



GENERAL COUNSEL CORNER

By Peter H. Gunst, Esquire

No Shelter Behind a Chinese Wall

In the law, a “Chinese wall” is an artificial barrier created to protect someone from responsibility. For example, a law firm may erect a Chinese wall prohibiting communication between an attorney actively working for a client and another attorney who previously represented the client’s adversary as a defense against disqualification. Chinese walls, unfortunately, may afford scant protection in other contexts.

Recently, Foreign Tire Sales, Inc. notified the public and the National Highway Traffic Safety Administration that it had imported from China and resold in the United States nearly a half million light truck radial tires that were lacking an important safety feature – a .6mm gum strip designed to protect the tire from belt and/or tread separations.

FTS told NHTSA that due to its small size – FTS has only 13 full time employees – it did not have the financial ability to recall nearly a half million tires, and requested NHTSA’s assistance.

NHTSA was unmoved. It reminded FTS that, as an importer of motor vehicle equipment, it qualified as the tires’ “manufacturer” under The National Traffic and Motor Vehicle Safety Act, 49 U.S.C. Chapter 301. As a “manufacturer,” NHTSA emphasized, FTS was responsible not only to provide notice, but also to remedy the safety defect.

How did a company that does not even own a warehouse become a

“manufacturer” of Chinese tires? The Safety Act includes in its definition of “manufacturer” all persons who import motor vehicles or motor vehicle equipment for resale. Thus, a small importer was forced to step into the shoes of its foreign manufacturer and face all the legal consequences of a safety violation, including NHTSA enforcement actions and product liability lawsuits.

Recalling a half million tires is no small task. FTS’ attorney estimates that it will cost \$80 million to perform a full recall of the defective tires – ten times what FTS says it can afford to pay. And the costs do not stop there.

Under the Safety Act, FTS faces fines amounting to \$6,000 per violation of the Act and its regulations, with a maximum of \$16,375,000 in penalties. Because it is the “manufacturer,” FTS can be fined for failure to provide timely notice of a defect to NHTSA, and for failure to provide tire purchasers with timely and proper notice of or sufficient remedies for defective tires.

If a defective tire causes death or serious bodily injury, as is alleged in one case filed against FTS, criminal penalties may be pursued against any person who knowingly and willfully submitted false information to the Secretary concerning the defect. These include a substantial fine or imprisonment of not more than 15 years, or both. There is, however, a “safe harbor” provision protecting individuals who attempt to correct a falsification within a reasonable period of time.

There is no way to totally escape the high costs of recalls and product liability lawsuits because there is no way for an importer to completely ensure that the products that it resells are free from defect. But there are ways to decrease the risk.

Besides the obvious – complying with all safety regulations – importers who are too small to conduct continual testing of the products they resell might want to rethink their distribution channels. One of FTS' problems appears to have been its reliance on the Chinese manufacturer's testing.

Sellers of imported products must take special precautions. Daryl Allegree, manager of Risk Engineering for the Direct Underwriters business unit of Zurich, formerly known as Universal Underwriters, suggests that importers only do business with reputable companies that will provide proof of product liability insurance coverage. He cautions that the importer should pay close attention to the limits of such insurance.

Gary Cecil, Zurich's National Account Executive for its Direct Underwriters business unit offers these suggestions if you decide to import directly:

- Consult qualified legal counsel regarding the negotiations. Discuss with counsel your potential liability and how to obtain certifications of insurance.
- Negotiate and put in writing how you and the manufacturer will handle recall and warranty issues.

- Obtain a certificate of insurance from the manufacturer's liability insurance carrier that does a substantial amount of business in the United States. Have your insurance representative and qualified legal counsel review the certificate to ensure that the manufacturer has adequate limits.
- Obtain additional insured vendor's status on the certificate and get 30-day notice of any cancellation or non-renewal.
- Place the certificate in a dated file to follow up on 30 days prior to expiration.

Importers should learn from FTS' unfortunate situation. They have a legal duty to ensure the safety of the products that they sell, and that they must protect themselves as best they can against the unforeseen. They cannot hide between a Chinese wall.

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