

THE INTERNET OF THINGS (IoT): MITIGATING TRANSACTIONAL RISK

Given the continuous and significant market growth in the IoT space, acquisitions and investments in companies that manufacture, distribute, sell, or otherwise make commercially available IoT products can be hugely profitable. However, by introducing the potential for physical-world consequences of digital failures, these products may present new and significant product liability risks and challenges. Buyers and investors should be aware of the associated risks and the increasing legal complexities created by such products.

RISK IDENTIFICATION

The target company's profile of existing and planned products should be reviewed to identify potential product failures and liability risks. Diligence includes:

- ☐ Analysis of insurance claim loss runs to determine the types of product claims, if any, that have historically threatened the company.
- ☐ Analysis of consumer complaints or incident reports to identify existing or potential modes of product failure.
- ☐ Analysis of potential liability risks and events with respect to similar products in the marketplace.

While every transaction is fact-specific and unique, the information below provides a framework for mitigating risk in the deal context.

LEGAL AND REGULATORY COMPLIANCE

The target company should be in compliance with all federal, state, and foreign laws and regulations applicable to its business and its products. Diligence includes:

- ☐ Careful examination of the company's litigation history and an evaluation of any prior disputes with or actions taken by governmental authorities relating to its products.
- ☐ Review of government agency databases concerning product performance and product complaints.
- ☐ Review of privacy policy disclosures and terms-of-service documents.
- ☐ Identification of legal requirements governing the company's industry and nature of its products, and analysis of compliance with such requirements.

INSURANCE COVERAGE FOR IOT EXPOSURES

It is important to ensure that manufacturers, distributors, retailers, software developers, and other related entities in the supply chain are protected through adequate insurance coverage. Conduct a review and analysis of related policies to confirm there are no gaps in the target company's coverage, and, where applicable, confirm the company is covered as an additional insured under the relevant policies maintained by any third-party contractors.

Commercial General Liability

IoT product companies should maintain a traditional Commercial General Liability ("CGL") policy, including excess coverage as appropriate, with limits sufficient to cover the company's assessment of its theoretical liability.

Products Liability and Product Recall Policy

Depending on the nature of the IoT company's products and the terms of its CGL policy, the company may require a separate products liability insurance policy and/or product recall policy to cover third-party claims of bodily injury or property damage arising from a product defect.

Cyber Liability Policy

To the extent an IoT product company hosts, stores, transmits, or otherwise collects personal or private data from its consumers, a Cyber Liability policy will be crucial to guarantee coverage in the event of security or personal data breaches.

Tech E&O Policy

A Technology Errors & Omissions ("Tech E&O") policy is intended to protect companies from third-party financial losses when the product fails to perform as intended and/or stemming from "professional" mistakes, which are likely not covered under a Cyber Liability policy. Tech E&O insurance coverage may be necessary for IoT product companies to ensure there are no gaps in insurance coverage under the company's other existing policies.

Standard Operating Procedures and Contracts

IoT product companies should have Standard Operating Procedures ("SOPs") tailored to the needs of the business and its products.

In addition to SOPs governing the manufacture, distribution, and/or sale of IoT products, companies should have precise and detailed SOPs for preventing and resolving product failure or security-related issues.

Supply-chain and consumer contracts constitute additional potential sources of risk or protection. Supply chain contracts should provide few and narrow representations and warranties in the company's dealings with third parties.

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