

CRAIN'S DETROIT BUSINESS

www.crainsdetroit.com

JUNE 23, 2013

Suppliers absorb more of costs from warranty claims

BY SHAWN WRIGHT

CRAIN'S DETROIT BUSINESS

As vehicle manufacturers increasingly require contributions from their suppliers for potential product liability, warranty and recall claims, the emphasis on shared responsibility has worked its way from the automakers down to all three tiers of the supply chain.

"Ten or 12 years ago, the dialogue that was happening between OEMs and the supply base was to really eliminate warranty costs," said Linda Watson, a member at **Clark Hill PLC** and co-chair of the firm's automotive and manufacturing practice group.

"I think they came a long way in achieving some of that, but it certainly didn't eliminate warranty costs. Over the course of the last three or four years, the goal now on the OEM side is to shift warranty costs."

One local bellwether case cited by attorneys centers on tier-one supplier **Hutchinson FTS Inc.** In 2009, **Dykema Gossett PLLC** won a nearly \$47.7 million breach-of-contract lawsuit in **Oakland County Circuit Court** for client **Chrysler LLC** after it countersued Troy-based tier one Hutchinson for supplying the automaker with defective parts. Hutchinson had provided hoses and cooling lines used in Chrysler's 2005 minivans, which were recalled because of leaks in those parts. Hutchinson denied that the parts were defective.

The finger-pointing in these scenarios is unavoidable and something the industry is talking about.

Dave Andrea, senior vice president of industry analysis and economics for the Troy-based **Original Equipment Suppliers Association**, said one of the OESA's goals has been to eliminate warranty problems. But while acknowledging that claims will be made, the association is looking at how automakers and suppliers along the chain can share the costs involved.

Andrea said the OESA wants to help carmakers and suppliers work on root causes -- pinpointing where the system broke down. Specificity is key: How did the supplier fail to meet the agreed-on parts order?

"That's the piece we'd like to see from the suppliers and vehicle manufacturers, to look at that in a responsible manner," Andrea said.

One of the reasons that automakers are able to have the supply base share more of the warranty costs, Watson said, is that some tier one and two suppliers have gotten bigger and most likely can share more of the costs. This size is a result of the consolidation of the supply base that has happened over the past several years, Watson said.

How this will affect business in the supply chain remains to be seen.

Watson, for one, thinks some fallout could occur when a company that's lower in the supply chain has a low-margin



Clark Hill attorney **Linda M. Watson**

part. To the extent that the tier ones and twos push down their warranty allocation programs with the automakers to the supply base below them, she said, situations may arise in which the lower suppliers could decide it doesn't make a lot of financial sense to pick up that type of warranty risk on such a small-margin part.

"In that regard, you might see some hiccups in the supply chain," Watson said. "Or you may see, potentially, some M&A activity where some of these bigger suppliers maybe pick up some of the parts that have lower margin and spread the risk of warranty cost allocation along a better overall margin."

In addition, if an issue arises down the supplier pipeline, the question for the

continued on page 2

continued from page 1

tier one is whether its tier two and three suppliers are financially viable to pay should warranty exposures or claims occur, said Daljit Doogal, managing partner of **Foley & Lardner LLP**'s Detroit office and a member of the firm's auto industry team.

"It's a race to figuring out who, ultimately, is liable for the defective part," Doogal said. "Most of the tier ones are solid players, but then you go further down the food chain to the tier twos and threes. They are definitely smaller companies that don't have as much financial wherewithal that some of the tier ones have."

The question also becomes how the potential liability is examined during an

supplier's employees and customers and look at the history of warranty and recall exposures. Companies that have higher incidents of warranty or product recall claims will depress the purchase price, he said.

One trend is buyers purchasing "representation and warranties" insurance. This covers a loss from claims made by a buyer for any breach or alleged inaccuracy made by a seller in a purchase and sale agreement. Policies generally cover transactions with values ranging from \$20 million to \$1 billion.

These policies also can protect against inaccuracies in representations and

or four years, this type of insurance has become more prevalent.

"It's just another tool in the toolbox as you're trying to figure out in a privately negotiated acquisition how you're allocating risk between buyer and seller and what will be the source recovered," DuBay said. "You're absolutely seeing more of that, and I think the insurance companies have realized that there's a market for this product."

What it comes down to, he said, is that buyers in the automotive world will want to make warranty and recall exposures one of their high-level items to check off early in the M&A due-diligence process.

Determining the seller's historical warranty and recall issues is important, DuBay said, but so is understanding the product line, the end product it's going into and the broader recall issues that may have happened at the automaker.

"The automotive space is a unique space," DuBay said. "There are going to be further discussions and intentions of having the entire supply chain take some role of responsibility in a product warranty or recall situation."

"Ten or 12 years ago, the dialogue that was happening between OEMs and the supply base was to really eliminate warranty costs," said Linda Watson, a member at Clark Hill PLC.

M&A deal evaluation of a supplier and whether it can go forward. Before any deal goes through, Doogal said, most companies hire operational consultants to talk with the

warranties made by the seller or target company in an M&A deal. Michael DuBay, a partner at **Honigman Miller Schwartz and Cohn LLP**, said that in the past three

Linda M. Watson is Co-chair of the Automotive & Manufacturing Practice Group. She has been listed as a Super Lawyer in business litigation for three consecutive years and has over 20 years of litigation experience representing small to large privately-held business entities, as well as public corporations both at the trial and appellate level of federal and state courts. Her practice covers all areas of business and commercial litigation, including contracts, employment claims, property matters, construction, intellectual property, trade secrets, and copyright and trademark law. Linda has significant experience in the following industries: automotive, health care, information technology, entertainment and banking.

Contact her at lwatson@clarkhill.com or 248-988-5881.

CLARK HILL

www.clarkhill.com