



LEGAL AND ETHICAL ISSUES RELATING TO PRODUCT RECALL

G. Karthick Velap* S. Mahalingam**

*MBA, CK College of Engineering & Technology, Cuddalore, Tamilnadu.

*HOD-MBA, CK College of Engineering & Technology, Cuddalore, Tamilnadu.

Abstract

Recall has been a familiar word in the west largely due to their strong legal framework and existence of various legal provisions that a citizen enjoys, some of the major recalls which have made headlines done by major global giants have taken place in the west. The paper aims to analyze the various customer centric legal and ethical issues relating to the concept of product recall. A product recall may be explained as a compulsory or voluntary action taken by an organization to pull back a product fully or in partial quantities from the supply chain or the end consumers or both, due to concerns regarding flaws in the product itself resulting in a health hazard/safety concern or operational deficiencies in the product. The paper aims to discuss how effective management of legal and ethical can lead to stronger customer loyalty and confidence, and finally to achieving brand equity and customer satisfaction.

Keywords: Product Recall, Legal Issues, Corporate Social Responsibility, Customer Loyalty.

Introduction

Recall generally is followed up by litigations; therefore the issue must be properly addressed with proper documentations to support your efforts for recall if challenged in the courts. It has to be kept in mind that a recall does not provides the company protection from lawsuits, there has been cases where companies are held liable due to an improperly conducted recall. Nowadays, corporate social responsibility is much talked about term. But when it comes to product recalls, a company should stand up to represent themselves as a corporate entity that is not only responsible for providing good quality products but also responsible for taking into consideration the safety issues, be it health related, environment related or ethics related. The company should be humble and ethical enough to stand up to accepting its mistakes and rectify them. A proper recall strategy formulation should therefore; also keep in mind that no action is taken or any circumstances are created that might make the company socially negligent in the eyes of the society.

Research Methodology

This research paper is mainly based on secondary data analysis. Various documents obtained were reviewed and analyzed.

The sources of secondary data were as follows:

- **Paper-based sources** – books, journals, periodicals, abstracts, indexes, directories, research reports, market reports, annual reports, published records of organizations, newspapers and magazines
- **Electronic sources**– CD-ROMs, on-line databases, Internet, videos and broadcasts.

Legal Issues Relating To Product Recall: Laws that govern the aspect of product and its specifications can generally be classified into the following

Categories

1. Product Safety rules enacted at the level of government. Sometimes these laws, called **statutes**, are enacted directly by a legislature.
2. **Regulations** are the rulings formed by the administrative agencies for promulgation and enforcement of safety guideline in the industries which comes under such agencies.



3. **Litigation** is sometimes seen as applying only to the aftermath of an injury, when prevention has failed, involving assessment and assigning liabilities and compensating the injured party. “However, litigation can serve as a powerful tool for prevention as well.

It has long been argued that transferring the cost of injuries through litigation, from the damaged person to the person or corporation who could have but did not prevent the injury, creates a motivation to invest in prevention rather than to pay the penalty of neglect.”

A company should recognize that significant product recalls are likely to generate a surge of claims and lawsuits, including any and all of the following types of litigation:

- Individual personal injury cases.
- Consumer class actions.
- State attorney general/regulatory investigations and cases.
- Securities and/or shareholder derivative actions.
- Inquiries and investigations by foreign regulators.

Apart from cases in India where there is absence of the legal framework which exists in the west and other European countries, it has been experienced that whenever there is a recall, there is likely to be litigation involved. ‘Just initiating a recall isn’t sufficient to insulate a company from liability. There are situations where companies are held liable because of an improperly conducted recall’ says Dave Wix, founder and managing partner of Wix Law Group. It is also noted that there is a real time correlation between media coverage of the recall and lawsuits against the product which is recalled. Thus within the ambit of strategizing a product recall due care should be given to the legal aspects and documentation of the process so as to have a sound defense ready for facing litigations.

In a case it was found that a distributor of electric kitchen appliances in U.S. received 23 complaints that a particular juicer model was dangerous and defective. The distributor estimated that 30,000 to 40,000 of these juicers had been distributed throughout the U.S. but did not report this fact or the number of consumer complaints to the CPSC (Consumer Product Safety Commission). After being specifically asked for a report by the CPSC, the distributor reported only the 23 complaints. Several months later, at the recall stage, the distributor was sued by the U.S. for violation of the reporting requirements. The distributor’s failure to report each potentially dangerous product sold or distributed for sale to consumers was a separate offense, bringing the total number of offenses to somewhere between 30,000 and 40,000.

Any company (and its management and board) should recognize that significant product recalls and associated problems are likely to generate a surge of claims and lawsuits. Typically, the number of cases and type of litigation claims will track factors such as the extent to which health issues or injuries have been (or can be) associated with the product, the publicity profile of the product problem, the size of the recall, the significance of the product in the company’s overall business, pre recall performance failures and related claims, and the perceived value of the recall remedy and relative difficulty in obtaining it.

In addition, no matter what the claim history or litigation relating to the product may be before the recall, there is likely to be a surge of cases in the weeks following any recall announcement, including the possibility of multiple, overlapping consumer class actions and shareholder suits. There is no “one size fits all” approach to defending product related lawsuits when a recall is in question. There are, however, some key concepts that can serve the company well in addressing the litigation.

1. There must be synchronization across the various types of legal action and across the geographic reach of the cases.
2. The company should try having one lawyer, or firm, directing the litigation response and a team structure with very focused responsibilities for all counsel who are involved in the defense effort.
3. The company should establish a protocol of priorities or steps in connection with the litigation.
4. Sometimes it is best to wait for the litigation to “stabilize.” Understanding the full scope of the litigation and having an informed appreciation of the real risks presented by the various cases are essential to establishing priorities, structuring the right total defense, and deciding on the best procedural steps.



5. It is important to decide as soon as realistically possible on the endgame for the litigation and to develop a proactive plan designed to maximize the possibility of achieving it.

Indeed, many important considerations come into play when contracting with suppliers of products and goods, particularly those manufactured abroad. Careful planning and appropriate contractual language can assist companies in managing and reducing the legal risks involved in such arrangements. Regular monitoring of supplier compliance with contractual provisions is another important ingredient in managing the risks presented by foreign supplier contracts. Reassessment and analysis of current supplier contracts can also help identify potential areas of risk concern as well as areas for future risks. It is essential that the relevant product quality specifications be spelled out in an appropriate fashion in any supply contract. Obviously, these specifications will vary in each individual circumstance, depending on the products or goods involved. Purchasers also can help ensure that the relevant quality and safety standards are met by requiring foreign suppliers to implement formal documented quality control programs. Expressly providing for periodic audits and inspections is another method typically used to help verify compliance with quality and safety standards. Appropriate indemnification provisions can be incorporated into supplier contracts indemnifying the purchaser from certain liabilities that arise from the supply of products that are subject to a recall.

It should also be noted that any business with a product that has been recalled, or threatened with recall, should address a number of issues regarding its insurance. It should identify all insurance policies that may provide coverage for all or part of its expenses, potential liability, and costs of defense. It should analyze those policies to determine their scope of coverage. Finally it should provide notice to its insurers. It should take care not to prejudice or compromise its insurance rights in its dealings with other entities also involved in the recall. Experienced counsel can assist clients in assessing their insurance situation and providing appropriate guidance with respect to coverage decisions. It is essential that the policyholder conduct a careful canvass of its current and past policies to identify the policies that may provide such coverage during a recall. Foreign supplier contracts may also contain provisions requiring suppliers to maintain insurance policies to insure against specific contingencies and containing specified minimum coverage limits.

The legal structural framework of the country also affects the recall process. In India, as it stands, most companies opt for product liability insurance that insures their liability against third party claims and bodily injuries. But they tend to overlook the recall cover that protects them against recall costs, consultancy fees, lab expenses, re-work and replacement costs, plus brand equity loss in case of a defective product. Over the last decade, US based FDA has triggered several recalls in the food and pharmaceutical industry as witnessed in the cases of Indian companies SUN Pharmaceuticals and RANBAXY.

Laboratories. In recent time's carmaker, Maruti Suzuki too faces a similar situation when it had to recall 100,000 A-Star cars faulty parts. The product recall insurance, which was introduced in the Indian market as an extension under the product liability insurance, has evolved as a standalone product over the years. General insurers say the new recall liabilities arising from pollution and transportation has given rise to the never comprehensive general liability policy that has practically replaced the traditional model of the product liability cover with extension for recalls. "There is also a demand for loss of stock due to recall. The product contamination cover which has its genesis in the food and beverage industry-chocolates and colas- has also triggered the demand for this cover," says R.K.Kaul, Chairman and M.D. of Oriental Insurance. General insurance companies are now selling different types of recall covers namely first party and third party. In India, demand is primarily for the third party recalls.

Unlike many other countries, product recall policy is at a nascent stage in India with consumers unaware of the rules and regulations. China for example, has an explicit policy on safety linked recalls. In fact the regulations in China are strict enough to even lead to prosecutions. In the case of SANLU Group, it had to withdraw all its milk products from the shelves after a deadly contaminant was found in them. Eventually the company was wound up. Such instances are rare in India as there are no specific rules pertaining to safety related product recalls. The government



cannot force any company to recall any faulty product without intervention of courts. Only in the case of food and nutrition products can the government ask the manufacturers to take them off the shelves for health reasons. Otherwise, product recall, by and large, is a voluntary act in India. The legal fraternity in India concentrated on securing relief to individual rather than addressing the issue through mass lawsuits, as is the practice in many developed countries. There is a need to bring in strong legislation to enforce product recalls as companies in cases of manufacturing defects or safety issues. In the US, the federal regulatory agencies can order product recalls for safety reasons. Agencies have specific product mandates, such as Consumer Product Safety Commission is responsible for toys and household products, Food and Drug Administration mandates medical devices and drugs, National Highway Traffic Safety Administration oversees cars, trucks and automotive equipment and the Department of Agriculture monitors meat and poultry products.

Product safety, if ignored, can be devastating for any company's image as well as earnings. Toyota's car recall is one such instance that attracted worldwide attention. From the automobile recall in 1959 when Cadillac cars with weak steering linkage were called back, many well known consumer brands have recalled their products due to faulty products or parts. They include, Ford, Sony, Dell, Apple, Toshiba, Lenovo, Hitachi, Fujitsu, Sharp and Sanyo. These companies had recalled products from many countries where the law protects consumer's interests. 'Companies do not recall products in India while recalling the same in developed countries'. It is imperative that the Indian government introduces appropriate rules to ensure that consumers are not discriminated against their counterparts in developed nations. The Indian Consumer Protection Act, 1986, does not contain any provisions for product recall and consumer products in India are sold with a Guarantee or Warranty limiting the extent of liability of the seller to mere replacement of the product with a new one or removing defects in the product. While the law obligates the seller to address each aggrieved consumer on a case-to-case basis, there is no provision for a recall of an entire range that may be defective, faulty or unsafe. The provision contained in Section 14 of the Consumer Protection Act, 1986, grants the consumer the right to only receive the value of the products purchased, along with any damages suffered as a consequence of use of defective products. In USA, the CPSC and FDA provide 24 hour helpline for consumer to register complaints, posting of recalled brands and names on the website and also let the consumer check the track records of a company.

China for example, has an explicit policy on safety linked recalls. In fact, the regulations in China are strict enough to even lead to prosecutions. A year ago, the Sanlu Group had to withdraw all its milk products from the shelves after a deadly contaminant was found in them. Eventually, the company was wound up. Such instances are rare in India as there are no specific rules pertaining to safety related product recalls. The government cannot force any company to recall any faulty product without intervention of courts. Only in the case of food and nutrition products can the government ask the manufacturers to take them off the shelves for health reasons otherwise, product recall, by and large, is a voluntary act in India. It is imperative that the Indian government introduces appropriate rules to ensure that consumers are not discriminated against their counterparts in developed nations. The Indian Consumer Protection Act, 1986, does not contain any provision for product recall, and consumer products in India are sold with a guarantee or warranty limiting the extent of liability of the seller to mere replacement of the product with a new one or removing defects in the product.' Though relief can be sought individually through courts in certain cases but again the problem of prolonged legal process involved in itself is a factor that discourages people to take a step towards it.

The article entitled "Total Recall: product liability in India" published in the Economic Times on 25 Apr, 2010 throws a more detailed spotlight on the issue of product recall in India "Even as more Indian manufacturers exporting goods to the overseas markets opt for the product recall insurance plan, insurance experts say the time has come for India Inc to look at this policy as a 'risk management tool' and not as a mere obligation. "Given the legal framework in India, there are limited damages slapped by consumers on to the manufacturers," feels Shashwat Sharma, director at KPMG Advisory Services, adding that "the product has a great future with the consumer market becoming more sensitive to safety standards and regulatory provisions more stringent." In India, If the defect is a recurrent phenomenon in a multiple number of products, the manufacturer is duty-bound to recall it. But manufacturers in India often get away with not doing it because few consumers bother to take them to court as



litigation can be expensive and long drawn out. Lack of awareness is another reason why few consumers take manufacturers to court. Consumer activists believe there is now a need for a Consumer Protection Safety Authority, on the lines of organizations that exist in Western nations, and a fast and effective legal redressal process to help resolve cases where manufacturers do not recall defective products voluntarily.

Consumer Protection Act 1987 (“CPA”): Liability Under Part I of The CPA

The CPA introduced statutory liability for defective products. Liability under the CPA exists alongside liability innegligence. The CPA applies to both products used by consumers, and products used in a place of work. It imposes strict liability on manufacturers of defective products for harm caused by those products. This means that people who are injured by defective products can sue for compensation without having to prove that the manufacturer was negligent. It is merely necessary to prove that the product was defective, and that any injury or damage was most likely caused by the product. A ‘product’ can include goods, electricity and the component parts of any product. Where a component of or raw material incorporated into a finished product is defective, both the manufacturer of the component and the manufacturer of the finished product are potentially liable.

A product is defective for the purposes of the CPA if its safety, including not only the risk of personal injury but also the risk of damage to property, is “not such as persons generally are entitled to expect”. A product will not generally be considered defective just because a safer version is later put on the market. In assessing the safety of the product, the Court will take into account all of the circumstances, specifically including:

1. all aspects of the marketing of the product;
2. The use of any mark in relation to the product;
3. Instructions and warnings;
4. What might reasonably be expected to be done with the product at the time the product was supplied.

Further, the Court will also take account of the ‘state of the art’ at the time of supply. Under the CPA, the ‘producer’ of a product is liable for any defects.

Corporate Ethical Issues in Product Recall

Corporate Social Responsibility (CSR) is defined as the voluntary activities undertaken by a **company** to operate in an economic, social and environmentally sustainable manner. The marketing ethics is the area of applied ethics which deals with the moral principles behind the operation and regulation of marketing. Practicing ethics in marketing means deliberately applying standards of fairness, or moral rights and wrongs, to marketing decision making, behavior, and practice in the organization. Some organizations practice the theory of ‘Due Care’. The Theory “Due Care” to Customers: Due care theory involves:

1. Design - products and services should meet all governmental regulations and specifications and be safe under all foreseeable conditions, including misuse by the consumer
2. Materials – materials should meet governmental regulations and durable enough to withstand reasonable use.
3. Production – products should be made without defects.
4. Quality control – products should be inspected regularly for quality.
5. Packaging, labeling and warnings – products should be safely packaged, should include clear, easily understood directions for use, and should include a clear description of any hazards.
6. Notification – manufacturers should have a system in place to recalls products that prove to be dangerous at some time after manufacture and distribution.

An example to quote for ethical responsibility could be of Nestle’. Nestlé has found itself in hot water in India after the local food safety regulators said the company’s instant noodles contained unsafe levels of lead and traces of monosodium glutamate (MSG), contrary to the food’s labeling. Nestle introduced instant noodles to India, where noodles were not previously part of the culinary culture and instant food was not common. An aggressive advertising campaign with a catchline of “two-minute noodles” proved so effective that Maggi became the breakfast of choice for parents struggling to get their children ready for school in the morning. The first sign of trouble emerged on 30 April this year when the local food safety regulator in Lucknow, the capital of the most populous



state of Uttar Pradesh, demanded the company recall a batch of Maggi noodles. The regulator said it found dangerous levels of lead and traces of MSG – Maggi labels claim no added MSG– in samples tested in its lab. This was the Nestlé’s first mistake was to underestimate the size of the problem. It kept quiet for almost three weeks after the recall order. The company issued the first press release on 21 May admitting it had received a recall order. The press release stated: “The Company does not agree with the order and is filing the requisite representations With the authorities.” It added: “People can be confident that Maggi Noodle products are safe to eat.” Alarmed by the public anger, several states ordered tests and started issuing bans on the sale of Maggi noodles. It had become a full-blown crisis by the first week of June. Nestle says it has recalled 27,000 tonnes of Maggi noodles, making it the country’s largest food product recall. The only pleasant side of the recall is that Nestle is incinerating the packets in cement factories to convert the waste into energy, a relatively environmentally friendly way of destroying the unwanted stocks.

Consumers increasingly don't accept unethical business practices or organizations who act irresponsibly. Advances in social media (giving everyone a voice) mean that negative or destructive practices quickly fuel conversations online. Organizations are accountable for their actions like never before.

Conclusion

It can be stated that it is very important for companies to address the legal and ethical issues relating to product recall. With the changing times and changing role of customers it is very important to handle the cases of recalls for a successful functioning of the business firms.

References

1. Burke D. (2012), Product recall- The Developing Story, A Caltin Group Limited Report, April 2011, Pg 1-21.
2. Rengan P.K. & Sriprada KS (2009), Product traceability and Recall Planning, Wipro Technologies Report, Pg 1-13.
3. Nicole J. Kaplan (2007), analyzing the Recent Recall of Chinese-Made Products: Understanding the Problems and Creating Effective Solutions, Business law Brief, Pg 39-43.
4. Smith L.(2011), Understanding the Effectiveness of Public Relations Strategies Used During Consumer Product Recalls: A Case Study and Content Analysis Examination of Mattel’s 2007 Recall Strategy, Research Paper, Ball Street University, Muncie, Indiana, Pg 1-58.
5. N. Craig Smith, Robert J. Thomas, and John A. Quelch, (1996), A Strategic Approach to Managing Product Recalls, The Magazine, Harvard Business Review.
6. McFarland A. (2010), Toyota Recall: Better to Lose Profits and Save Face, Money Watch, Feb 1, 2010
7. Wathen A. T. (1987), the Case against Corporate Crime, Multinational Monitor, Vol 8, No. 5.
8. Yubo Chen, Shankar Ganesan, & Yong Liu (2009), Does a Firm's Product-Recall Strategy Affect Its Financial Value? An Examination of Strategic Alternatives during Product-Harm Crises, Journal of Marketing, Volume 73, Number 6, November 2009.
9. http://www.telegraphindia.com/1110801/jsp/atleisure/story_14316116.jsp.
10. <http://economictimes.indiatimes.com/features/special-report/total-recall-product-liability-inindia/articleshow/5854623.cms>.
11. <http://economictimes.indiatimes.com/topic/Consumer-Product-Safety-Commission>.
12. <http://www.autoproductsfinder.com/APFCONTENT/coverstory/automotive-recall-comes-to-india.php>.
13. http://www.cbsnews.com/8301-505125_162-39040715/toyota-recall-better-to-lose-profits-and-save-face/.
14. <http://www.pitmans.com/news/article/defective-products-and-product-recall-issues-for-businesses>.
15. Davidson, Wallace and Worrell, & Dan, L., (1992). The Effect of Product Recall Announcements on Shareholder Wealth, Strategic Management Journal, 3, 467-473.