

*Central & Eastern European
Automotive Forum* & Bird & Bird

*Dealing with OEMs successfully in contract negotiations and
recourse claims for serial defects/product liability*

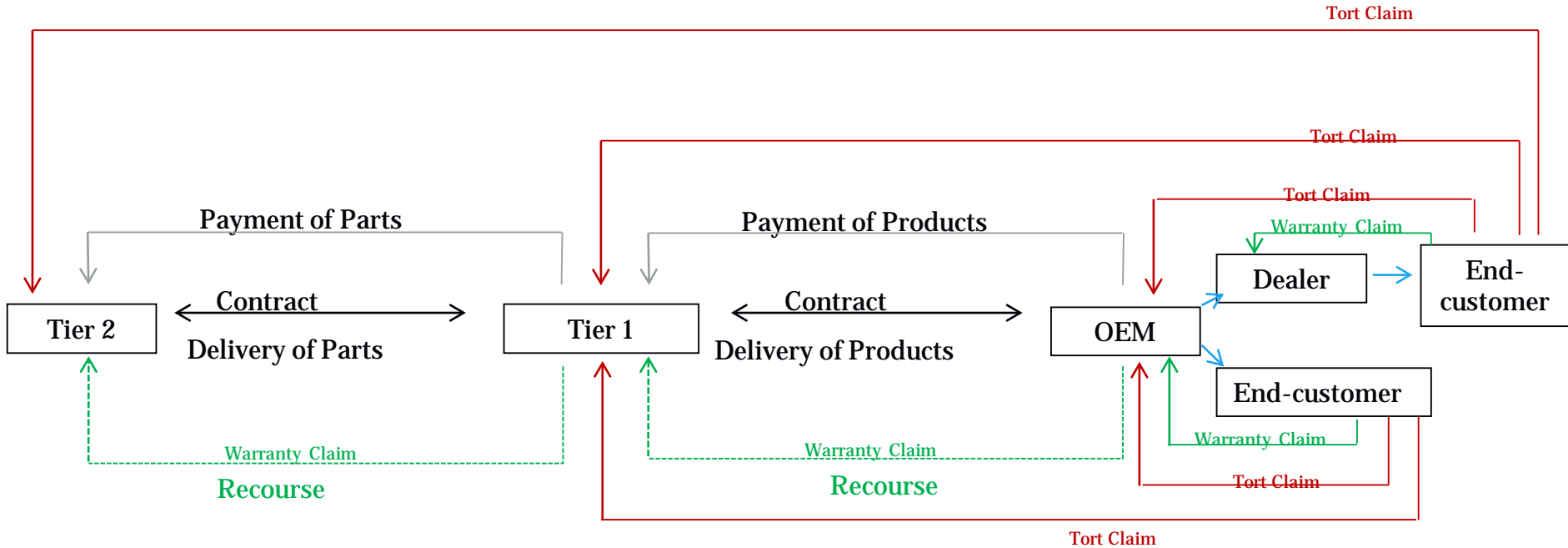
Budapest
21 November 2019

Dr. Christian Kessel, LL.M.
Head of Bird & Bird's International Automotive Group
Frankfurt/Main, Germany

Daniel Arányi,
Senior Associate
Bird & Bird Budapest, Hungary

1. Supply Chain – legacy and future

Recourse within the supply chain



Claims regarding defective cars can be raised against

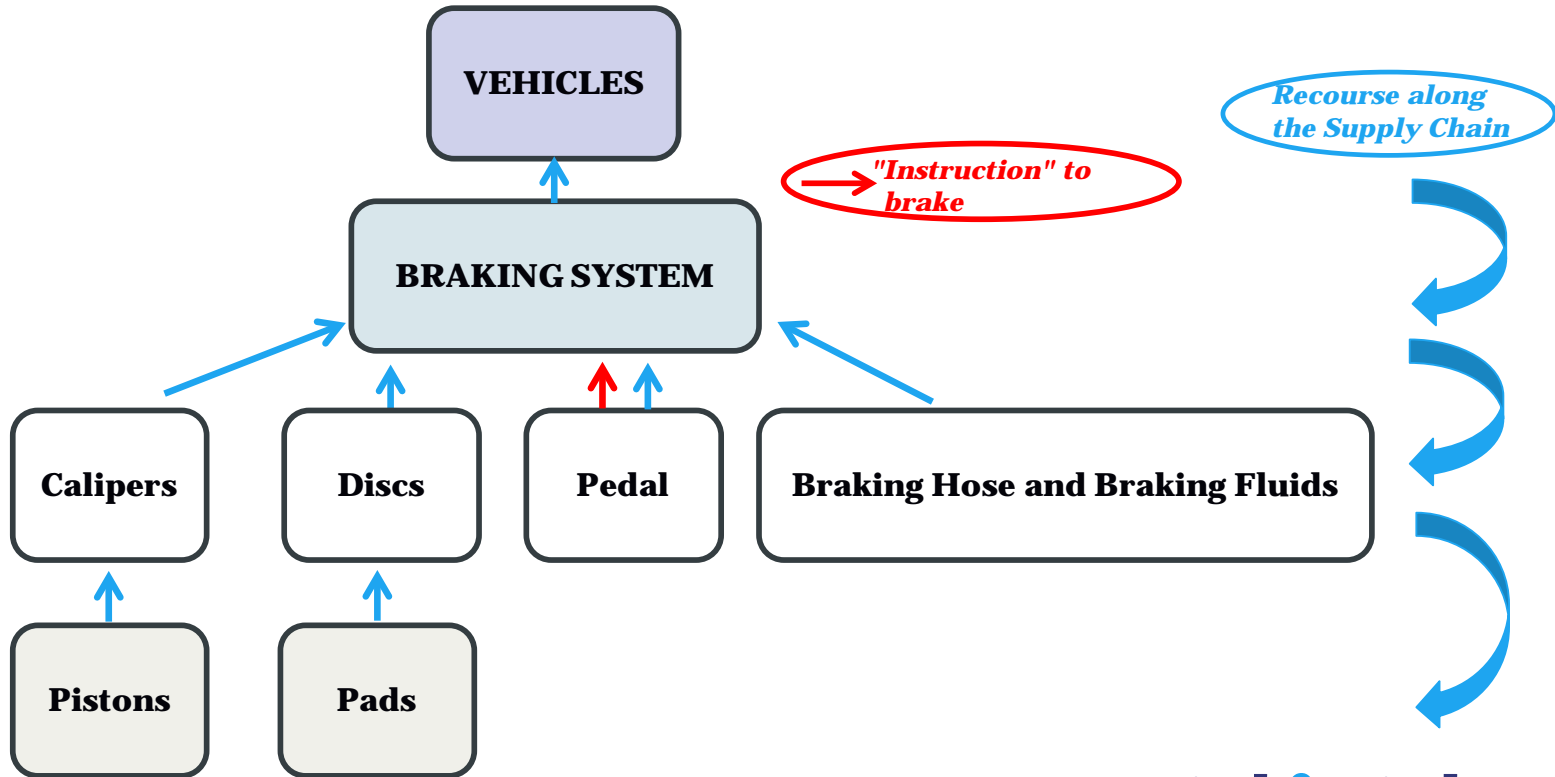
The Seller	The OEM	The Supplier	The Guarantor
<ul style="list-style-type: none">Pursuant to the warranty rights	<ul style="list-style-type: none">As manufacturer of the unsafe "<u>end-product</u>" (<u>vehicle</u>)	<ul style="list-style-type: none">As manufacturer of the unsafe <u>part</u>	<ul style="list-style-type: none">Any party giving a product guarantee<ul style="list-style-type: none">e.g. the DealerNormally the OEM ("manufacturers' guarantee")Rarely the Supplier
<ul style="list-style-type: none">If the vehicle is defective	<ul style="list-style-type: none">If the vehicle is unsafe	<ul style="list-style-type: none">If the vehicle is unsafe	<ul style="list-style-type: none">Normally scope of applicability quite limited or lots of exceptions/qualifications
<ul style="list-style-type: none">Under the sales contract	<ul style="list-style-type: none">Under product liability principles (statutory provisions)	<ul style="list-style-type: none">Under product liability principles	<ul style="list-style-type: none">Under the third party/manufacture's guaranty contract

If the OEM sells the vehicle, there may be claims in both

- contract law, and
- tort/product liability law

"Traditional" brakes fail

The traditional Supply Chain – at the example of brakes



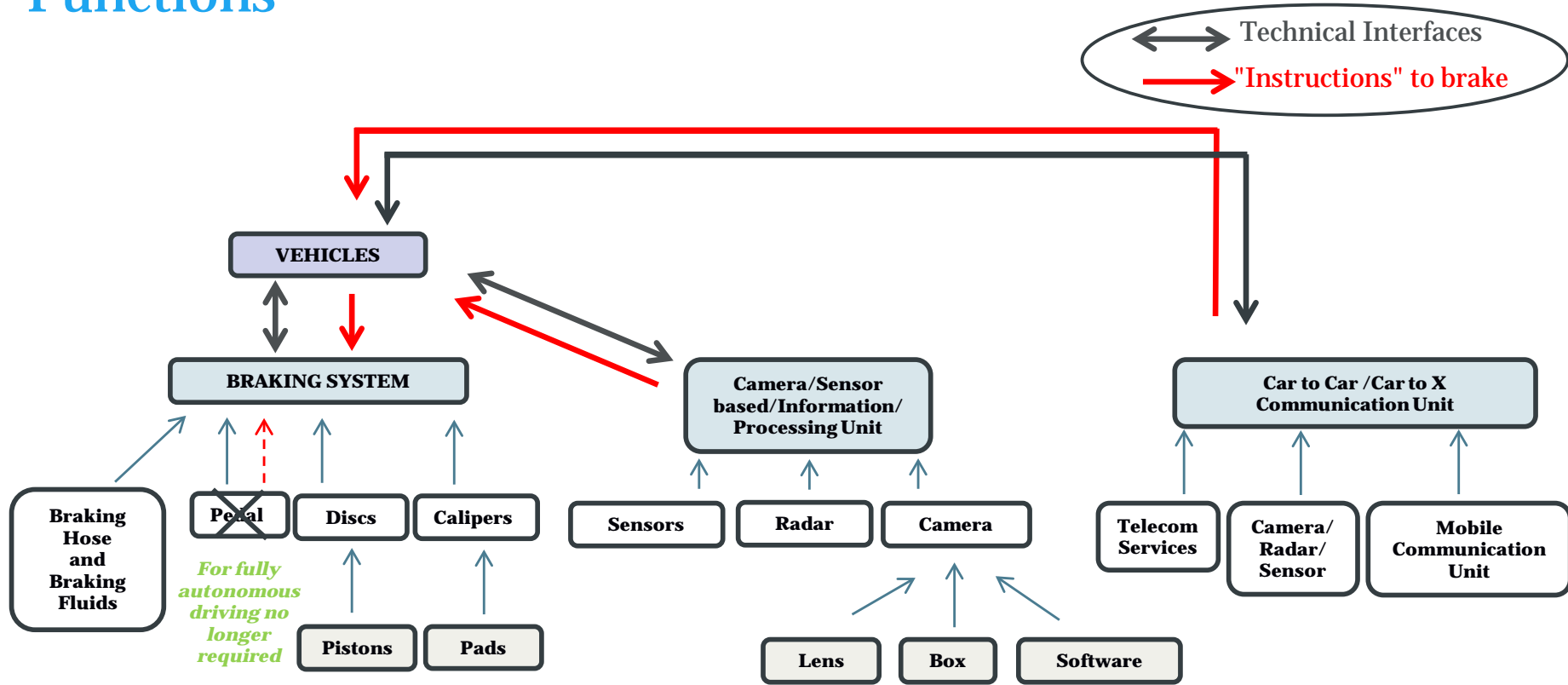
OEM

Tier 1

Tier 2

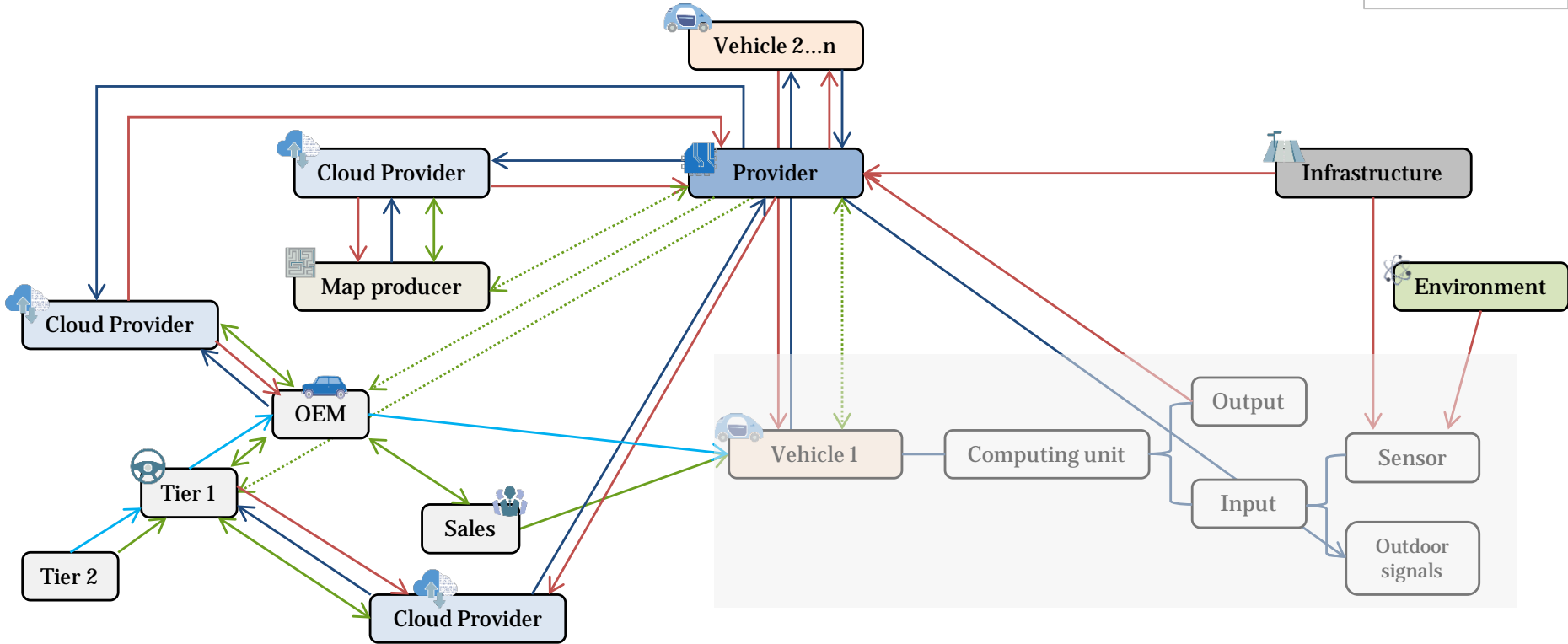
Tier 3

The extended Supply Chain for Autonomous Driving Functions



The complexity increases....

Legend
Data
Data
Hardware (sold data)
Contract



Impact on the recourse in the supply chain

- **Identification of Root Cause**

- Increasing complexity of products
- More interfaces
- Identification of the cause of the defect and hence of the liable party will become more difficult

- **Contractual liability**

- Principle: Recourse (only) against the contractual partner
 - Thus: Multi-party Contracts might be useful
- Important: Clear distinction of responsibilities
 - Clear and narrow description of the "Scope of Work" in the Specification/functional specification
 - Interface agreements/Risk Matrix as standard
- Limitation of liability clauses (currently barely possible – requires culture change)

2. Latest developments on General Purchase Terms of German OEMs

Recent Trends and Developments

The Purchase Terms of the German OEMs become

- Longer
- More sophisticated (both the legacy terms and the IT/Software/disruptive technology) terms
- Increasingly more one-sided (the legacy terms only)
- Updated more often
- More complex as regards the contractual suite of documents that apply
- Increasingly separate suites of documents for IT Projects

Suite of Documents (1)

Volkswagen Group

- Negotiation Fax/Negotiation Protocol
- Nomination Agreement
- Formula Q – Quality Assurance Agreement, comprising, inter alia,
 - Agreement on Design Responsibility ("KVV"):
 - i. Master Agreement on a Design Responsibility
 - ii. Agreement on a Design Responsibility Quota (DR-Quota)
 - for each part/module/ system
 - regarding concept or design or development defects (construction defects)
 - for handling field (warranty) cases only
 - Different documents for the Technical Factor:
 - Description Procedure for the Processing of Defective Deliveries
 - Agreement on the Determination of Supplier Responsibility
 - Field Damage Handling Agreement (FAV)
- Purchase Terms (based on VDA-recommendation)
- On IP Rights: VW-Norm 9400

Suite of Documents (2)

BMW:

- International Conditions of Purchase (2018)
- Warranty Agreement (2017)
- Warranty Agreement (2018)
- E-contracting terms
- Development Agreements

Daimler:

- Purchase Terms (based on VDA-recommendation)
- Mercedes Benz Special Terms – MBST – (2016):
 - Suite of various documents of different years, inter alia:
 - 18/05 on Recalls, Field Actions, Serial Damage
- Purchase terms for Development Services
 - exclusive
 - non-exclusive

All these documents relate to "traditional" serial hardware production parts

Suite of Documents (3)

Terms for the purchase of "disruptive technologies" related services and products

Volkswagen AG:

- General Purchase Terms for services relating to IT and/or Electronic Information and Communication (Telecoms) of VW AG (November 2016)
 - they relate to the purchase of, inter alia,
 - Open Source Software
 - Standard Software
 - Individual Software
 - Customized Software
 - data carrier
 - documentation
 - concepts
 - hardware

Suite of Documents (4)

Porsche AG:

- Purchase Terms for IT of Porsche AG (January 2019)
 - relating, inter alia, to
 - Purchase and lease of hardware and standard software
 - Maintenance of hard- and software
 - Development of individual software
 - Free and open source software (FOSS)

Suite of Documents (5)

Daimler AG:

- General Purchase Terms for IT of Daimler AG
- consisting of Parts A-M relating, inter alia, to
 - General provisions (Part A, September 2010)
 - Purchase lease and maintenance of hardware (Parts B-D, February 2009)
 - Purchase and lease of standard software, maintenance of software Parts E-G, February 2009)
 - Development of individual software and adaptation of software (Part H, May 2018)
 - IT Services (Part I, February 2009)
 - IT Operation and Application Maintenance Services (Part J, May 2018)
 - Licensing of Contents of Mobile Apps (Part K, April 2014)
 - Agile Development and Adaptation of Individual Software (Part L, May 2018)
 - Cloud Services (Part M, May 2018)

Suite of Documents (6)

BMW Group

- General Terms for indirect purchasing (September 2018)
- Special Terms for IT-Projects/Services (November 2018)

After All:

- Nothing specific on autonomous driving or electric mobility
- The above documents need to be amended accordingly
- In addition:
 - *cooperation agreements*
 - *research and development agreements*
 - *platform-/hosting contracts etc.*
- Data licensing seems underdeveloped so far (except for BMW perhaps in its IT terms)

Laws on General Terms and Conditions (GTCs)

Hungarian Law:

- very strict in B2C
- applicable also to B2B
- codified in Civil Code
- clash of GTCs

German Law:

- very strict
- lots of case law
- codified since 1976
- applicable both to B2C and B2B

China:

- based on German law
- potentially similarly strict
- no case law
- questionable whether applicable to B2B

Example:

- It is a general principle of German law that any claim for damages (whether for breach of contract or in tort) requires fault, i.e. at least negligence
- Any clause in general terms and conditions providing for damages to be paid without fault/negligence is invalid

Status quo: German Law on terms and conditions

A protective shield for suppliers to German OEMs

- The German law on terms and conditions (and the German jurisdiction!) is probably the strictest in the world.
 - It is almost impossible to validly deviate from statutory German law to the benefit of the party using such general terms and conditions.
 - Nevertheless, German OEM keep choosing German law in their contracts. Many of their terms are unenforceable (before German courts).
- German law on terms and conditions protects the suppliers which are often not able to negotiate the terms of the OEMs.

Key Developments in the "traditional" hardware serial parts terms

- Liquidated damages for competition law and other compliance breaches (BMW ICP)
- Reference market clauses for calculation of costs for field cases increasingly replaced by 50/50 sharing of costs or similar models (BMW Warranty Agreement 2018, Daimler MBST 15/08i)
- No Trouble Found: Supplier bears 50% or even 100% of costs
- Clauses for Software, Digital or Electronic parts or services slowly increase
- BMW warranty Agreements 2017 and 2018: directed buy provisions
- BMW warranty agreement: dispute resolution by technical expert
- BMW warranty agreement "light": German law, exclusion of statutory provisions on general terms and conditions arbitration in Zurich, Switzerland (see next slides for details)

3. Possible Defences of Suppliers

Practical scenarios highlighting exposure to warranty, field action and recall liability/ serial defects cases

Scenario 1: Single Vehicle Warranty issue

"One-off- "warranty case

An end-user brings the vehicle to the dealership outside of the regular maintenance schedule specifically to fix a defect/ a problem

Scenario 2a: Regular "Fixing of Defects"

Field Action (Serial Damage)

A vehicle's defect is fixed during a regularly scheduled service maintenance at the dealer (unknown to the vehicle's owner = "silent recall")

Scenario 2b: Voluntary Full "Recall" (rare)

Field Action with owner notification

(Serial Damage)

A defect leads the OEM to issue a (voluntary) notice to all vehicles owners. End-users bring the vehicle to the dealer for fixing at their convenience. (mainly comfort/customer satisfaction driven)

Scenario 3: Mandatory Full Recall

Recall

A defect causing risk of personal injury or death leads the gov't to issue a safety recall on all vehicles or the OEM is obliged to do so under product liability law or tort law

Warranty claims

Safety Recall

Possible defenses of Suppliers (1)

Typical starting-points for a defense of Suppliers against (recourse) claims of customers:

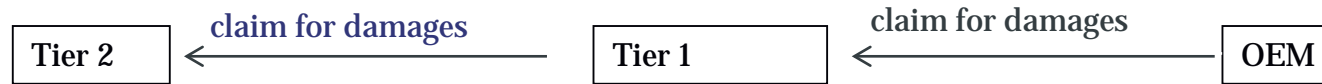
- **Defect does not exist**
 - question of fact/ technical issue;
 - possibly question of burden of proof (on purchaser/ customer!)

Possible defenses of Suppliers (2)

The Supplier is not at fault:

- Provided there is no strict liability/non-fault regime (contractual or statutory) that applies
- The Supplier has delivered a defective product, but cannot be blamed for it (i.e. was not negligent)
 - e.g. the design of the product reflected the state of the art at the time the product was put on the market
 - A "one-off" manufacturing fault occurs in spite of "perfect" organisation and supervision
 - No responsibility for the sub-supplier (works for instance in Germany as an argument)
- In particular in "directed supply" relationships: The Tier 1 is not able and does not have to be able to understand/examine the parts delivered by the "directed" Tier 2
 - if the parts of the Tier 2 are defective
 - this is not the Tier 1's fault

No recourse along the supply chain: Lack of fault



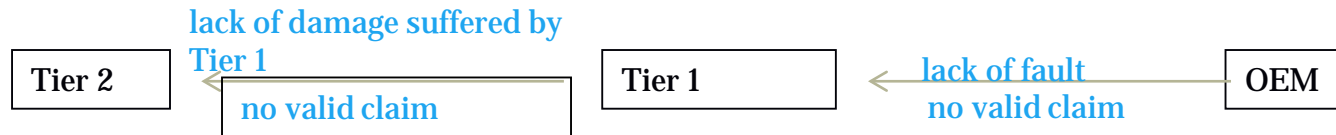
not at fault for defectiveness of parts



no obligation to compensate OEM



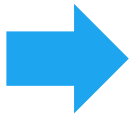
no damage suffered



Possible defenses of Supplier (3)

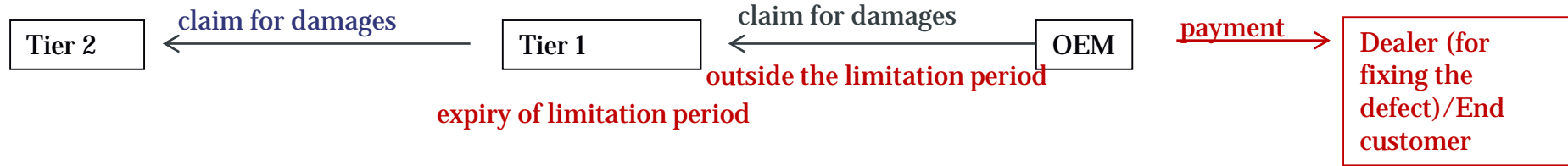
Expiry of the (agreed or statutory) Warranty Period/Limitation Period

1. Within the relationship Tier 1 – OEM
 - all claims of the OEM are excluded,
 - there are no reimbursable legal damages which the OEM can claim
 - no recourse against Tier 1
2. Within the relationship OEM – end customer (passenger car/ truck/ van)
 - pure goodwill payment by the OEM
 - OEM suffers financial loss, but not "legal damages"
 - no recourse against Tier 1



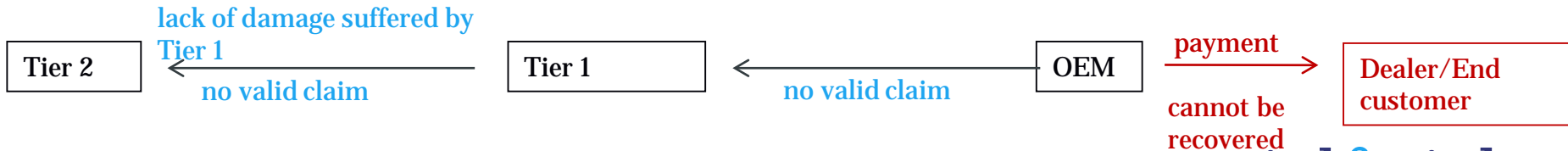
Double test on expiry of the limitation claim!

No recourse along the supply chain: Expiry of limitation period Tier 1-OEM



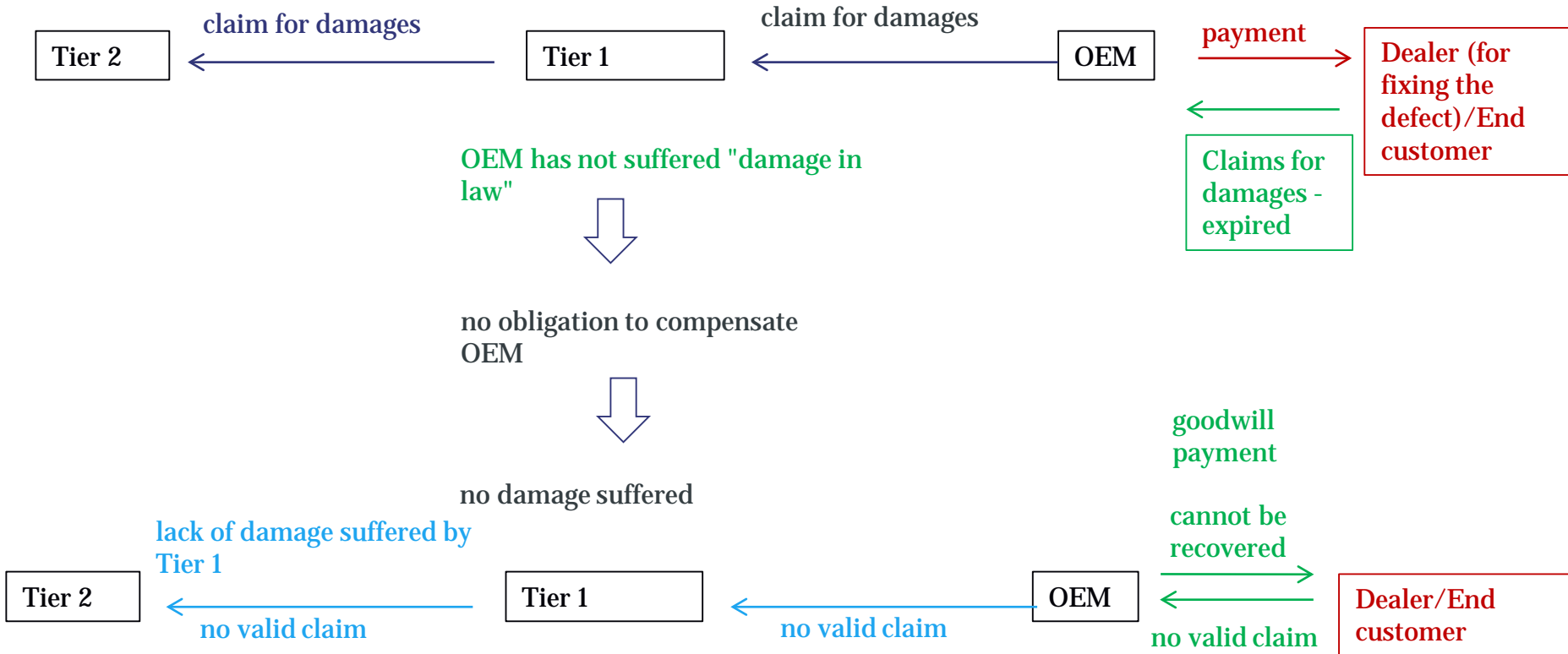
no obligation to compensate
OEM

no damage suffered



No recourse along the supply chain: Expiry of limitation period

OEM-End Custom



Possible defenses of Supplier (4)

Contributory fault of OEM/Tier 1

- The own drawings/ design specifications of the Customer are wrong
- Approvals/releases had been granted by the Customer
- Own testing obligations of the Customer were not, not timely or not properly performed
- RASIC-Matrix was not complied with by Customer
- No review of the Supplier's FMEA by Customer
- No traceability of products
- Delayed decision on remedial action by the Customer
- Delays in validation of improved parts by the Customer

Possible defenses of Supplier (5)

A field action would be more expensive than the handling of single warranty cases

➡ exclusion of compensation for damages insofar

- N.B.: Weibul-Analysis of number of defective/unsafe parts is legally dubious
- A number of vehicles do not require remedial action due to accidents, theft, sale abroad, etc.

The Calculation of Damages of the Claimant (OEM or Tier 1) is simply faulty, as it includes

- Remedial actions after expiry of the limitation period
- Remedial actions not related to the alleged defect
- Remedial actions undertaken on Sundays and holidays
- Remedial actions more experience than reflects the "working units"

➡ Careful analysis of the database may reduce the amount of damage by 25-50 %!!

Possible defenses of Supplier (6)

However bad the case may look factually or on the technical or engineering side – i.e. the Supplier really "messed up"

Do not underestimate the legal defences



The Supplier may still get away with no or a severely reduced liability!!

Thank you & Bird & Bird

Dr. Christian Kessel, LL.M.

Bird & Bird LLP, Frankfurt am Main

christian.kessel@twobirds.com

twobirds.com

Abu Dhabi & Amsterdam & Beijing & Berlin & Bratislava & Brussels & Budapest & Copenhagen & Dubai & Dusseldorf & Frankfurt & The Hague & Hamburg & Helsinki & Hong Kong & London & Luxembourg & Lyon & Madrid & Milan & Munich & Paris & Prague & Rome & San Francisco & Shanghai & Singapore & Stockholm & Sydney & Warsaw

The information given in this document concerning technical legal or professional subject matter is for guidance only and does not constitute legal or professional advice. Always consult a suitably qualified lawyer on any specific legal problem or matter. Bird & Bird assumes no responsibility for such information contained in this document and disclaims all liability in respect of such information.

This document is confidential. Bird & Bird is, unless otherwise stated, the owner of copyright of this document and its contents. No part of this document may be published, distributed, extracted, re-utilised, or reproduced in any material form.

Bird & Bird is an international legal practice comprising Bird & Bird LLP and its affiliated and associated businesses.

Bird & Bird LLP is a limited liability partnership, registered in England and Wales with registered number OC340318 and is authorised and regulated by the Solicitors Regulation Authority. Its registered office and principal place of business is at 12 New Fetter Lane, London EC4A 1JP. A list of members of Bird & Bird LLP and of any non-members who are designated as partners, and of their respective professional qualifications, is open to inspection at that address.