

Product Liability as The Crucial Factor in The Risk Management

Małgorzata Maternowska

AGH University of Science and Technology, Kraków, Poland

The aim of this article is to point out that the product liability can be a tool of the risk control in case of damages in supply chains. Its significance is associated with the risk reduction through actions leading to the improvement of the level of product safety.

Keywords: risk, risk management, liability, product liability.

1. INTRODUCTION

Recently, in the area of supply chains management a brand new field of research has arisen which drew the attention of both theorists and practitioners, namely: risk management in supply chains. Two issues are a matter of interest.

First – a wave of crises and disasters. Natural disasters such as Katrina hurricane, which destroyed the American coast of the Mexican Gulf in 2005, terrorist acts such as the 9/11 strike in 2001, and epidemics such as SARS in south-east Asia in 2003 violently remind us that the world we live in is unpredictable and is becoming less stable.

Second – growing susceptibility to disruption in supply chains. In the last ten years nearly each branch of industry has experienced negative effects of globalization and had to face increased competition inside the business area. These changes provoked aiming at the improvement of effectiveness and adjustability of internal and external business processes, e.g. through *outsourcing* and *offshoring* of production as well as research-and-development, acquiring supplies in cheap labour force countries, stock reduction etc.[2],[5],[7]. Although such modifications to the supply chain model can lead to the improvement of operations executed, they at the same time cause a

growing susceptibility of the supply chain to disruption[3].

At first it appears obvious that enterprises are strictly obliged to face the risk in supply chain. However, one must take into consideration the fact that risk management, most often regarded as the taking of particular actions in order to reduce¹, disperse and use risk, is of a high price. This action is justified, when the risk directly is threatening the achievement of the basic objectives and the function of the given enterprise. Minimizing thus defined risk is, partly economical, technical, and partly ethical issue as it concerns independence and responsibility in the decision making processes.

2. RISK AND LIABILITY – TWO SIDES OF THE SAME STORY

The notion of risk is an ambiguous term, therefore it is most difficult to find one strict definition, quite useful in the analysis of various system conditions. In its most general meaning, risk is a venture whose result is unknown,

¹ reducing the probability of occurrence of disruption and/or reducing its effects.

uncertain² (risk as taking actions with imponderable effects; conation) or the likeliness of failure (risk as the opposite of possibility: the probability of negative occurrence³, the product of the probability and volume of a failure). It is integral with independence and choice making. With regard to freedom, independence refers to free choice of values and means the possibility of realizing one's objectives. It is acceptable under the condition that one maintains satisfactory accuracy in the decision making process regarding actual activity or its abandonment and thus avoiding interference with somebody else's justified interests. In case of a wrong decision it brings responsibility. In this sense liability and risk are two sides of the same issue. In creating the rules for liability one also determines the acceptable risk.

The aim of this paper is to point out that product liability can be a tool of the risk control in case of damages in supply chains. Its significance is associated with risk reduction through actions improving the level of product safety (security features).

3. LEGAL LIABILITY

The Dictionary of Polish defines 'responsibility' as: (1) a moral or legal obligation to be liable for one's own or somebody else's actions, and (2) obliging oneself to show concern for someone or something. Thus, responsibility is a state of certain duty. Whereas obligation is conditioned by an objective: something constitutes an obligation because it presents the means of achieving a goal and is a decisive factor in its realization.

By law one understands a set of standards established or accepted by the state, pointing out to the subjects the regulations for due proceeding. Legal norm as a model for due proceeding defines and determines the extent of liability. The function of the system of legal norms in each sphere is to

² As such it will always accompany progress and actions associated with exceeding present material, social and symbolic.

³ E.g. risk as a probability that a particular danger will be the result of susceptibility of a supply or a group of supplies resulting in losses in or destruction of supplies.

guarantee 'social harmony' by means of value realization⁴. It follows that law is a function of objective, which is the pursue, through particular imposed regulations (norms, standards), to shape proper conditions of social life (e.g. ensuring safety⁵).

The analysis of legal aspects of a liability can lead to the assumption that each person is responsible before the law only for that aspect of one's actions which affect others. Within supply chains, liability is conditioned with regard to customer protection law⁶. This law implies a necessity to determine responsibilities and the extent of a business liability, i.a. product liability⁷. The extent mentioned is, in practice, marked on the basis of one of three theories.

First, named a *contractual theory*, admits that fundamental value is the freedom of contracting. Producers are both under legal and moral obligation to offer only such products which do not constitute a safety threat. A balance of power

⁴ Values are criteria of something desirable, irrespective of tangible situations, defined in norms. Same value can be a benchmark for many substantial norms; a particular norm can express simultaneous use of many different values. Therefore, values as criteria to decide on that which is desirable constitute the basis and the measure of accepting or rejecting of certain standards.

⁵ recognized in general as certainty (...), which can be viewed in three aspects: subjective, as certainty of existence and endurance, sustained in the absence of serious threats as well as in the subjective and process aspect, as certainty of essential development and activity conditions, as well as certain conditions for satisfying basic needs (values) as well as defending against their loss now and in the anticipated future [4]

⁶ Occurring in supply chains, cultural differences, varying levels of applied technologies, as well as objections to share full information on dangerous features of products and the safety methods of their use, facing both increasing rate of product and process advancement as well as profit orientation, have increased the risk of various errors occurring already at the stage of product design, during production and monitoring processes. Modern technologies of manufacturing and products delivery have appeared to be profitable as well as dangerous, often causing serious threats.

⁷ To put it simply one could assume that this definition refers to creating producer's responsibility for damages caused by a product with dangerous features.

between partners is assumed (supplier - recipient), business partners equally share responsibility for their individual commitments, however only intra-contractual.

Second theory on product liability is defined as *due care theory*. This theory applies to products, the use of which inclines, possible threats⁸. Hence, as the producer's responsibilities exceed contractual settlements he is guilty of negligence and is liable in the case of due care neglect⁹.

Third theory is known as *strict liability rule*. It claims that the producer is responsible for all the damage caused by the product, even though he followed the due care procedures as well as any legal and regulations and obligations. The deciding factor is the dangerous product reaching the consumers.

In accord with the above-mentioned regulations for shaping the extent of responsibility, two fundamental kinds of liability are associated:

- Legally enforced liability, so called *ex contractu* – a civil-legal liability for a failure or undue completion of a duty, following any legal acts (i.e. contract, administrative decision, or civil injury)
- A liability enforced by social expectation, so called *ex delicto*, which results from: emergence of the damage, a commitment of a tortious act, a causal act between the damage and the tortious act, a perpetrator's guilt.

As with the *ex contractu* liability, the infliction of damage succeeds within the present liability relation, hence the subject liable for damage is

⁸ According to the due care theory, producers are principally responsible for their actions, most especially for those which have caused any damage. The damage itself caused by the product cannot result in bringing the producer to account. Pursuant to this, one must point out the negligence of the producer which in effect can be difficult.

⁹ Due care is determined with regard to the professional character of a business activity (it. 355 § 2 civil law code). The criterion for due care is the objective measure, relating to anybody in a defined situation, determined by standards such as: community life, legal norms, profession regulations, practices etc.

directly known, so with the *ex delicto* liability the subject liable for damage still remains to be recognized.

4. PRODUCT LIABILITY – PREMISES

The premises for product liability are based on general regulations for liability in tort [9]. A **tortious act** consists in this case in the placement on the market dangerous (as a result of the imperfect performance) product, when the defectiveness has become the cause of personal or material damage. Defectiveness is recognized as the absence of due safety, expected with the regular use of a product - it. 449 § 3 civil law code. The resulting damage¹⁰ is therefore the effect of insufficient product safety. Safety estimation requires regular monitoring of recipient expectations (consumer) and maintaining the balance between the interests of the sides (aggrieved and liable)¹¹.

Product liability burdens professional subjects who, according to their professional activity, launch a product on market. Besides the producer, the group comprises of manufacturers of materials, composites and components of the final product as well as, so called *quasi*-producers (claiming producers, placing their name on a particular product¹²) and import dealers who are obliged with the 'producer liability'. Each of those subjects

¹⁰ By damage (personal and material) one defines detriment to the present and the prospective asset, affecting the aggrieved party contrary to his will. The damage is determined by the difference between two financial situations: that after the damage had been inflicted, and the one that would have existed if the damage had not been caused. Property damage consists of two items: (1) loss – a significant detriment decreasing the asset of the aggrieved party, (2) lost profit, which is benefit, the aggrieved party would have acquired if the damage had not been inflicted.

¹¹ Here emerges, noticeable with 'construction fault', a crucial problem referring to the issue of informative obligation. It is a matter of balancing both the producer's as well as the product user's interests (accessibility of information on existing threats, with no 'discouraging' of a potential buyer).

¹² Examples of quasi-producers are large distribution networks which label products manufactured by no-name cooperators.

participates in the manufacturing process or in 'forwarding' the product into a next cycle. In this sense one could speak of legally warranted liability of 'supply chains'.

According to the due care theory, producers are liable to undertake every means of precaution to protect the recipient against any harmful effects resulting from product usage. Apart from anticipating any possible misuse of a product and striving to prevent resulting effects, the producers are also obliged to avoid the misapplication being suggested in any way in marketing or advertizing. The analysis of the issue from the duty perspective, which must be met by the producer so that the due care is present, suggests that it refers to a very broad time-span and holds the producer liable at various stages of product lifecycle, starting with design, through manufacturing process until product distribution. Taking that into consideration, one can distinguish four main 'fault' areas of a producer¹³: construction, production, instruction and overlooking [9]¹⁴:

1. Construction fault. Undue care may occur at the first stage of product creation. It occurs when dangerous features of a product (machine) are the result of design errors, misconception, and wrong production specifications. The

¹³ The producer is subjected to risk liability. It is a fault free liability. If somebody is taking benefits from a business activity, should incur risk with this activity tied and should be responsible for damages from here arising. (according to the principle *cuius commodum eius periculum*). In other words, profit gaining should not overshadow the producer's regard for the effects of a business activity.

¹⁴ It is reflected in establishing the subject matter of detailed trade recommendations on the producer's liability. E.g. in Engineering Directive 98/37/EU, in the section on Conformity Assessment Procedures, we find that just in the process of the machine design, the producer should estimate the potential risk in all phases of the operation of a machine and as a result of the conducted risk assessment he should decide what proper action one should take in order to (a) eliminate or ultimately reduce the risk through a failsafe design solutions, (b) totally reduce the remaining risk through the application precautions described in fundamental requirements of the health and safety care, (c) convey information concerning every remaining danger and, within their extent, define requirements concerning operating, training, monitoring, personal protection equipment etc. Cf. [8]

producer's fault lies in initiating the manufacturing of a rough device which has not been properly tested and researched.

2. Production fault. It refers most often to the irregularities in the production process and its monitoring. It usually evinces in the use of inadequate materials.
3. Instruction fault. The producer is obliged to ensure a safe use of the product. Due care at this stage demands the inclusion of adequate product instructions concerning its proper use, providing information regarding dangers connected with the appropriate use of a product, as well as the consequences of improper product usage. Furthermore, it is also essential to inform of a product's indirect danger and the manners of preventing its occurrence. Significant is the fact that the warning of danger does not discharge the producer from liability, unless it is supplemented with potential precautions.
4. Overlooking. Determined by a failure to observe a product on the market and a lack of respond to any occurring irregularities.

Another premise is the presence of causality between the damage and the tortious act. With regard to product liability this notion is not explicitly interpreted. However, it is significant for it is the aggrieved party who is hindered by the cause and effect relation between the adverse occurrence (hazardous features of a product) and the damage. As stated by F.J. Mohmand: 'the source for unconformity is the formulation of item 449 §1 civil code law. This regulation presents the premise as a cause-effect relation between the anticipated absence of safety and the damage' [9]. Hence, some distinguish producer's fault in the absence of safety, whilst others assert that for the product liability to occur it is crucial for the damage to relate causally to the launching of a dangerous product onto the market. Such a cause-effect relation has a two-stage structure. A supporter of such an approach is E. Łętowska who agrees that admitting a dangerous product on the market 'creates an emergency which at certain point (second stage of relation) results in a damage' [quoted for 9]¹⁵.

¹⁵ It acquires a particular meaning with rapid industrial and technological improvement which implies repeatedly new threats exceeding prior establishments. It leads to the con-

5. LIABILITY – RISK MANAGEMENT

Main functions of product liability can be discerned in its compensative, preventive and distributive influence [1],[9], hence:

- compensative function of product liability consists in ensuring indemnity in case of incurred loss for the aggrieved party;
- preventive function is realized through protecting sales participants against any future damage;
- distributive function is based on a certain 'collectivization' of damage by spreading the risk of a loss and its financial consequences over a wider group of people.

Consideration of the product liability issue in analyses of detailed problems which involves a certain amount of risk in supply chains should enable to shape attitudes of the decision-makers, obliging them to take the *ex ante* action of the applied level of securities. It is assumed that a producer taking the liability regime into consideration will be trying to eliminate the risk of danger lying in the product. It results in paying more attention to the product quality (multi-storey inspection of the production), in reliability of informing recipient/users of the risk of wrong exploitation of the product, as well as it restrains from launching the product with no safe passage into the market. It should improve the situation of consumers. Therefore, the product liability can be a tool of the risk control in case of damages in supply chains.

In this sense one could speak of its beneficial influence on the reduction of professional risk [cf. 8]. On the other hand, product liability regime is regarded – particularly by the producers – as risk increasing¹⁶. In effect, the law neither diminishes nor increases the risk in supply chains, which is evidenced through conducted research, cf. [10], at

clusion that each new product is charged with a high risk of damage at the hands of the recipient. In this situation the legislator assumes the implicit cause-effect relation between product launch and the exposure of its dangerous features, therefore there is no need for the aggrieved party to prove it. A turning point in indemnification procedure is threat realization in the form of incurred damage, where examination of evidence is required.

¹⁶ The object for concern of contractors – risk principle in product liability.

most the risk is allocated (the incurred damage must in any way be redressed). General risk may however increase along with social chaos and anomie, whose indispensable feature is internally contradicting and exorbitant positive law¹⁷.

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¹⁷ Positive law (*ius positivum*) a law regarded most of all as – time and place conditioned – an act of a particular society, performed within the framework of a modern parliamentary democracy comprising legislative state agencies, political parties, non-governmental organizations and pressure groups.

