China Implements New Laws in Foreign-Related Products Liability Cases

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In 2010, the People's Republic of China ("PRC") enacted two laws that together will substantially affect all civil litigation in China – and, in particular, product liability litigation regarding foreign entities. The Law of the Application of Law for Foreign-Related Civil Relations of the PRC ("the Choice of Law Statute") covers almost all aspects of the application of law in foreign-related civil cases. The Tort Law of the PRC ("the Tort Law") comprehensively governs tort liabilities. This article will focus on the provisions of these laws relevant to product liability disputes, particularly as they affect foreign entities.

The new laws will likely lead to increased litigation and compensation awarded to plaintiffs. Under the Choice of Law Statute, foreign law will be applied more widely, which could frequently be more favorable to plaintiffs. Under the new Tort Law, manufacturers and sellers now have substantive obligations to recall, implement remedial measures, and warn of potentially defective products. Punitive damages may now also be awarded for all kinds of product defects. Because the laws are so new, it is still unclear how Chinese courts will resolve legal issues arising from application of foreign law in actual cases.

New Choice of Law Rules in Foreign-Related Product Liability Cases

In China, product liability constitutes a distinct kind of tort liability. Previously, there was no special provision in Chinese law governing the choice of law in foreign-related product liability cases. The choice of law rules were the same as in ordinary tort liability cases, *lex loci delictus,* requiring the application of the law of the place in which the tort occurred. If damage occurred in China in a foreign-related product liability case, Chinese law generally governed.

The Choice of Law Statute now requires the application of the rule of *lex loci domicilii* in foreign-related product liability cases, thus making defendants subject to the law of their place of habitual residence. Although the law of the habitual residence of the plaintiff (foreign or Chinese) will ordinarily apply, the plaintiff may instead choose to apply the laws of the defendant's main business place (*i.e.,* the law of the manufacturer's home country) or the laws of the location where the damage occurred (*i.e.,* China) – unless the defendant has no relevant business operations at the habitual residence of the plaintiff, in which case only the latter two choices are available.

As a result of this reform, successful plaintiffs may now be awarded the same compensation as they would under the law of their state of habitual residence. That will likely be more than Chinese substantive law would permit. The damages awarded by Chinese courts are assessed conservatively to reflect necessary costs within China, which may well be less than

the costs that injured parties would incur in their home states.

For example, if a Beijing hospital purchased defective medical equipment from a U.S. manufacturer, resulting in harm to patients from China, the U.S., Germany, and Cuba, the following outcomes could arise in suits against the manufacturer. The plaintiffs could choose to apply U.S. law (*i.e.,* the tortfeasor's principal place of business) or Chinese law (*i.e.,* the law of the place where the injuries occurred). Alternatively, the plaintiffs could choose to allow *lex loci domicilli* to apply by default, in which case the laws of China, the U.S., Germany and Cuba would apply depending on each plaintiff's nationality. That would, however, prejudice the plaintiffs domiciled in Cuba because U.S. companies have no relevant operations there. Thus, the Cuban plaintiffs would want to elect U.S. or Chinese law.

What will the consequences of the new choice of law rules be for multinational companies? Here, we discuss only a few briefly. But, in general there will be a lot of uncertainty as courts work through how to implement the new regime.

First, the choice of law may determine the elements of product liability and burden of proof issues – as to both the allocation of burdens and the required evidentiary showing – and might therefore be outcome determinative. Consider the potential difference in outcome if the plaintiff or the defendant bears the burden of proof for a required element, or if rules governing joint-and-several liability vary. Chinese law could be more favorable than foreign law. The provisions of the new Tort Law of the PRC shift the burden on many elements to the defendants, through the introduction of proactive duties. Yet, at the same time, foreign law on damages may be much more favorable. So, new flexibility in choice of law rules means increased strategic complexity.

Second, if the availability of foreign law proves attractive to plaintiffs, then foreign manufacturers will likely face more direct proceedings. The Tort Law maintains provisions of the former Product Quality Law of the PRC regarding liability for product liability claims, thus allowing plaintiffs to sue both manufacturers and sellers. Previously, for the sake of procedural convenience, Chinese plaintiffs preferred to sue local distributors or domestic manufacturers of foreign-trademarked goods. But targeting foreign manufacturers will likely become more attractive now, if doing so results in more generous damage awards. Pursuant to an interpretation of the Supreme People's Court of 2002, any entity that allows a product to be labeled with its name, trademark, or distinguishable sign qualifies as a manufacturer in the context of product liability. While this "quasi-manufacturer" principle was developed under the previous Product Quality Law, it likely also applies to the new legal regime established by the Choice of Law Statute and Tort Law. Consequently, foreign manufacturers will likely face more direct product liability claims in China, and will be unable to confine litigation risk to their Chinese distributors and manufacturers.

Third, an important uncertainty concerns what legal issues will be subject to the plaintiff's choice of law. Generally, courts apply *lex fora* ("law of the forum") principles for procedural

rules, which would require their application of Chinese rules. However, it is not always clear whether a particular rule is procedural or substantive. In the United States, for example, courts have sometimes interpreted the burden of proof requirements on elements as "procedural" rather than "substantive."

Another open question concerns the application of discovery rules. China has no equivalent to U.S.-style discovery. Similarly, Chinese procedural rules also affect litigation timelines. The application of such procedural rules can have significant substantive consequences, potentially diminishing the extent to which the ability to apply foreign law will change Chinese product liability suits. The situation will remain uncertain and possibly vary from court to court until either the Supreme People's Court or the legislators provide guidance on the extent to which *lex fora* should be applied to Chinese procedural law.

On the whole, the new choice of law regime will likely increase the cost and duration of the proceedings. As outlined here, courts will face complex new technical questions, as will multinational companies defending product liability suits. If foreign legal and scientific experts are used, additional costs for translation and travel will be incurred. Most of all, the application of foreign law will pose a significant challenge to Chinese lawyers, who typically lack education and expertise in foreign legal regimes.

Product Liability Under the New Tort Law

Once a court holds that Chinese law applies to a product liability case pursuant to the Choice of Law Statute, it will apply the new Tort Law. Most provisions regarding product liability in the Tort Law are derived from and remain consistent with the Product Quality Law promulgated in 1993 and revised in 2000. There are, however, four significant differences that apply to product liability suits.

First, the scope of liability includes the defective products themselves, which was not the case under the now-obsolete Product Quality Law. This eliminates the last vestiges of the civil law privity-of-contract principle, in which a party to a contract who suffered damage could recover only from the other party to the contract and not another party. The reform is intended to reduce the litigation burden on victims, who may now seek compensation for product losses in the same action as for other harms caused by the product defect.

However, this change raises new questions. For instance, if an injured party sues the manufacturer to recover compensation, should the manufacturer compensate the plaintiff at its direct wholesale price or at the ultimate retail price paid by the plaintiff? If the latter, could the manufacturer indemnify itself by suing the distributor? If there are multiple levels of distributors, against which should the manufacture pursue an action for indemnification? Multinational corporations facing these kinds of issues should closely monitor the attitudes expressed by jurists and legislators as actions are brought under the new Tort Law regime.

Second, the Tort Law extends the duty of manufacturers and sellers to recall all defective products. Previous regulations applied to limited classes of products, such as automobiles, foods, medicines, and toys. The failure to recall products will result in tort liability if the defect causes harm. This change makes multinational manufactures responsible for tracking potential defects. Doing so will require new infrastructure and management practices, including additional oversight of distribution networks.

Third, the new Tort Law also imposes a duty to warn "after the product is put in circulation." By contrast, under Article 41 of the Product Quality Law, producers were not held responsible if they could prove that the defect could not be found at the time of circulation due to scientific or technological reasons. This means that after first sale, even if there are technical obstacles that might prevent warning or recall of a defective product, the manufacturer or seller will nonetheless face tort liability for any harm that occurs. This removes a broad exception that manufacturers and sellers formerly used to avoid strict liability for product defects.

Fourth, and perhaps most controversially, the Tort Law allows for the award of punitive damages in product liability cases. Traditionally, Chinese courts have applied equitable principles in civil cases, making the recoverable compensation equal to the victim's harm as measured by medical costs and lost income, for example, the award of punitive damages emerged in consumer fraud laws. Regulations imposing punitive damages have also been adopted for abuses in the sale of residential housing and food.

The Tort Law now extends the availability of punitive damages to all products, but important limitations remain. Article 47 requires that the manufacturer or seller know of the defect while continuing to manufacture or sell the product, and that the defect cause death or serious bodily harm. Even with these limitations, manufacturers and sellers will face more complaints seeking punitive compensation. They will have to take this into account in planning their public relations response to product liability lawsuits.

Conclusions and Next Steps

The new product liability provisions of the Conflict of Law Statute and Tort Law are part of an effort by Chinese authorities to stem the growing problem posed by large-scale and individual product defect-related incidents. These reforms represent an important legal component of China's economic transformation. But, the adoption of novel principles, such as the choice of foreign law provisions, the expansion of duties imposed on manufacturers, and Western-style punitive awards, will inject new questions into the Chinese legal landscape.

Starting now, multinational companies should carefully monitor manufacturing and distribution systems to meet the duties of recall, warning and remedial measures. Companies will have to implement institutional procedures before any problems engender litigation, not only to avoid the consequences of litigation, but to comply with the Tort Law. Further, companies should determine in advance whether their Chinese counsel have the capability to address suits

brought under foreign law, including the ability to understand differences between the foreign tort law and Chinese law, and perform tasks that may be new for them, such as selecting and training expert witnesses from abroad, conducting extensive legal translation work, and the like.

Finally, companies should encourage the counsel who represent them to engage in mock trials and other exercises to understand how the new laws may affect product liability claims and maintain close communications with legislators, jurists, and government agencies to help guide their implementation and refinement of those laws.

This article was authored by Liu Hong Huan, Liu Chi and Zhou Xi, attorneys from Jun He Law offices, and was published in original format in Asian Counsel Magazine, Vol. 8, Issue 10. Jun He is widely recognized as a leading full-service law firm in China, positioned to provide superior legal services in commercial transactions and disputes. For more information on the firm, please visit www.junhe.com.