

# Liability for customer specifications from the perspective of an automotive supplier

*In the automotive industry, close cooperation between original equipment manufacturers (OEMs) and suppliers is essential. The OEM typically assumes overall responsibility for the vehicle concept, provides the supplier with functional requirements and often also specifies specific technical requirements for individual components. The suppliers, in turn, implement these requirements and develop the corresponding components, which then proceed to series production.*

*The division of duties raises important questions regarding the allocation of liability: Is the supplier liable for design defects if these are based on binding specifications provided by the OEM? Is the supplier obliged to critically examine the specifications? And is the supplier liable for damage resulting from such specifications?*

These questions are particularly controversial in view of the millions of parts installed and the potentially enormous claims for damages. The Stuttgart Regional Court dealt with this issue and explained the conditions under which the supplier's liability must be rejected.<sup>1</sup>

## Judgment of the Stuttgart Regional Court: Background to the legal dispute

At the centre of the legal dispute was a plastic part – a cooling water outlet nozzle – which a supplier had designed and produced for a large OEM in accordance with detailed customer specifications. Based on the preliminary development of one of the supplier's competitors, the OEM initially commissioned the supplier to develop a charge air distribution system. The supplier was then also commissioned to design and deliver a cooling water outlet nozzle for series production.

For series production, the OEM provided the supplier with a design drawing that originated from the competitor's preliminary development. This specified a design with a so-called two-hole flange.

After integration into series production, a significant number of vehicles experienced coolant leakage at the interface between the coolant outlet nozzle and the cylinder head, which in turn led to engine damage. An investigation of the defective parts revealed that the position of one of the three screw holes in the coolant outlet, through which the screws must be inserted to connect the coolant outlet to the charge air distribution pipe during assembly, deviated from the design drawings and was not dimensionally accurate.

The OEM demanded millions in damages from the supplier, as the leaks were allegedly due to a product defect. The supplier had made design and manufacturing errors because it had chosen an unsuitable

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<sup>1</sup> Regional Court Stuttgart, November 9, 2019 – 10 O 193/13.

design despite its responsibility for development. In this respect, the OEM's design specifications were not irrefutable; rather, the supplier had culpably failed to identify the necessary adjustments in a failure mode and effects analysis (FMEA).

The supplier argued that its design responsibility related exclusively – and only to a limited extent – to the cooling water outlet connection, but not to the connection to the cylinder head. Above all, however, it had manufactured the component exactly in accordance with the OEM's specifications. The alleged design fault was solely attributable to the customer's incorrect specifications. The leak was in fact due to the OEM's faulty assembly, which did not correspond to the state of the art and was not carried out in accordance with the OEM's own assembly specifications.

## Decision grounds

### 1. No liability for the exclusive implementation of customer specifications?

The Stuttgart Regional Court found that the design developed by the supplier was not suitable for the intended use because it did not have the required tightness. It was therefore defective.

However, the supplier was not liable for this defect if the defect was attributable to a specific and binding specification of the customer, as was the case here. Section 645(1) of the German Civil Code (BGB) was applicable in this case: According to this provision, the customer bears the risk if the contractor had to perform defective work due to the customer's instructions. In its reasoning, the court stated:

*„If a contractor manufactures a work in accordance with the customer's express specifications and is not*

*given any technical alternatives, it is not liable for defects that are attributable to these specifications.“*

The court's key finding was that the decision to use a two-hole flange was made solely by the OEM without giving the supplier any freedom of choice. There was no scope for design flexibility. In this respect, the court followed the findings of an expert: the OEM's specifications constituted an inadequate overall concept.

### 2. Scope of the duty to inspect and notify

Nevertheless, it is recognised in case law that a contractor or supplier has certain obligations to check and notify. According to the established case law of the Federal Court of Justice<sup>2</sup>, a contractor is obliged to report any recognisable errors or concerns regarding the client's plans. This applies in particular if the contractor has special expertise or if the error is obvious.

Against this background, the Regional Court of Stuttgart concluded that the supplier could not be held liable for a breach of this obligation to check. The decisive factors were:

- The OEM was a technically highly competent company and had – predominantly exclusive – knowledge of the overall concept of the vehicle and the specific use of the components.
- The chosen design was not clearly faulty in a technical sense.
- Neither the state of the art nor the relevant DIN standards made the three-hole flange the necessarily better solution.

<sup>2</sup> German Federal Court of Justice, November 15, 2007 – VII ZR 45/06.

Therefore, the supplier was entitled to rely on the correctness of the specification.

## Assessment of the judgment

### 1. Limits of responsibility

Although a supplier is generally obliged to deliver a defect-free product in accordance with Section 633 BGB when developing a product, a special case arises when the customer specifies the design. This is because there is no defect if the contractor has produced the product in accordance with the customer's incorrect but binding specifications, provided that these errors were not obvious or technically recognisable.

In the automotive industry in particular, it is common practice that customer specifications must be strictly adhered to, even in the case of developments by highly specialised suppliers. Deviations from this can usually only be made in individual cases through a complex approval process. In practice, it is often problematic that the supplier does not have all the technical information necessary for a complete assessment of the customer's specifications. This makes it even more difficult to identify any faulty specifications. Against this background, the decision results in particular innovations with regard to the supplier's obligations to check and notify in the event of specifications from customers (e.g. OEM or 1st tier). Depending on the circumstances of the underlying case, the supplier's obligations to check and notify may be limited or even excluded on the basis of the Stuttgart Regional Court's decision.

The limit is therefore set at the point where the defect is attributable to a breach of duty

on the part of the contractor – whether through failure to warn, incorrect implementation or unauthorised deviation from the plan. Contractors have a duty to provide information if the customer's performance specifications are insufficient. This requires that the errors in the specifications are recognisable.<sup>3</sup> The circumstances of the individual case, in particular the customer's need for advice and expertise, are decisive for the content and scope of the contractor's duty to check and provide information. The limit here is what is reasonable.<sup>4</sup> The more the contractor can rely on the customer having the relevant knowledge in the circumstances, the fewer inspection obligations the contractor has and the less information needs to be provided to the customer.<sup>5</sup>

### 2. Law on work and services

According to Section 650 (1) sentence 2 and Section 442 (1) sentence 1 BGB, the decisive factor for the transferability of the Stuttgart Regional Court's reasoning to series deliveries is, first of all, that the contract is aimed at the manufacture and delivery of a new item (a so-called 'contract for work and services').<sup>6</sup> If, in addition, the contract concerns the manufacture of an item that is adapted to the customer's requirements so that the item has individual characteristics (a so-called 'non-fungible item')<sup>7</sup>, § 645 BGB also applies in accordance with § 650 (1) sentence 3 BGB. This is particularly the case if the customer specifies certain requirements regarding the manufacture of a specific part and its use, as was particularly the case in the LG Stuttgart ruling and is also frequently the subject of typical supplier relationships.

<sup>3</sup> Higher Regional Court Saarbrücken, June 2, 2016 – 4 U 136/15.

<sup>4</sup> Busche, in: Münchner Kommentar zum BGB, 8th edition 2020, Section 634 note 86

<sup>5</sup> Higher Regional Court Zweibrücken, July 20, 2015 – U 7/14.

<sup>6</sup> Retzlaff, in: Grüneberg, BGB, 81st edition 2022, Section 650 note 3.

<sup>7</sup> Ibid., Section 650 note 11.

### 3. Cause

The assessment on the cause is particularly noteworthy: the damage was directly caused by the technical design specified by the OEM. The incorrect specification was therefore causally relevant for liability. The court ruled that this circumstance interrupts the attribution to the supplier. Accordingly, liability for defects can be excluded if the cause of the defect lies within the sphere of responsibility of the customer. A defect cannot be attributed to a contractor if it the result of binding specifications of the customer.<sup>8</sup>

### 4. Side Note: directed buys

In so-called set part or directed buy situations, in which the OEM specifies certain sub-suppliers, the supplier is regularly obliged to use specified parts from specified suppliers. In these cases too, deviations are generally only possible with the prior approval of the customer. It therefore stands to reason that, against the background of the decision of the Regional Court of Stuttgart, the commissioning of a set part supplier and the use of its products by the supplier can also be regarded as a specification of the customer within the meaning of Section 645 (1) BGB. As a result, the supplier may not be liable for defects in the design and/or products of the component supplier resulting from the customer's specifications under these circumstances. This is important not least because, in practice, the supplier is often faced with claims for compensation in the event of damage caused by the component supplier, but cannot, or at least not to the same extent, seek recourse against the component or sub-supplier due to the lack of corresponding agreements.

## Practical implications

In order to preventively reduce risks and to be able to exonerate themselves in the event of a dispute, suppliers should observe and implement a number of aspects.

### 1. Create reliable contractual provisions

Contractual provisions form the basis of every business relationship, both for partnership-based cooperation and for dealing with dynamic situations during the project. The following aspects in particular should therefore be comprehensively regulated:

- Requirements and specifications relating to the duties and services;
- The (limits of) the supplier's responsibility; development contracts, specifications or QSVs should explicitly regulate who has development authority and who is ultimately responsible for approval;
- The inspection and notification obligations clearly in relation to the duties and services;
- Procedures and processes in the course of the supply relationship, for example with regard to subsequent changes to customer specifications for duties and services.

### 2. Address concerns early and in a verifiable manner

Regardless of contractually agreed responsibilities for development and production or with regard to notification and inspection obligations: If you have concerns or suspicions that your customer is formulating specifications and requirements that you cannot implement for legal or factual/technical reasons, you should report these immediately.

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<sup>8</sup> Ibid., Section 645 note 7.

### 3. Avoid implied approvals

Another pitfall to avoid are discrepancies between 'actual' and agreed processes. This applies to differences between agreed specifications and those in (later) initial sample or series approvals, as well as changes to the contract products after series approval. Agree with the customer how change plans will affect orders or delivery schedules that have already been placed and when any agreed changes are to be implemented.

### 4. Document the processes and specifications

The processes must be documented in writing in a comprehensible and reproducible manner. This includes not only a mutual understanding of the workflow before the start of the project, but also any changes during the project. Legally sound documentation of the customer's specifications and your own notes is essential in order to be able to provide evidence to exonerate yourself.

## Conclusion

The ruling of the Regional Court of Stuttgart is significant in the context of the automotive industry and significantly strengthens the position of suppliers when implementing customer specifications. In summary, the following applies: A supplier who delivers technically correct goods based on binding customer specifications without having any recognisable leeway is generally not liable for any resulting defects – provided that it could not or did not have to recognise obvious planning errors.

But beware: the ruling does not provide a general exemption. As soon as technical doubts arise – especially in the case of safety-relevant components – there is an active duty to investigate. If a supplier identifies a potential defect, it must report and document this to the OEM. Otherwise, it may be liable for 'failure to warn' (Sections 280 (1) and 241 (2) BGB).

It must also be taken into account that this is a decision at the regional court level, so it remains to be seen whether other (higher) courts will decide similar cases in a similar manner or whether there will be a departure from this case law in the future. Nevertheless, the decision is based on an issue that manufacturers and suppliers in all industries should continue to monitor closely and, if necessary, use as a basis for arguments regarding exclusion of liability in similar cases.

### Next step: Contact us

We are happy to support you. We would be happy to explain our approach in detail in a personal meeting. Contact us now with no obligation!

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