

Potential OEM Warranty & Maintenance Issues with Technical Assets after Catastrophic Events®

May 31, 2014©

by

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I. PURPOSE OF WHITE PAPER

This white paper discusses in general terms various warranty and maintenance issues relating to the assessment, evaluation, and recovery protocol for high value, technical assets. This white paper relies primarily on general principles of American law and is based upon the assumptions and qualifications described below.

II. BACKGROUND

Original equipment manufacturers (“OEMs”) typically sell high value, technical assets subject to an express warranty with an optional maintenance or service agreement. Oftentimes, the maintenance agreement provides the OEM with an additional post-sale revenue stream from the customer. However, the express warranty and maintenance agreement generally do not cover any damage or failures caused by neglect, improper use, fire, water exposure, electrical surge, contamination, or other events which impact the assets. In those circumstances, the OEM’s warranty and maintenance agreement generally exclude, disclaim, or void coverage, that might otherwise create issues for the OEM.

One effect can be the cessation of revenue from any maintenance agreement. Another effect may be the possible loss of the customer should it decide to replace the asset with a competitor’s model. Moreover, the OEM may have exposure to a customer which decides to legally contest whether its warranty coverage and/or maintenance agreement were properly excluded or voided. These repercussions can be likely reduced, and possibly avoided as discussed below.

There are several qualified pre- and post-disaster assessment and recovery companies which specialize in providing damage assessment, support, restoration, and recovery solutions for technical assets. The services of these companies can be employed both before and after the occurrence of a disaster or an environmental impact event, ranging in significance from a hurricane, flood, fire, or act of terrorism, to humidity exposure, construction dust, overheating, and electrical surge.

The services of such a qualified, independent restoration company can be instrumental in assessing the various ways in which a customer’s business may be affected before the event occurs. These companies can systematically analyze the effect an event may have on the function, performance or lifecycle of a customer’s technical assets with the creation of a scientific impact study or survey. A qualified restoration company can also develop disaster recovery plans that include corrosion abatement, emergency preservation and, if necessary, restoration and repair service options. However, as discussed below, all interested parties should ensure that analytical services and recovery protocols adhere to nationally or internationally accredited standards, where applicable.

In the aftermath of such an event, a technically qualified restoration service can evaluate the impact and damage incurred to manufactured equipment, determine

whether the asset has been compromised and whether it can be restored or replaced, remedy and remove any contaminants, verify results and test the performance, and otherwise restore the asset to its pre-event functionality and warranty status. Qualified assessment and restoration companies specialize in evaluating and restoring analog and digital electronic hardware, computer systems (IT), production machinery, medical and dental equipment, aerospace systems, and a wide range of electro-mechanical devices.

III. ANALYSIS

As summarized above, an OEM may experience several negative effects from voiding or prematurely denying coverage under its warranty or maintenance agreement for its customer's technical assets. In order to reduce or avoid these effects, the OEM should consider formulating contractual provisions for the requirements and disposition of technical assets sold to customers prior to and after an environmental impact event. These provisions should require pre-event, annual evaluations of the customer's technical assets to establish their warranty status, functionality, and level of maintenance. The provisions should also mandate the post-event procedures for assessing and evaluating the technical assets to determine whether they may be restored to a pre-event, warrantable condition, rather than voiding the customer's warranty and maintenance agreement. If the customer complies with these procedures and the asset is certified to have been restored to its pre-event condition by a qualified restoration company, the OEM should then be able to reinstate its warranty and maintenance agreement. Finally, the provisions should give the OEM the ability to qualify any restoration company before it is engaged by the customer. Alternatively, the contractual provisions would allow the OEM to enlist or supply resources for an assessment of the technical assets to determine their warranty and maintenance status. The OEM would decide whether the assets can be restored to a warrantable condition or whether there were any undisclosed events which might otherwise void the warranty or maintenance agreement.

A. Pre-Event Evaluation

On an annual or other periodic basis, an OEM should require or conduct full diagnostic testing on technical assets previously sold to its customers so as to evaluate and document the warrantable condition and warranty status of the assets. Without such an evaluation, an undisclosed or undetected event could expose an OEM to potentially avoidable liability. Failure to conduct such periodic testing could expose the OEM to unnecessary warranty coverage and avoidable maintenance costs on the technical asset.

B. Requiring Customer to Comply with OEM Specifications

Warranty provisions should require the customer to maintain and service all covered technical assets in accordance with applicable specifications and standards of the OEM. Additionally, the OEM should require the customer to follow the OEM's recommended disaster recovery processes after an event, with testing and protocols adhering to identified national or international standards, where applicable.

Adding this type of language to any warranty has the potential of reducing the OEM's coverage exposure to unwarranted claims, and reducing the amount of exposure in the event of a valid claim. For example, where the customer fails to abide by an OEM's standards of maintenance for technical assets, the OEM should not be liable in the event of a claim, as it may be impossible to distinguish the cause of the asset's failure post-event if it had not been properly maintained, inspected and serviced.

Failure of an OEM to require its customers to follow the OEM's standards may also expose the OEM to an array of claims arising from a disaster or environmental impact event, depending on whether consequential damages are properly disclaimed in the warranty. Consequential damages can consist of business interruption losses, data loss, data theft and lost profits. One example includes medical laboratories that are responsible for conducting analyses of medical specimens for medical offices, clinics and hospitals. Damage to, or loss of, equipment may negatively impact the ability of the laboratory to conduct diagnosis and treatment. Any avoidable delay in restoring functionality may result in liability exposure to third party claims, as well as business interruption damages of the customer. This exposure could be deemed to be a direct result of the OEM's inefficiency and inexperience in handling damage recovery solutions for its customers' technical assets in the field. Appropriate warranty language, as suggested below, may reduce an OEM's exposure to such a scenario.

C. OEM's Exposure to Customer

In the absence of clear protocols and procedures for pre- and post-event assessment of a customer's technical assets, an OEM could be exposed to liability for a claim that the customer's warranty coverage and/or maintenance agreement were wrongfully voided without legal justification. Whether due to organizational structure or regional differences, OEMs with inconsistent procedures and responses to disaster situations are at greater liability risk. The inclusion of appropriate, formal provisions in an OEM's warranty or maintenance agreement may reduce its exposure to litigation costs and possible liability to a customer.

The OEM may also be exposed to unwarranted or fraudulent warranty or service claims where an environmental event has not been disclosed by the customer or where the customer has neglected to properly maintain its covered equipment. An assessment of the customer's technical assets may discover such an event or improper maintenance, and thereby document the OEM's justification for voiding any maintenance agreement or warranty. The suggested provisions will give the customer

direction on the maintenance required for its covered assets, as well as an incentive to report any event(s) which impact(s) its technical assets.

Further, should a customer endeavor to handle the post-disaster recovery and repair of its own technical assets, there may be an increased probability of unreliable restoration results and possible workers' compensation liability. That could be the case where the customer's personnel lack the required experience and expertise to properly handle contaminated equipment or operate in a potentially hazardous environment. The customer might also face potential liability exposure from third parties, including suppliers, vendors and end users. For example, a customer that maintains or stores unique or sensitive data could face potential exposure from customers in the event of data loss or compromise of such data. Additionally, manufacturers of fragile or perishable goods face potential third-party exposure in the event of equipment damage, resulting in an interruption in a supply chain and a customer's inability to promptly restore the delivery of its services or goods. Improperly restored equipment puts the future reliability of technical assets at risk, and may increase or extend the exposure of the OEM to ongoing liability and support costs. In these types of situations, it is much more expeditious and desirable to engage a qualified independent recovery company, equipped with the proper resources, trained personnel, and insurance coverage to accomplish the requisite restoration of assets.

IV. RECOMMENDATIONS

A. Suggested Warranty and/or Maintenance Agreement Provisions¹

1. *Pre-event requirements during warranty/maintenance period:*

"All Property shall be inspected, tested, maintained, serviced and repaired by the Customer, on a timely basis and at the Customer's expense, by an independent contractor approved by OEM. All such inspections, testing, maintenance, service and repairs shall be performed in accordance with all applicable standards and procedures of OEM for the Property. If no standards or procedures are published by OEM, the Customer shall be required to engage, at the Customer's expense, an independent contractor approved by OEM to inspect, test, maintain, service and repair the Property on an annual basis in accordance with generally accepted standards and procedures for the Property. The Customer shall maintain in its ordinary course of business retrievable records which document all inspections, testing, maintenance, service and repair work completed for the Property. OEM shall not be liable for any coverage or remedies for any service, maintenance or damage of any nature

¹ The example language set forth herein is general in nature and should be tailored to each specific situation, with appropriate legal counsel reviewing all specific language prior to implementing any such provisions.

for the Property due to the Customer's failure to strictly comply with this provision."

"At any time, OEM may review maintenance and service records, inspect, test, assess and evaluate, at its own expense, the Property using the services of an independent contractor of OEM's choice for any reason, including, without limitation, for the purpose of determining the condition of the Property and whether it has been properly operated and maintained by Customer."

2. *When a warranty or maintenance claim is made:*

"In the event of any catastrophic impact event, including, but not limited to any hurricane, flood, act of God, fire/ smoke, moisture or humidity intrusion, fire suppression release, construction residues, contamination, electrical anomalies, physical shock, or terrorism, the Customer shall notify OEM no later than twenty-four hours after the occurrence of such an event. Should an aforementioned event occur, the Customer shall follow all recommended disaster recovery protocols, procedures and standards of OEM for the Property."

"After reporting a Claim by the Customer relating to the Property, OEM reserves the right to inspect, test, assess and evaluate, at its own expense, the Property using the services of an independent contractor of OEM's choice. If OEM determines that the Customer has suffered a covered Claim, the Property will be repaired and restored to its condition and warranty status prior to the date of the Claim. The repair and restoration will be performed by an independent contractor of OEM's choice. If the independent contractor determines that the Property may not be so repaired and the Claim is covered hereunder, OEM shall require replacement of the Property, subject to any deductible and all other terms hereof."

B. Potential benefits of suggested warranty/maintenance provisions

An OEM may enjoy a multitude of benefits by adoption of provisions similar to those suggested above. Among others, the OEM may be able to: (a) prevent fraudulent or unjustified warranty and maintenance claims by its customers; (b) preserve potential revenue streams resulting from continued maintenance agreements with its customers; (c) build and continue customer relationships that emphasize service oriented partnerships, rather than adversarial circumstances that push the customer to purchase replacement equipment from a competitor; (d) develop its own disaster recovery protocols that are compatible with manufacturing standards to avoid having an unauthorized third party make such determinations in the field; (e) ensure that any covered assets are tested and restored by a qualified restoration company in

accordance with the OEM's specifications and protocols; (f) avoid unnecessary exposure to liability and litigation costs for legal claims brought by its customers; (g) establish objective standards by which disputes with customers and/or insurers can be resolved; and (h) establish control of the salvaged, damaged or compromised assets in order to prevent their reintroduction into the supply chain through resellers or counterfeiters.

Adopting appropriate warranty/maintenance provisions which involve a qualified, independent restoration company prior to the occurrence of an environmental event should enable the OEM to verify that the customer is not overstating or misrepresenting the condition, functionality, or warranty status of the covered assets based on an unreported or undisclosed event or lack of proper maintenance. Requiring customers to comply with the OEM's schedules and standards for maintenance and service of the technical equipment, including any standards for disaster recovery, may also eliminate the potential for differing standards to be met, and may avoid the resulting costs of competing consultants. This ensures that warranty claims are administered efficiently and consistently, and otherwise guards against selective enforcement of the maintenance and service provisions.

Additionally, appropriate warranty provisions may reduce the cost of litigation due to objective and more accurate data grounded in contractually agreed upon standards. The exposure to such litigation may be further minimized since any material failure to comply with applicable standards should be a valid coverage defense. Should litigation result, a qualified, independent restoration company can serve as an expert witness when a coverage dispute arises and the customer failed to follow the OEM's protocols as required by the warranty. The qualified restoration specialist should, at a minimum, be able to detect when maintenance fell below required standards under the warranty.

An OEM may also be afforded more opportunities to choose repair and restoration over replacement of technical assets by implementing appropriate warranty provisions. When replacement of a technical asset is necessary, however, the pre-event condition of the asset should be determined based upon an objective, unbiased evaluation, employing generally accepted scientific principles and procedures. The implementation of appropriate protocols and the use of proper technologies and methodologies may help to control and prevent the reuse of salvaged, damaged or compromised assets by the customer and discourage the reintroduction of damaged components into the supply chain through resellers or counterfeiters. Qualified, independent restoration companies know how to properly and lawfully dispose of such assets and parts, and are unlikely to jeopardize their status and reputation by doing otherwise.

By implementing appropriate warranty provisions, an OEM may also be afforded more opportunities to choose restoration over replacement of technical assets as the most cost effective resolution. When compared to replacement, the advantages of repair and restoration may be significant, including more rapid recovery, alleviation of short supply or long manufacturing lead times, known compatibility with existing

infrastructure and other benefits. For customers that are self-insured or under-insured, the cost savings afforded by the repair and restoration of assets can be significant as well. The suggested OEM warranty offers a service that is in itself an asset to the customer, thereby enhancing the value of the OEM's product.

Partnering with a qualified, independent restoration company in the wake of a disaster or environmental impact event can mitigate the exposure of the OEM to claims resulting from impairment of the technical assets, including business interruption damages. The OEM, with the help of the qualified restoration company, will have formal evaluation protocols for the assets, and established procedures to employ, should a disaster or environmental impact event occur. Depending upon the warranty language, the OEM or the customer may also be able to contact the restoration specialist to be immediately dispatched for emergency preservation of the technical assets, monitoring the disaster recovery and oversight of qualified personnel. The ability to deploy an emergency response team would mitigate the total losses of the customer and exposure of the OEM by protecting and preserving the assets promptly after the event.

The OEM has a compelling stake to ensure that its customer's business operations are interrupted for as short of a time period as possible. If not properly disclaimed in the warranty, the OEM could be exposed to liability for lost profits during the period when its technical assets were not functional. A qualified restoration company with the expertise and resources necessary to fully and quickly restore the assets to pre-disaster functionality and warranty status will help reduce the OEM's exposure for unnecessary business interruption claims.

Further, safety of the work force is of the utmost importance following a disaster. By collaborating with such a restoration company following an event, the OEM can ensure that only qualified experts are exposed to the various hazards of a disaster, rather than personnel employed by the customer, who may lack the proper experience and training to service, restore and repair technical assets under potentially extreme field conditions.

An OEM may also be able to prevent any unauthorized third parties (e.g. insurance company agents) from making field determinations if the OEM develops its own disaster recovery protocols with the requirement that an OEM qualified, independent expert perform the assessment and restoration services, where applicable. These protocols should require the expert to use objective standards established or adopted by the OEM. By doing so, disputes between the OEM and its customers and/or insurers can be minimized and more readily resolved, particularly where an unqualified, interested third-party is precluded from the post-disaster process.

V. QUALIFICATIONS AND DISCLAIMER

In reading the analysis set forth above, please recognize that potential liability for the risks discussed herein may be further subject to the provisions of various warranty documents and/or service agreements which contain numerous conditions and exceptions which have not been discussed in this white paper, and many other interpretive provisions and opinions have been issued by various courts in connection therewith which also have not been discussed herein. Therefore, a definitive determination as to whether any particular fact or situation could result in liability will depend upon the specific facts and circumstances surrounding each situation. Please remember that the information contained in this white paper is based on general facts and may not apply to specific situations.

In addition, this information is based on general principles of American law, and the laws of any specific jurisdiction may differ substantially. Readers of this white paper should not consider this information to be legal advice and they should consult with their own licensed lawyer for any legal issues and to apply the law of the applicable jurisdiction to the specific facts of any situation. Further, the authors do not intend to enter into any attorney-client relationship with any reader of this white paper, unless and until the authors speak to the potential client, check for conflicts of interest and receive a fully executed engagement letter.

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