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MANUFACTURER INDEMNIFICATION OF RETAILERS IN PRODUCTS LIABILITY CASES

The relationship between manufacturers and retailers is often characterized as a partnership. Both parties share an interest in promoting and selling the manufacturer's goods, and this shared interest is often reflected in joint advertising or other forms of cooperation. However, the onset of litigation can place manufacturers and retailers at odds with one another. This is particularly true in products liability litigation, where manufacturers and retail sellers can have opposing interests – each seeking to shift liability to the other.

One ready example of the conflict between manufacturers and sellers came to light in the Firestone tread separation litigation: There, the longstanding alliance between Ford Motor Co. and Bridgestone/Firestone, Inc. soured when Ford contended that it had merely sold Firestone's defective tires (as opposed to having produced a defective vehicle of its own). In publicly airing their grievances with one another, the two companies were doing more than simply protecting their brand names. If, as Ford contends, Firestone's tires are defective and the sole cause of various rollover accidents, Ford will minimize its own litigation losses. On the other hand, if

Firestone demonstrates that both tires and vehicles combined to cause accidents, the damages for those accidents will be shared by the two companies – and their insurers.

The stakes in the Firestone case are high, certainly amounting to millions and probably to billions of dollars. Such enormous sums are often at issue in products liability cases. In fact, some of Texas' most prominent attorneys have made their reputations bringing (or defending) asbestos, breast implant, and Fen-Phen products liability actions. The potential for billion dollar judgments can make any semblance of a civil relationship between manufacturers and sellers virtually impossible to maintain.

There has always been some solace for retail sellers (the place where Ford is attempting to position itself), who often view themselves as innocent victims caught in the crossfire of products liability litigation. In Texas, “innocent” retail sellers – sellers who did not contribute to a given product's dangerousness – have traditionally had a Common Law right to be indemnified by manufacturers. This Common Law right to indemnification did not prevent sellers from being made defendants in products liability suits. Rather, it simply provided that a manufacturer would pay any damages that a jury awarded against an innocent retail seller, if the manufacturer was financially capable of doing so. Common Law indemnification also extended to litigation expenses, such as court costs and attorney's fees. However, retailers were required to prove their own innocence in order to receive Common Law indemnification.

Proof of innocence is expensive, and cannot be predicted with certainty. In some cases, in the past, the time and expense necessary to prove a seller's innocence might have made it reasonable for a seller to settle, *even where no liability existed*. Other, practical considerations – such as the retailer's long-term relationship with the manufacturer – also frequently pushed sellers toward settlement and the assumption of some liability.

In 1993, the Texas Legislature enacted the Products Liability Act, a series of statutes aimed at

standardizing and improving the state's products liability laws. One of the principal goals of the legislation was to ensure the fair treatment of innocent retail sellers. In order to accomplish that, legislators included a provision in the Act that created a right of indemnification for all innocent retail sellers. This statutory right of indemnification expressly extends to attorney fees, court costs, and other reasonable expenses, *and presumes that the seller is innocent*. It is essentially a 180 degree departure from the old system, where the seller had to prove its innocence.

Predicting the effect of such new legislation is not an exact science. The Act was clearly passed with the best of intentions, and many of the Act's consequences have been favorable: Innocent retail sellers no longer have to watch the steady growth of their attorney fees, nor are they compelled to settle in order to escape the burden of proving their innocence. Also, the fact that a ready pool of seller settlement money no longer exists may deter some marginal or frivolous litigation.

But manufacturers (and their insurers) are less enamored of the Act than sellers, and recent opinions handed down by the Supreme Court of Texas have set manufacturers on edge. While many would agree that manufacturers should indemnify "innocent" retail sellers, the law, when applied to real situations, does not always provide clear cut results. Oftentimes, a plaintiff in a products liability case alleges that some independent act of negligence on the seller's part caused or contributed to his injuries (a so-called "alternative allegation"). For instance, a plaintiff might allege that a product was defectively designed, or, alternatively, that it was improperly assembled by the retail seller. The seller is presumed innocent under the law, since nothing has been proven against it, but how are litigation costs to be apportioned if the case settles before trial?

This situation was addressed by the Supreme Court's decision in *Meritor Automotive, Inc. v. Ruan Leasing Co.*, handed down in March of this year. In *Meritor*, Paul Hampton, a truck driver, was injured while trying to remove the hood from his Freightliner truck. The truck was actually leased from Ruan, and therefore both Freightliner and Ruan were made defendants in the ensuing action. In regard to Ruan, the plaintiff claimed that the leasing company had failed to properly maintain the truck's hood, and that this had caused or contributed to Hampton's injury.

Freightliner settled the plaintiff's products liability claims on the day before trial, and all that remained after-

ward was the plaintiff's claim against Ruan. The plaintiff non-suited this last-remaining claim, essentially ending the liability phase of the case.

But of course, *Meritor* was not quite over. The matter of who would pay for Ruan's defense was hotly contested. Freightliner argued that, since the plaintiff had asserted an independent claim of negligence against Ruan, Ruan was not an "innocent" seller and was not entitled to indemnification for its litigation expenses. Ruan countered that, inasmuch as there had never been a trial, there had never been any determination of its "innocence." Essentially, Ruan argued that it was innocent by default, and that Freightliner had to pay for all of the company's litigation expenses.

In analyzing the issue, Texas' Supreme Court took a long look at the language of the Products Liability Act. The Act provides indemnification for sellers except for harm "caused by" the sellers. The Court reflected that the statute did not say "allegedly caused by," and therefore inferred that a plaintiff's unproven negligence allegation against a seller did not relieve a manufacturer of the duty to indemnify the seller. Only where it was *proven* that the seller's negligence caused the injury would the seller lose his right to indemnification. In the end, Freightliner was forced to pay both its settlement to the plaintiff *and* Ruan's litigation expenses.

The ramifications of this decision are broader than might initially be apparent. In Texas, the vast majority of cases settle before trial. These settlements are economically driven. In a sense, settlement is as much mathematical as legal. A defendant appraises the risk of loss at trial, the risk of negative publicity, and the cost of further litigation, and balances these factors against a dollar amount that will mollify the plaintiff.

The Products Liability Act, as it has been interpreted, creates an additional consideration for manufacturers contemplating settlement: They will now have to weigh the possibility that they will be paying the attorney's fees for a (conceivably) negligent retail seller after the case is settled. If the case settles without any finding of liability on the seller's part, the manufacturer can expect a bill in the mail. Probably a large bill.

This possibility raises questions on all sides. From the manufacturer's perspective, the first and foremost question will likely be, "Does my insurance cover the seller's litigation expenses?" The manufacturer's insurer will be asking itself the same question, and may have to modify its insurance policies in order to completely decide the issue. The seller, for its part, will have to

determine how it can best position itself to pay nothing at the end of the day. And, last but not least, the plaintiff, through its attorney, must plead and argue in a way likely to keep the most feet near the biggest fire.

“IS THAT COVERED?”

– Shoddy Workmanship?

The Austin Court of Appeals recently ruled that shoddy workmanship could not be considered an accidental “occurrence” under a Commercial General Liability Policy. In that case, Dave and Kim Devoe had contracted with Tri-Mark Development Corporation to build a custom home. The Devoes claimed that, due to shoddy workmanship, their home had drainage problems, warped windows, rotten woodwork, a leaky roof, and uneven floors (not to mention some problems they had with the elevator). Tri-Mark requested that its insurer, Great American Insurance, provide defense and indemnification, but Tri-Mark refused. In ruling that Great American owed Tri-Mark neither defense nor indemnification, the appellate court wrote, “The Devoes’ home was constructed over a period of time as a voluntary and intentional act by [Tri-Mark].” Under these circumstances, the defects in the house’s construction could not be construed as an “accident” and therefore were not covered by Tri-Mark’s policy.

–Your Boss’s Car?

In *Sink v. Progressive County Mutual Insurance Company*, the Texarkana Court of Appeals held that Joshua McCauley’s automobile insurance covered him, even though he was driving a car that he had “borrowed” from his employer (Alamo Rent-A-Car) at the time of the accident. McCauley’s insurer had argued that McCauley did not have permission to use the Alamo vehicle at the time, and therefore the vehicle was not a covered “temporary substitute auto,” as that term was defined in the policy. The Court held that, under the plain terms of McCauley’s policy, he was not required to show that he had permission to drive a vehicle in order for it to be considered a “temporary substitute auto.”

–Hail Damage?

In late 1994, Sharon Kaip contacted her insurer, State Farm Lloyds, about what she perceived to be hail damage to her roof. When State Farm’s adjuster arrived, he found that a single shingle had been damaged by hail. According to the adjuster, the roof’s poor condition was

simply due to wear and tear, and wear and tear was not covered by Kaip’s policy. She called for a second opinion, and then for a third: These adjusters all agreed with the first. Finally, Kaip sued State Farm, alleging that the company had refused her claim in bad faith. Despite the fact that a jury found in Kaip’s favor, the Dallas Court of Appeals ruled for State Farm. Specifically, the appellate court reasoned that State Farm’s defense of the suit had raised the issue of “concurrent causation,” requiring that Kaip prove which damage to her roof was the result of wear and which damage was the result of hail. Since she had never apportioned the damages in this way, the court indicated that Kaip had failed to prove her case.

–Making Rude Telephone Calls?

Green Tree Financial Corp. was out to collect on a debt. According to Sylvia Lazo and Eduardo Saenz, the debtors, the company went over the top in its collection efforts, making “frequent rude and abusive telephone calls” from 1986 to 1993. Finally, Lazo and Saenz filed suit against Green Tree. Among other things, Lazo and Saenz claimed that Green Tree had invaded their privacy. Green Tree turned to its insurer to provide a defense against the claim, but the insurance company (St. Paul Fire & Marine) chose to defend under a reservation of rights to deny coverage.

In a Fifth Circuit opinion strictly applying Texas’ traditional “eight corners” rule, Judge Robert Parker

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compared Lazo's and Saenz's petition against Green Tree's policy and found that an invasion of privacy claim could fit within the policy's coverage for "personal injuries." For that reason, the Court compelled Green Tree's insurer to provide the company with a defense.

AROUND THE CIRCUIT

–*Mortgage County National Bank. John Deere Insurance Co.* Fire insurer has no duty to inform mortgagee of the impending expiration of a fire insurance policy under the Texas Insurance Code.

–*In re Davis.* A *Stowers* claim against a debtor's insurer (for negligently failing to settle a claim within the policy limits) was not a part of the debtor's bankruptcy estate, since that claim had not accrued at the time of bankruptcy.

–*Ran-Nan Inc. v. General Accidental Insurance Company of America.* Under Texas Law, two thefts from a convenience store by two employees acting independently were two separate "occurrences" under the store's employee dishonesty policy.

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