“Made in China” Safety

Tips for Preventing and Managing

Everyone involved in the distribution of products made in China and sold to American consumers is aware of the growing safety controversy surrounding a number of high-profile U.S. recalls of Chinese products over the last year. But not everyone understands that a recall can escalate into a media and legal nightmare that can bring devastating legal consequences to the American manufacturer/designers, importers, distributors, and retailers—each of which has more direct potential exposure to the vagaries of the American legal system than the Chinese fabricator that actually made the recalled product.

The adverse publicity of a recall can destroy a product’s U.S. market overnight and infect the sales of related products that were not recalled. Recalls can trigger expensive federal civil and criminal penalties, congressional hearings, and burdensome legislation and rulemaking. Under the laws of the 50 states, individual consumers, groups of consumers, and attorneys general can sue each company with a U.S. presence that is involved in the distribution chain of the allegedly defective products.

Prudent management can reduce, although not eliminate, these risks by establishing robust testing, quality control, and careful attention to warn-
Tips for Preventing and Managing Controversies

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Chinese-Made Products Sold to U.S. Consumers—Great Success, Great Challenges

The toy industry is the poster child for this success; fully 80 percent of toys sold in the U.S. are made in China. Astonishing statistics like this attest to the irreversible globalization of manufacturing in general and to the success of Chinese entry into the world's markets in particular. But alarm in the U.S. about the safety of certain Chinese products continues to emerge as a dark side to this success. In 2006, there were 467 U.S. recalls of Chinese products, twice as many as in 2001. During a five-week period in the summer of 2007, toy manufacturer Mattel issued three separate, widely publicized recalls involving almost 20 million Chinese-made toys. Mattel’s stock price dropped. It was sued by consumers and shareholders. But Mattel’s problems with its Chinese-made toys were far from unique. Ninety-eight percent of all toys recalled last year were made in China.

The toy story is just a small part of the Chinese product-recall drama. In 2007, over 100 brands of Chinese-made pet food were recalled over allegations that they were contaminated. Next came news that hogs destined for U.S. dinner tables had been fed the same contaminated food prior to slaughter, posing a risk to humans as well. Shrimp raised in China showed traces of an antibiotic that can cause leukemia and anemia. Chinese-made snack foods were recalled because they were contaminated with salmonella. Chinese-made toothpaste was recalled because it was contaminated with an ingredient used to make antifreeze. Tires made in China were recalled because of concerns related to tread separation. According to Consumers Union, the publisher of Consumer Reports, 60 percent of all consumer recalls in 2007 were for Chinese-made products.

This series of Chinese product recalls has generated not just news stories and lawsuits, but also congressional hearings, proposals for new federal legislation to mandate testing of imported products, revisions to federal agency import monitoring protocols, and new export controls by the Chinese government. All of these initiatives received media coverage, prolonging a story that renewed and reinforced the negative view of some U.S. consumers toward Chinese-made products.

U.S. Consumers Are Cautious, Suspicious and Litigious

U.S. consumers, risk-averse to begin with, have become especially sensitive to the perceived risks of products made in China. U.S. consumers increasingly expect long product life with no malfunctions, no safety hazards, and full disclosure of all product limitations and risks. They have long been wary of manufacturers in general, suspecting them of sacrificing quality and safety, concealing known product defects, and overstating quality—all to maximize sales and profits. U.S. consumers hold these beliefs about all manufacturers, domestic and foreign, but they also assume, until proven otherwise, that imported products are of especially low quality. Fueled by the recent controversies, American consumers have grown particularly suspicious of products fabricated in China. But once these consumers look behind the “Made in China” label, they quickly discover that many of the recalled products are conceived, designed, contracted for, imported, distributed, and sold at retail by American companies.

When a product is reported to be defective in some way, consumers’ suspicions are confirmed, and they immediately look for someone to blame. According to a 2007 poll published in USA Today, consumers blame everyone in the chain of distribution as well as the U.S. government and even themselves. But regardless of where the responsibility actually belongs, when U.S. consumers hear news stories telling them the child’s toothpaste is made with an antifreeze ingredient, their reaction is to sue everyone who had anything to do with that toothpaste. While the U.S. legal system allows them to name whoever they wish in a lawsuit, the entities that are the most likely sources of recovery in these suits are American companies associated with the recalled product as the designer, the contracting manufacturer, the importer/distributor, and the retailer.

Any company involved in the manufacturing and distribution chain of a recalled product can find itself at the center of an escalating media and legal quagmire that can quickly become hugely expensive and damaging. The initial disclosure of a product recall, although viewed by the recalling company as “the right thing to do for consumers,” often generates intense, hostile media scrutiny. It may prompt lawsuits, with additional negative publicity, which can feed a round of regulatory and legislative action, bringing even more bad publicity. The product’s sales plummet, assuming it is allowed to stay on the market at all. The resulting lawsuits are expensive to defend and can sap the energy and focus of the companies involved. Adverse judgments, with compensatory and punitive damages, are possible. And regulatory and legislative actions, in addition to consuming more time and money, often result in new rules and legislation that raise the cost of doing business. This “vicious circle” can repeat itself, with greater intensity, when the next product recall is disclosed.
To Prevent Product Recall Problems, Understand the Risks and Plan Ahead

Although the prospect of being caught in one of these maelstroms can be intimidating, involved companies can—and should—plan carefully to avoid them and to manage them successfully if and when they occur. Regardless of whether the controversy over Chinese products is justified, there can be no dispute that it is real. For the purposes of planning a response, that is all that matters. Complaining about it, or attacking the messenger, will not help. Acknowledging the controversy and planning effective responses will. Like most controversies, the one involving Chinese products will fade away in time, but in the short term, companies that protect their interests effectively will survive it and prosper.

To manage product safety issues, a company must first know the types of legal problems that can arise from a recall, recognizing that federal and state laws create very different types of legal exposure with respect to product safety. The federal government regulates many consumer products through the actions of agencies such as the Food and Drug Administration (FDA), which can seize allegedly unsafe foods and drugs, seek injunctions requiring recalls, impose certain civil penalties, and bring criminal actions. The Consumer Products Safety Commission (CPSC) has similar, although not identical, authority over about 15,000 consumer products. The National Highway Traffic Safety Commission (NHTSA) regulates automobiles and vehicle components in much the same way.

Federal enforcement usually begins with regulatory contact, possibly an agency investigation, and then, depending on the outcome, some degree of pressure to effect a recall. The agencies can ratchet this pressure all the way from encouragement through recommendation to an agency order or court order. The process usually involves negotiation, and the extent to which civil or criminal penalties are sought often depends on the degree of cooperation the company provides during the recall process, as well as the degree of culpability the company bears for whatever circumstance led to the recall in the first place. While the prospects of congressional hearings and new legislation or regulation are real, they are less immediate and, to some extent, contingent on what takes place in the initial regulatory encounters.

Concurrent with federal regulatory jurisdiction, state laws provide the legal framework for suits by individual plaintiffs, by consumer classes, and by state attorneys general. Depending on the state and the nature of the alleged harm and the product at issue, plaintiffs can sue under theories of strict liability, negligence, breach of express or implied warranty, common law fraud, and state consumer protection laws. Individual plaintiffs, often represented by law firms working for a fee contingent on recovery, generally allege personal injury, property damage, and/or economic harm, seeking compensatory damages and, often, punitive damages, which can vastly increase their recoveries when successful.

State laws also provide the bases for other types of suits. Class actions are often developed by lawyers or law firms that represent a few token consumer “victims” supposedly suing on behalf of all purchasers or users allegedly injured by the product. State attorneys general may also bring suit on behalf of the states, state agencies that have purchased the product, and/or the citizens of the states. In class actions and attorney general suits, plaintiffs seek damages, penalties, and court orders regulating future conduct.

Because product controversies often spawn large numbers of individual personal injury suits and multiple proposed class actions, federal courts and some state courts may consolidate multiple lawsuits involving the same claims. Consolidated actions reduce the burden on the court system caused by a single allegedly defective product, but they create a far higher risk of great financial exposure to the defendants by aggregating many cases into a single proceeding.

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What makes this specter so daunting is the fact that federal regulatory actions, state attorney general suits, and a variety of single-plaintiff and class action suits in a number of states can all be brought at the same time. Suits may be brought individually or in combination against the U.S. retail seller, the U.S. importer/distributor, and the manufacturer/designer. Although target companies without U.S. operations can take some comfort in the fact that they are not subject to the jurisdiction of U.S. courts, they will still be at risk of losing their U.S. market. U.S. agencies, regulatory agencies, and both federal and state courts do have jurisdiction over U.S.-based companies, which, therefore, will be at risk of civil and criminal penalties as well as compensatory and punitive damages. U.S.-based targets will also be at risk of losing their markets for imported products with tarnished reputations.

Planning Can Help Avoid Damaging Product Controversies

The best way to deal with the prospect of this exposure is to avoid product controversies in the first place through proactive management and legal strategies. These include testing, quality control, inter-company agreements, and careful attention to a variety of early warning systems.

Companies should regard testing and quality control as two indispensable parts of the same process. They should test both the design and the manufacturing processes, preserving all test results. Testing by a third party will remove any tinge of self-interest that could be seen as affecting the results. Third-party testing is not an absolute necessity, however. Self-testing can be effective when the tests are conducted by someone within the company who has no stake in the results, but is, instead, incentivized to make the testing thorough, accurate, and objective.

Quality control is as important as testing. Part of quality control includes making corrections if products fail their tests. Quality control staff should document all corrective actions they take, as well as subsequent test results showing that the corrective actions were effective. Quality control also means implementing early warning systems within the manufacturing process, in combination with rules requiring that production stop immediately if any of
these early warning systems are triggered. Finally, quality control means that whenever a warning is triggered, the entire distribution chain is inspected to determine the extent to which the problem may have existed before detection. All damaged or spoiled products in the distribution chain must be kept from consumers.

U.S. companies involved in the distribution chain have found that one way to enhance quality control is to place their own representatives at the design and manufacturing sites in China to monitor the testing and quality control. Some U.S. companies have also worked out inter-company liability-sharing agreements with Chinese manufacturers and designers containing indemnification provisions and commitments to share information in litigation and regulatory situations.

U.S. companies involved in importing Chinese products should also recognize and take advantage of all the information available to them, both during the manufacturing process and once the products reach consumers. During manufacture, they should encourage contractors to raise concerns about product quality/safety and listen to and carefully evaluate them, taking action if necessary. Establishing the degree of trust required for a Chinese contractor to come forward and report concerns may require a considerable investment of time and effort, and will need frequent nurturing. If a company is able to establish such a relationship with its Chinese contractor, the benefits of obtaining and acting on these reports will usually exceed the later litigation risk of dismissing them.

Once the products reach the U.S. consumers, companies—usually, the U.S.-based retailers, distributors, and importers—receive a variety of information they should evaluate as potential early warning signs that significant problems may be developing. If a company has a coordinated process for analyzing customer complaints and warranty claims, it can watch for patterns, especially those that impact consumer safety. An elevated number of complaints or claims may point to a need to modify product design, manufacture, or distribution. It may also be an early warning of a problem that could become a high-profile controversy.

Similarly, a company should watch patterns of litigation involving its products. Changes in litigation patterns may warn of two different developments. First, an elevated number of individual lawsuits may signal a product problem. Second, multiple suits brought by the same lawyers, class action lawsuits, and lawyers pursuing media coverage may indicate an emerging lawyer-manufactured controversy.

Government inquiries may also be bellwethers of incipient product problems. Companies should treat all government inquiries with great care and attention because of their inherently serious nature, and because lack of cooperation almost invariably exacerbates whatever genuine problems exist. In addition, a marked uptick in government inquiries may be a sign of broader controversy developing over a product.

Finally, publicly available information may point to the start of an adverse reaction to a product. This includes general news media as well as more specialized news organs that report on particular industries in much greater detail. When a public information source identifies an industry trend, even when that trend does not have an obvious, immediate impact on a company in the industry, the company should consider how the trend might apply to its business practices. Although some public information sources may require expensive subscriptions, they may still be very economical means of proactive threat detection, especially in comparison to litigation and government inquiries.

**Crisis Management Teams**

Sometimes, despite the best testing, quality control, and attention to all information resources, a product controversy develops: a company learns that some sort of official or public questioning of a product’s integrity is about to become widely publicized. Companies should anticipate that this may happen and should plan their approach to managing a product controversy.

Companies should create and train crisis management teams. Although a particular controversy probably cannot be anticipated, a well-prepared crisis management team can adapt to the nuances of whatever crisis may develop. A senior executive who will be the “voice of the company” at least internally, is indispensable to the team. Other must-have members of the team include a representative of the company’s legal department, a human resources representative, a public-affairs specialist, an internal audit representative, and a compliance officer (when applicable). Outside expertise should be retained as needed if any of these areas requires reinforcement.

The crisis management team’s most important job is to manage the first 72 hours of the crisis intensively. The process involves four steps, each critical. First, the team must understand the allegation being made about the product. Second, it must gather all the facts. Third, with its understanding and information, it must formulate a corrective action plan. If the problem is real, the company should admit it and devise short- and long-term solutions. But if the alleged problem is not real, the team should plan to defend the product. The last step is to execute the plan, taking great pains to get it right the first time.

Where the problem involves an inquiry from a government agency, it is important that the crisis management team go out of its way to establish credibility with the agency. It should candidly disclose all relevant facts. Especially when communicating with government representatives, the team should combine advocacy with conciliation. The nature of the government’s response will be shaped, in part, by the degree to which it feels the company takes the issues seriously and communicates candidly. The consequences of not doing so can compound the damage far beyond penalties imposed for the product’s failings, by creating severe ancillary legal problems for the company and its key personnel. False statements made to government officials can bring criminal penalties. If an officer of a publicly traded company allegedly has knowledge of undisclosed, material product deficiencies, shareholder derivative suits are almost inevitable. If an officer trades in company stock with non-public information, it can create insider trading problems with the SEC. The combination of product defects with failure to disclose adverse test results to agencies like the FDA can result in criminal liability and devastating economic consequences. Finally, any hint that the company knew of the problems and compensated the Chinese fabricator or designer to remain silent despite this knowledge can lead to charges under the Foreign Corrupt Practices Act.
When public disclosure and the attendant media firestorm are inevitable, the rule is to get to the news media as quickly as possible and then say it early, say it all, and say it often. Companies usually have some warning that a media frenzy is about to erupt over an alleged failing of one of its products. Federal agencies, in particular, usually try first to negotiate a resolution with the companies involved with the products at issue. Therefore, a company will know when negotiations break down or become so acrimonious that an impasse is inevitable. This knowledge gives the crisis management team the opportunity to get the company’s message out in the first news cycle involving the allegations against the product. This is important because otherwise, this first, and most impactful, news cycle is ceded to the company’s adversaries. When speaking to the media, be truthful; stick to the known facts and do not speculate. Finally, be consistent. If the message is correct, repeat it at every turn.

It is possible that the crisis management team can at least mitigate whatever damage is caused by the media firestorm, but companies should keep in mind the vicious circle discussed earlier: media coverage leads to lawsuits, which lead to regulatory and legislative processes, which lead to more media, which leads to more lawsuits, and so on. Therefore, even as the crisis management team seeks damage control, the litigation defense team should be waiting in the wings and monitoring the situation. When litigation appears inevitable, the litigation team should immediately start planning the defense. The crisis management team should include a representative of the company’s legal department; this will facilitate a transition from crisis management to litigation planning, should it become necessary. The counsel can provide legal guidance to the team and can advise as to transition strategy. Equally important, the presence of legal counsel creates a privileged setting for the consultations of the crisis management team and the litigation defense planning.

The legal team should first preserve and collect all relevant evidence. If planning has been thorough, this evidence will include testing of the product, test results, corrective action, and retesting showing that problems necessitating the retesting were resolved. Second, while the company should “do the right thing” for the consumers, the legal team should remind the company of how ill-considered written statements (including emails) will look in later litigation and recommend that they be kept factual and responsible in content and tone. Finally, the legal team should encourage the company to resolve “legitimate” consumer injuries outside of litigation, thereby reserving litigation for the non-meritorious claims.

Designers, manufacturers, importer/distributors, and retailers of consumer products made in China should anticipate that the cycle of recalls, negative media coverage, and legal action will continue, at least for the next few years. The market and legal consequences can be catastrophic when a company’s product is recalled, but companies can take steps to reduce the possibility of recall through testing, quality control, and watching for warning signs. If a recall occurs despite these preventive measures, companies that create and prepare crisis management teams should be able to reduce the damage done by a recall. Finally, companies should realize that litigation is sometimes unavoidable. When this is so, a litigation defense team should work side by side with the crisis management team to strategize and prepare, so that the response of the crisis management team does not compromise the prospects for success in the litigation and to reduce the costs and risk of adverse judgments.