/0,8599,1664428,00.html.

[12] Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil or Commercial Matters, Nov. 15, 1965, 20 U.S.T. 361 (1965).

[13] A majority of states have adopted a form of the Uniform Foreign Money Judgments Act. California's version of this Act can be found at Uniform Foreign-Country Money-Judgments Recognition Act, CAL. CIV..PROC. CODE §§ 1713-1724 (2008) (Loislaw through 2007 legislation).

challenge and could make for the topic of an entire article in and of itself.

III. Legal Issues: New Angles on Old Defenses.

Litigation involving a foreign supplier may also pose new angles on old defenses. Plaintiffs often assert product liability or consumer protection claims. Three defenses are uniquely situated in this type of litigation.

A. Third Party Actions

Generally, in product liability litigation, retailers and distributors in the United States are part of the chain of distribution and, therefore, subject to liability for defective products. The standard modus operandi is for retailers and distributors to maintain a low profile in the lawsuit and look to the manufacturer for their defense and indemnification. In instances where the manufacturer or supplier is in China, it is a different story. One has to consider how, and to what extent, the Chinese supplier should or can be involved.

First, in deciding whether to bring in the foreign manufacturer as a party, a defendant needs to consider several factors. Is there an indemnity agreement? Would it damage an ongoing business relationship? Would it lead to finger pointing and infighting among defendants? Ultimately, is it helpful to the domestic defendant's case?

Second, does the jurisdiction permit the jury to apportion liability to a foreign supplier, even if it is not a party? If the case is filed in a jurisdiction like Indiana[14] or California,[15] where the defendant company can point to the empty chair and a jury is allowed to apportion liability to all potential tortfeasors, whether a party or not, the defendant company may enjoy the benefit of pointing the finger at the foreign manufacturer without the problems of joining it. But some states, like New York, require the tortfeasor to be a party to the action to allocate fault.[16] Thus, in evaluating whether to add the foreign supplier as a third party defendant, a company should consider whether fault can be allocated to a non-party tortfeasor in the jurisdiction where the suit is pending.

B. Innocent Seller Defense

A foreign manufacturer without a U.S. presence also has potential implications for the innocent seller defense. The general rule is that a seller in the chain of distribution is liable for defects in the product, irrespective of whether it had a role in the manufacture or design of the product. The innocent seller defense is an exception to that rule. In 22 states, sellers can be shielded from liability if they can show that they are basically a pass-through seller of a product in sealed containers, that the product did not undergo any change or manipulation by the seller, or that the retailer played no role in designing or specifying the contents of the product.[17] However, plaintiffs may challenge this defense. Consider, for example, a big box retailer that imports and sells products which are later recalled. A plaintiff might contend that she or he has no viable remedy against the foreign supplier, so the defendant should not have the advantage of the innocent seller defense.

Thirteen states have adopted an exception to the innocent seller defense: the defense does not apply when the

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[14] Rockrohr v. Norfolk Southern Corp., 797 F. Supp. 664 (N.D. Ind. 1992).

[15] DaFonte v. Up-Right, Inc., 828 P.2d 140 (Cal. 1992).

[16] Schmelzer v. Hilton Hotels Corp., No. 1:05-cv-10307, (JFK) 2007 WL 2789269 (S.D.N.Y. Sept. 24, 2007).

[17] Colorado, Delaware, Georgia, Idaho, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maryland, Michigan, Minnesota, Missouri, Nebraska, New Jersey, North Carolina, North Dakota, Ohio, South Dakota, Tennessee, Texas, and Washington.

manufacturer is bankrupt or insolvent.[18] The rationale behind the exception is that, where it is essentially impossible for a plaintiff to recover from a manufacturer because it is bankrupt or insolvent, the seller cannot shield itself from liability and leave the plaintiff without a viable remedy.

Would that rationale also apply in the case of a foreign supplier based on equitable principles? Creative plaintiffs' lawyers may argue just that -- where the manufacturer is foreign, plaintiff has no viable remedy. While they may have to establish the difficulties of obtaining and enforcing a judgment against a foreign supplier, plaintiffs' lawyers are likely to contend that these difficulties are so great that a remedy would be virtually impossible. In turn, they may assert that the American distributor or seller should not be allowed to shield itself from liability by the innocent seller defense. On the other hand, defendants can look to forum non conveniens cases for authority that U.S. courts do not require non-U.S. jurisdictions to have the same system or to offer the same remedies in order to provide justice to litigants.[19]

C. Medical Monitoring

The plaintiffs may also bring medical monitoring class actions. These actions pose significant hurdles for plaintiffs. For starters, many jurisdictions do not recognize a cause of action for medical monitoring or permit this relief.[20] In addition, class actions for medical monitoring are awash in individual issues. For example, in the case of toys with lead paint, the timing and extent of exposure to the toy, as well as alternative sources of lead exposure, vary from child to child. Causation also is an individual issue. A detailed examination of each child and his or her medical history, family and environment would be necessary to establish that the claimed slight difference in I.Q. points or subtle developmental delay was caused by exposure to the toy as opposed to factors for which the defendant is not responsible. The nature and duration of monitoring could also be different for each case.

IV. The Buck Stops Here: Proposed Legislation

The Federal Government has set in motion legislation that will place more responsibility on American companies for the importation of defective products from abroad. Proposed legislation introduced in Congress in 2007 provides a good illustration.

The Import Safety Act of 2007, introduced in Congress shortly after several recalls, seeks to amend the Food, Drug and Cosmetic Act and the Consumer Product Safety Act to increase civil and criminal penalties for violations of product safety laws.[21]

Other legislation proposed in 2007 is directed specifically at toys. Senate Bill 2038 seeks to prohibit interstate commerce of child products with lead exceeding certain levels.[22] Senate Bill 1833[23] and House of Representative Bill 3499[24] would require third party verification of compliance with Consumer Product Safety Commission ("CPSC") standards for child toys. Senate Bill 1306 directs CPSC to classify certain child toys with lead as banned hazardous substances.[25]

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[18] Delaware, Idaho, Iowa, Kansas, Maryland, Minnesota, Missouri, New Jersey, North Carolina, Ohio, Tennessee, Texas, and Washington.

[19] *See, e.g.,* Borden, Inc. v. Meji Milk Products Co., *Ltd.*, 919 F.2d 822, 829 (2nd Cir. 1990).

[20] *See, e.g.,* Wood v. Wyeth-Averst Laboratories, 82 S.W.3d 849 (Ky. 2002).

[21] Import Safety Act of 2007, H.R. 3100, 110th Cong. (2007).

[22] S. 2038, 110th Cong. (2007).

[23] Children's Products Safety Act of 2007, S. 1833, 110th Cong. (2007).

[24] Children's Products Safety Act of 2007, H.R. 3499, 110th Cong. (2007).

[25] Lead Free Toys Act of 2007, S. 1306, 110th Cong. (2007).

The flurry of legislative activity in response to the 2007 recalls reflects the increasing government involvement in the importation of consumer products. The FDA has taken steps to develop more stringent regulations regarding importation of food products and drugs. The U.S. Department of Agriculture and Center for Disease Control have also become more active. The U.S. Department of Health and Human Services signed a Memorandum of Agreement with the General Administration of Quality Supervision Inspection and Quarantine of the Peoples' Republic of China.[26] And, the Consumer Product Safety Commission has publicly stated that it views the U.S.-based-retailers as responsible for defective imported products. Democratic Senators and Representatives have voiced a plan to increase the CPSC budget.

V. International Response

The response to problem imports is not limited to America. There has also been an international response. Recently, Japan recalled Chinese-made dumplings that were tainted with insecticides. South Africa, Spain and Australia have recalled toys that were made in China. And recently, the European Union ("EU") issued the Toy Safety Directive, which seeks to provide a common standard for the safety of toys throughout the EU, to reduce maximum limits for lead and mercury and to impose greater responsibility on manufacturers and importers. The 2007 recalls represent a truly global problem emanating from the explosive growth of the global economy.

VI. On the Horizon

Several initiatives are underway to address the issues and infrastructure problems that lead to the 2007 recalls. For example, in October of 2007, the Chinese government issued its first standards for cold chain logistics. In addition, on December 11, 2007, the United States and China signed the Global Food Safety Initiative. The agreement contains registration and certification requirements; greater information sharing; increased access to production facilities; stronger product integrity and security; key benchmarks; and China's involvement in international regulatory and public-health bodies. The agreement reflects the growing recognition by the Chinese government that U.S. companies and the Chinese government should collaborate on quality issues. Finally, on Dec. 10, 2007, China's State Food & Drug Administration ("SFDA") issued new State Food and Drug Administration Recall Management Methods. Thus, there are now laws that allow for the voluntary recall of unsafe drugs with fines, monitoring systems, and the ability to analyze and utilize information from hospitals and retailers.

In sum, there may be a silver lining to the 2007 recalls. As companies go forward in 2008, the measures taken by U.S. and foreign governments and the private sector in response to the recalls may reduce legal fallout in the future.

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[26] Press Release, U.S. Dep't of Health & Human Services, New Agreement Will Enhance the Safety of Food and Feed Imported From the People's Republic of China, Dec. 11, 2007, http://www.hhs.gov/news/facts/foodfeed.html.