

## Product Liability - Switzerland

### Product Liability Implications of New Auditing Requirements

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#### **New Auditing Requirements**

The new Swiss auditing and company laws subject all companies governed by Swiss law to the same auditing regime. A key innovation of the new law requires the board of directors to set up an adequate risk management system and internal control system.

Although the law is not specific as to the standard to follow in this respect, it is common understanding that at least, companies must draw up a comprehensive risk policy and common risk management terminology, and must set up a company-wide risk management procedure. Risk management involves the systematic identification, assessment and mitigation of risks, and necessitates adequate training of the persons who exercise risk-relevant activities within the company. The new law requires audit companies to testify to the existence of an internal control system. The exact meaning of this concept is widely debated among audit experts. Whereas the law expressly excludes control of the company's business activities, it may be assumed that at the least the auditors must check whether the basic features of a risk management and internal control system are in place and whether employees have a minimum understanding of them.

To date, no risk management or internal control system benchmark exists in Switzerland which defines what 'adequate' means, but the Swiss Association of Auditing Companies is developing an internal control system standard which should be published in the first half of 2007. Until then, Swiss companies are looking to international standards such as the Committee of Sponsoring Organizations of the Treadway Commission system, which often serve as a useful starting point for their own internal control systems.

While the general responsibility for the establishment and supervision of a risk management and internal control system lies with the board, their implementation is a function of the management.

#### **Product Liability Implications**

Manufacturers are well accustomed to establishing risk management and internal control systems. Under Swiss and EU product liability law, a manufacturer is liable for damages resulting from defective material, design or manufacturing in its products, or for the incomplete or incorrect instruction of users. Manufacturers must also observe the market and take action if defects are observed in competing products (eg, obligation to warn, product recall). Finally, it is standard practice and a product safety law requirement that manufacturers establish emergency procedures which enable them to respond to observed product defects - in particular, to issue product warnings and to commence a product recall in due time. Failure to do so may result in the company's liability with regards to the party that suffers the damage under Swiss general liability law for the damage incurred. If a product liability event occurs, the emergency team must also handle the company's communications to minimize the damage to its reputation.

What is new under the revised company and auditing law is that Swiss companies must now

establish a comprehensive and systematic risk management and internal control system; failure to do so may result in liability claims by shareholders or even creditors, if the company goes bankrupt.

By expressly stipulating the obligations of the board and directors in terms of risk management and internal control - which for manufacturers will principally involve product liability issues - the new law establishes their personal liability if they fail to establish an adequate and effective risk management and internal control system or supervise its operation and shareholders and/or creditors suffer damage as a result. This new aspect of good corporate governance may extend the liability of board members and directors in product liability cases.

As a consequence, from the product liability perspective, companies would be well advised to review their risk management and internal control systems to ensure that liability issues are adequately taken into consideration - for example, by:





- introducing clear rules on how to document the purchase of materials and the design, production and testing of products;
- establishing a 'red flag' system in product liability cases to inform the management and the legal department, and submitting all consumer instruction and marketing activities for review by the legal department or an external lawyer who specializes in product liability law;
- systematically observing the market and taking adequate measures if dangerous products similar to those sold by the company cause personal or other damage or attract serious criticism (pre-loss management);
- defining a standard on how to react when product liability cases occur (post-loss management); and
- documenting the risk management and internal controlling systems of their company.

It would also be wise for board members and directors to check whether their directors' and officers' liability insurance grants the protection sought for liability cases under the new law.

From the product liability perspective, the new laws urge companies to review their pre and post-loss management. For board members and directors, product liability events may trigger actions not only from damaged persons, but also from shareholders and even creditors.

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