

Avoiding Unnecessary U.S. Litigation Arising from the Export of Products Across the Border

by Kent J. Schmidt

Canadian companies exporting products across the border into U.S. markets have understandably been focused in recent months on concerns relating to trade, including the uncertain future of NAFTA. While trade concerns grab headlines and attention, it is also imperative that Canadian companies consider another aspect of cross-border commerce—the risk of litigation arising from products sold and distributed in the U.S.

It is common knowledge that the U.S. is much more litigious than Canada. Several aspects of the U.S. legal system account for this. Civil cases, including product liability lawsuits, are submitted to juries, who are empowered to determine that a product is “defective” or an advertisement is “deceptive.” Hundreds of consumer class actions are filed each day in the U.S., driven by plaintiff firms who reap handsome rewards through contingency fee arrangements. Shocking punitive damage awards in product liability cases are typically not covered by insurance policies.

Companies exporting products into the U.S. and considering these hazards can take some comfort in the fact that many risks of product-related lawsuits can be avoided through a thoughtful risk mitigation strategy. To grapple with these risks, it is helpful to identify key areas of vulnerability by creating a litigation risk profile. A litigation risk profile must evolve with the business and take into consideration the unique aspects of the product, the customers and distribution channels. Guarding against unforced errors in product liability cases requires that a company assemble various stakeholders, from the engineers in R&D, to the sales and marketing team, key executives, outside consultants and vendors such as insurance brokers.

Tailored to each unique business, an effective litigation risk profile identifies the *sources* of legal trouble (e.g., class actions and regulatory investigations) and the *types* of claims typically brought. The potential of litigation or regulatory action includes legal claims in at least these four categories:

- Risks relating to **product liability** claims if a person or property is injured or damaged

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by the product;

- Risks of ***breach of warranty claims*** in both the consumer and B2B context;
- Risks of ***false advertising and consumer protection claims***, including class actions and regulatory investigations; and
- Risks arising from the collection, use or compromise of ***consumer data and personal information***.

Each of these four risks requires its own unique approach. Beyond some of the more obvious prophylactic measures designing a safe product, submitting it to rigorous testing and third-party analysis, scrutinizing advertisements and promotional claims about the product's efficacy, and learning where regulatory and litigation trends are heading, one should consider risk mitigation strategies that are sometimes overlooked. A generally-applicable framework for avoiding product-related litigation risks includes consideration of at least these five factors.

1. Choose the Forum and Law

Companies should be mindful of how U.S. courts exercise jurisdiction over Canadian and other foreign corporate defendants. It may be possible to structure corporate entities and distribution channels to insulate a foreign entity from a court's jurisdictional reach in at least some types of cases.

There are limitations on the effectiveness of this jurisdictional strategy. Sending a defective injury-causing product into the "stream of commerce" will almost always subject a foreign company to jurisdiction in the U.S. But planning and forethought may avoid personal jurisdiction in other contexts, including contract disputes.

If a lawsuit is rooted in contract theories, factors such as where the contract was negotiated and performed and the presence of forum selection and choice of law clauses are material in deciding whether the Canadian company can be sued in the U.S. It is often strategically advantageous (as well as convenient) to stipulate that any dispute will be resolved in Canada. It may be possible to insist that the governing law is either Canadian law or the United Nations Convention on Contracts in International Sale of Goods ("CISG").

Arbitration clauses mandating private adjudication of disputes have long been accepted in the commercial context. Due to recent trends in U.S. law, similar arbitration clauses, coupled with class action waivers, may be binding on consumers and be asserted to prevent a costly class action lawsuit. Caution must be exercised in drafting class action waivers to ensure that the provision will not be set aside by a U.S. court as unconscionable or the product of unfair surprise.

2. Limit the Time in Which a Claim Can be Brought

The second approach to mitigating against product-related claims is to limit the time in which a lawsuit or other claim can be filed. This can be done in some instances through a provision that functions as a contractual statute of limitations. Attention should be paid

to the duration of various written warranties.

As with all contractual provisions, greater latitude and freedom of contract is permitted in business-to-business transactions than in the consumer context, where courts use consumer protection statutes to invalidate certain seller-friendly provisions.

3. Limit the Remedies to the Extent Feasible

Robust contract terms can be negotiated to limit the remedies available to the buyer and protect the seller from a variety of claims. At least in commercial context (“B2B”), parties can disclaim implied warranties. Consumers enjoy additional protections under many laws that limit a seller’s ability to disclaim warranties. But even in the consumer context, many jurisdictions allow the parties to agree that the buyer’s sole remedy is to repair or replace the product and certain purely economic damages can be disclaimed through a reasonable liquidated damages clause. Above all, a seller should insist on a contractual limitation precluding a claim for lost profits.

4. Shift the Risk to Third Parties

While it might appear to be an obvious risk mitigation measure, many companies do not take full advantage of the opportunity to transfer risks to third parties, including insurers and other partners providing indemnity. Securing a general liability insurance policy, which typically comes with dozens of exclusions to coverage, may not be enough. The exclusionary language in many insurance policies, skimmed over when the policy is secured, becomes a central focus after a claim has been filed at which time words and phrases are parsed in an almost hermeneutic fashion. The better time to engage in this analysis of coverage and exclusionary language is before the claim is brought, not after the fact when it is too late.

It is important to also think strategically about insurance up and down the chain of distribution. Suppose a product that a company is manufacturing has component parts that are defective. A prudent manufacturer which has unwittingly incorporated those component parts will have an indemnity provision in a supply contract pursuant to which the claim may be tendered to the vendor of the defective components. But suppose further the vendor is now insolvent or beyond the jurisdiction reach of most courts. A further strategy is to demand that vendors obtain an insurance policy to cover the loss and name the manufacturer as an additional insured.

These types of indemnity provisions and insurance policies should be considered throughout the distribution chain. Obtaining a full understanding of the possibility that a product-related claim might be compounded by another party’s insolvency or lack of insurance is one way to mitigate against product-related litigation risks.

5. Create a Crisis Management Plan for a Doomsday Scenario

The fifth prophylactic measure is based on the assumption that, notwithstanding the foregoing best practices, a crisis will arise at the most inopportune time. These crises take many forms. In addition to preparing for run-of-the-mill commercial litigation disputes, one must anticipate a massive product recall, a disparaging tweet about the product that goes viral, a surprise visit from regulators that shuts down a factory or a class action lawsuit with expedited and burdensome discovery. In some instances, decisions that would take days of careful contemplation must be made in hours or even moments. To avoid being caught flatfooted, a company should develop various crisis management plans well in advance, outlining a plan to swiftly convene a team of key executive and outside consultants and implement a response.

The challenges of succeeding in a business venture are daunting enough without the potential of costly litigation or regulatory problems. But with careful planning, including these five considerations, many of claims and legal risks that come with exporting products into the U.S. can be avoided.

Kent Schmidt will provide a free seminar on how Canadian companies can avoid product related claims in the U.S. on May 31 (Vancouver) and June 1 (Calgary). Information regarding this presentation and how to register is available [here](#).