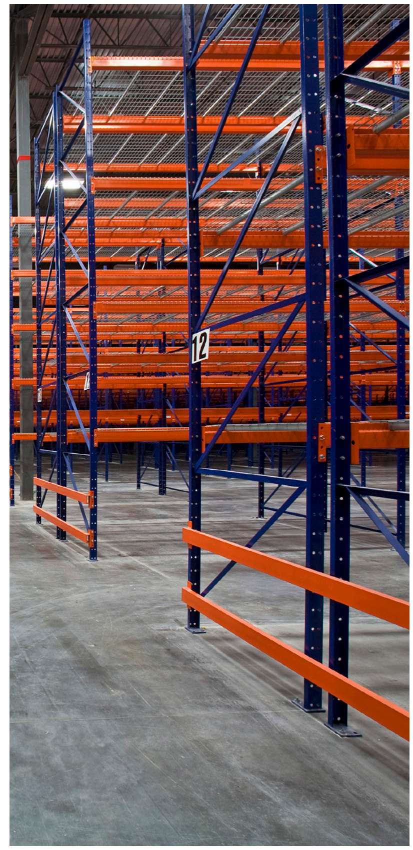
How Directors and Officers Can Rein in Product Liability Risks



Consider this scenario: One of your most profitable products — available globally — suffers a defect that has the potential to harm users physically or financially. An extensive recall is issued. Several regulatory agencies initiate investigations in various countries. Your company faces recall logistics, brand damage, revenue losses, shareholder lawsuits, and potential fines. Investigators scrutinize not only events leading up to the recall, but how it is handled. And there is one more risk that many companies have not typically considered: liability for directors and officers.

Recent global events have put directors and officers (D&O) liability front and center in product recalls. For example, a German automotive manufacturer's recent product recall resulted in lawsuits in more than 25 jurisdictions around the world and included civil, criminal, and Privacy Shield cases. And a global mobile phone manufacturer faces regulatory issues in the US and abroad over the recall of a device alleged to have the potential to injure users.

How you respond once a product defect is discovered and the liability insurance it has in place will help determine how your executives and organization fare in the wake of a recall event.

PRODUCT LIABILITY D&O RISKS

Managing product liability risks resulting in D&O exposures can be challenging for global organizations. The chain of events leading to a D&O claim — from initial product development and subsequent recall to how the organization responds to whistleblowers and investigations — can result in immediate revenue and reputational losses. Historically, global manufacturers and biopharmaceutical companies were particularly at risk. But recent product recalls highlight that the exposure is not limited to these two groups.

For example, if shareholders expected a new product to increase the company's stock price, but instead it plummets following a recall, they may sue. And if leadership had previous knowledge of problems with the product but chose to ignore them or not share them with shareholders and others—despite a bodily injury and property damages exclusion in the D&O policy—significant liability issues may arise, including:

- Shareholder, bondholder, or securities class-action lawsuits.
- Penalties, fines, and scrutiny from global regulators.
- Whistleblowers.

MARSH

MANAGING THE RISKS

Many regulatory agencies require organizations to have robust corporate governance plans. These could come under scrutiny if regulators or courts conclude that directors and officers should have detected, prevented, or at least warned stakeholders of the possibility of a product liability issue. As a result, corporate boards of directors need to understand product liability exposures and the regulatory environment that could lead to a potential claim.

In the event of a product liability issue that could lead to D&O claims, organizations should:

- Work closely with the US government and other regulatory agencies.
- Alert the US Consumer Product Safety Commission (CPSC) or other consumer safety agencies at the first notice of a possible recall. Be aware of their reporting procedures and build good relationships.
- Be prepared for regulators — particularly from the US — to move quickly when an issue arises. Immediately assess your products and services around the world to determine if other potential product liability issues could arise from any regionalized concerns.
- Immediately look at ways to rebuild brand trust. Exhibit rigor and robustness in rooting out the problem, and be transparent in what led to the issue and how decisions are made to fix it.
- Consider appointing a special committee to monitor and manage corporate litigation issues stemming from product liability risks. Such matters can pose a significant diversion for the board, which must stay on top of the day-to-day activities needed to keep the organization running.

INSURANCE

Product liability and D&O exposures present enhanced liability for corporate boards, especially if the organization is underinsured. Make sure to:

- Understand your potential D&O exposures and whether adequate D&O coverage is in place in the event of a global product liability event.
- Consider using automatic reinstatement in insurance policies, which replenishes limits after a claim occurs.
- Review third-party vendors' indemnification. The prevalence of component manufacturing requires organizations to ensure their suppliers have enough insurance, including D&O liability and product liability.

Any bad practice can potentially lead to a liability lawsuit against corporate directors and officers. Although risk-taking is a fundamental driving force in business, the cost of risk management failures amid an challenging regulatory environment across various regions can sometimes be underestimated. This is especially true for product liability events where risks can compound quickly, and one D&O claim may lead to others.

Work with your insurance advisors to better understand your D&O exposures related to product recalls. The ability to effectively respond to regulatory agencies along with adequate product liability and D&O insurance can help protect your directors and officers against liability amid complex global product recalls.