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Managing Supply-Chain Risks Post Goodyear, McIntyre

Law360, New York (July 18, 2011) -- On June 27, 2011, the United States Supreme Court announced two decisions that clarify and limit the ability of plaintiffs, including corporate plaintiffs, to pursue products liability suits against foreign manufacturers in state courts under a stream-of-commerce theory of jurisdiction.

In *Goodyear Dunlop Tires Operations SA v. Brown*, No. 10-76, slip op. (U.S. June 27, 2011), and *J. McIntyre Machinery Ltd. v. Nicastro*, No. 09-1343, slip op. (U.S. June 27, 2011), the Supreme Court held that state courts could not properly exercise personal jurisdiction over foreign manufacturers that had not engaged in conduct that directly targeted markets in the forum states.

The Supreme Court's decisions in *Goodyear* and *McIntyre* have the potential to limit the liability of some U.S. corporations, but these decisions could expand the liability of others. For example, domestic corporations with foreign affiliates that engage in manufacturing may benefit from more limited exposure to product liability claims.

In contrast, some domestic companies may incur increased product-liability risk because injured plaintiffs cannot sue foreign suppliers or manufacturers of defective or dangerous products in the U.S. Likewise domestic companies may lack a U.S. forum in which they can enforce indemnification agreements.

In light of these two Supreme Court decisions, companies that do business with foreign suppliers should have renewed focus on how they manage the product-related risks of their foreign supply chains. In addition, companies that operate foreign divisions or have foreign subsidiaries should consider how these decisions affect their own potential for supply-chain liability.

The New Limits On Personal Jurisdiction Over Foreign Manufacturers

The Supreme Court consistently has held that a state may constitutionally exercise personal jurisdiction over a foreign entity under two jurisdictional doctrines: the general-jurisdiction and the specific-jurisdiction doctrines. Under the general-jurisdiction doctrine, a court has personal jurisdiction over a foreign company if the company has "continuous and systemic" contact with the forum state such that the forum state is analogous to a "home" state. *Goodyear*, slip op. at 2. Under the specific-jurisdiction doctrine, a court has jurisdiction over a foreign company based on issues or controversies arising out of an activity or occurrence in the forum state. *McIntyre*, slip op. at 6.

The court's recent decisions in *Goodyear* and *McIntyre* make clear that both jurisdictional

doctrines require the foreign defendant to have directed a course of conduct at the society or economy of the forum state, and not merely to have foreseen that its products could end up there. In *Goodyear*, the Supreme Court reaffirmed that state courts do not have general jurisdiction over foreign subsidiaries that lack continuous and systemic contact with the forum state.

In this case, two American teenagers died in a bus accident in France, allegedly because of a defective tire designed, manufactured and sold by three of Goodyear USA's foreign subsidiaries. The teenagers' parents sued Goodyear USA and its three foreign subsidiaries in North Carolina state court. The foreign subsidiaries' only contacts with North Carolina were based on occasional sales of custom-ordered specialty tires that constituted a tiny fraction of their worldwide sales.

The plaintiffs asserted, and the state court agreed, that North Carolina state courts could exercise general jurisdiction over Goodyear USA's foreign subsidiaries because some products that the foreign subsidiaries made overseas entered North Carolina through the stream of commerce and because the subsidiaries had labeled the tires consistent with American standards. Based on these facts, the state court concluded that the foreign subsidiaries had a "continuous and systemic affiliation" with the forum state, justifying the application of general jurisdiction over the subsidiaries.

In a unanimous decision, the Supreme Court held that the foreign subsidiaries' contacts to North Carolina were "an inadequate basis for the exercise of general jurisdiction." *Goodyear*, slip op. at 3. The court pointed to the fact that the foreign subsidiaries were not registered in North Carolina; had no place of business, employees or bank accounts there; did not manufacture or design the product there; did not advertise the product there; did not solicit business there; and did not directly ship their products there. The court held that the placement of a product into the stream of commerce alone is not sufficient to support a state court's exercise of general jurisdiction.

In *McIntyre*, which the Supreme Court decided on the same day, a majority of the court emphasized the "purposeful" component of its prior holding in *Hanson v. Denkla*, that "the exercise of judicial power is not lawful unless the defendant 'purposefully avails itself of the privilege of conducting activities within the forum State.'" *McIntyre*, slip op. at 2 (quoting 375 U.S. 235, 253 (1958)).

In *McIntyre*, a British manufacturer made scrap-metal machines that it sold in the United States through a single distributor. The plaintiff's employer purchased one of these machines after seeing it at a Las Vegas trade show where the U.S. distributor and the foreign manufacturer had side-by-side booths. The plaintiff lost his fingers using the machine while working at his employer's location in New Jersey, and he sued the foreign manufacturer in New Jersey state court alleging that the product was defective.

Although the Supreme Court did not have a single majority opinion, six justices joined opinions that concluded that the New Jersey state court could not exercise personal jurisdiction over the foreign manufacturer under the facts presented.

A four-justice plurality relied on several factors to find that although the foreign manufacturer intended to sell to the U.S. market, it did not purposefully avail itself of the market in the forum state. Those factors include: None of the trade shows attended by the manufacturer's employees were in the forum state; at most four of the manufacturer's machines ended up in the forum state; the manufacturer had no office, property or employees in the forum state; and the manufacturer never paid taxes in the forum state.

Based on these factors, the plurality found there were insufficient contacts with the forum state to allow the New Jersey state court to assert specific jurisdiction.

Two justices concurred in the ruling that, under the court's prior precedents, specific jurisdiction did not exist under the facts presented. The four-justice plurality, however, announced that they would go farther. The plurality opinion thus stated that, even if it was foreseeable that a product placed in the stream of commerce ultimately would end up in New Jersey, foreseeability alone was insufficient to establish specific jurisdiction. "The plurality emphasized that 'it is the defendant's actions, not his expectations, that empower a State's courts to subject him to judgment.'" *McIntyre*, slip op. at 8.

Accordingly, the plurality opinion articulated a general rule that personal jurisdiction turns on "whether a defendant has followed a course of conduct directed at the society or economy existing within the jurisdiction of a given sovereign, so that the sovereign has the power to subject the defendant to judgment concerning that conduct."

Three justices dissented, stating that the foreign manufacturer had purposefully marketed the product in the United States with the intent that the product would be sold in any of the 50 states. The dissenting record in this case established the necessary connection to New Jersey to justify the state court exercising personal jurisdiction over the foreign manufacturer.

Managing Supply-Chain Risks in a Post-Goodyear, Post-McIntyre World

Goodyear and *McIntyre* increase the risk to domestic companies that they will be unable to pursue foreign suppliers in American courts. These cases can create particular risk for companies that import supplies or products from companies located in jurisdictions that are unfriendly to corporate plaintiffs or are hostile to lawsuits brought in their courts by foreign companies or citizens.

For instance, it is difficult for American companies to sue Chinese companies in the Chinese courts. As a result, companies that do business with foreign suppliers should recognize that the Goodyear and *McIntyre* cases increase their risk of being unable to seek compensation, though tort or contractual indemnities, from those foreign entities. American companies can mitigate the enhanced risks that Goodyear and *McIntyre* create by taking a hard look at their own risk-management and insurance strategies.

By taking steps now, American companies can boost their chances of weathering a product liability event caused by a defect in a product supplied by a foreign entity.

1) Include consent-to-jurisdiction clauses in indemnification contracts.

The court in Goodyear and *McIntyre* noted that a foreign manufacturer can expressly consent to a state court's exercise of personal jurisdiction, and that such consent-to-jurisdiction clauses may be enforceable. Because many American companies rely on contractual indemnities to protect against the risks of supply-chain-caused product liability claims, those companies should include in their contracts unambiguous consent-to-jurisdiction clauses that make clear that the foreign manufacturer consents to personal jurisdiction in the American company's home court.

2) Require foreign suppliers to include the domestic company under additional insured

clauses in the foreign suppliers' insurance program.

To protect against potential losses, domestic companies should require their foreign suppliers to designate them as an additional insured on the foreign suppliers' insurance policies. With this provision, the foreign suppliers' insurance will cover the domestic company as though it were insured under the policy, subject to the terms and conditions of the policies. Such protection can allow a domestic company to pursue the foreign entity's insurance directly, sometimes avoiding the need to pursue the foreign entity altogether.

American companies, though, should understand the limitations of additional-insured protection. For example, it is important that the foreign entity's insurance company itself either consents to personal jurisdiction in an appropriate domestic forum or has contacts with a domestic forum sufficient to establish personal jurisdiction.

Otherwise, the American company still may fall afoul of the jurisdictional limitations imposed under *Goodyear* and *McIntyre*. Similarly, American companies should conduct sufficient due diligence to understand the limitations of the coverage provided under the foreign supplier's insurance policies, and American companies should be prepared to supplement that coverage as needed.

3) Review your company's own insurance policies, and consider additional protections to account for the increased risks.

Because *Goodyear* and *McIntyre* increase the risk that domestic companies (and injured plaintiffs) will be unable to pursue foreign suppliers in U.S. courts, American companies should recognize that they may need to rely more heavily on their own insurance policies and other risk-spreading tools for compensation. Accordingly, domestic companies should review their insurance portfolios to confirm that the coverage is sufficient in scope and quantity to address product liability claims arising from foreign manufacturer's products.

4) Be aware that the mere existence of a U.S. parent company or U.S. distributor may be insufficient to establish personal jurisdiction over a foreign corporation.

Goodyear and *McIntyre* make clear that the mere existence of a domestic parent company or distributor may not be sufficient to allow suit to go forward against a foreign corporation. Without either "continuous and systemic" affiliation with the forum state, or "purposeful availment" of the laws and privileges of conducting business in the forum state, state courts may not have jurisdiction.

Goodyear and *McIntyre* leave open, however, the possibility that a court could pierce the corporate veil for jurisdictional purposes, thus exercising jurisdiction over a foreign entity based on its corporate affiliation with a domestic company.

In the *Goodyear* case, the court stated that it did not consider this single-enterprise theory because the plaintiffs did not make the argument in a timely fashion and therefore waived it. Under a single enterprise or unitary business theory, a plaintiff would argue that a U.S. parent company and its foreign subsidiaries essentially are a single entity. If the court accepted this argument, it could justify jurisdiction over the foreign subsidiary in a domestic court.

5) Consider how Goodyear and McIntyre affect the potential liability of foreign divisions or subsidiaries.

Because Goodyear and McIntyre create the possibility that foreign subsidiaries of domestic companies may not be subject to jurisdiction in the U.S. absent conduct targeted at the economy of a particular state, some companies that have substantial product-based operations in foreign countries may structure their foreign operations in a manner that limits their exposure to state court product liability claims.

For instance, companies might focus on whether their foreign corporate subsidiaries are engaged in activities that will expose them to jurisdiction under Goodyear or McIntyre, and they may take steps to limit or eliminate any such activities. Such companies might attempt to protect themselves by using an American distributor rather than using the foreign subsidiary itself to distribute products in the United States.

Companies that utilize foreign divisions also might seek to incorporate those divisions in foreign countries to avoid personal jurisdiction. Domestic companies doing business with foreign divisions or subsidiaries of other American companies should be aware of the types of efforts that their supply-chain partners might attempt to use to limit jurisdiction and avoid liability for allegedly defective products.

It is not yet possible to predict accurately what practical effect the Goodyear and McIntyre cases will have on the daily operations of domestic companies working with foreign manufacturers. What is certain, though, is that domestic plaintiffs will have to demonstrate that a foreign manufacturer engaged in a course of conduct that targeted a forum state's economy to sue that manufacturer in a U.S. court.

American companies can mitigate the risks associated with the Supreme Court's changed jurisdictional doctrines by carefully reviewing their risk-management strategies and tools.

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