

Indemnity Issues in Product Liability Claims arising from Construction Defect Litigation

Recent Cases

In a recent decision, the Texas Supreme Court held that a subcontractor is a "seller," under Tex. Civ. Prac. & Rem. Code Ann. § 82.002(a) and that the manufacturer owes the subcontractor a statutory indemnity duty.¹ This case may well have just as significant an impact on risk transfer for building product manufacturers in Texas as *Crawford v. Weather Shield Mfg., Inc.* had in California.² Moreover, at least one other state, Oklahoma, has a statute very similar to the manufacturer's indemnity statute in Texas.³

In *Fresh Coat, Inc. v. K-2*, Fresh Coat contracted with a homebuilder, Life Forms, Inc., to install exterior insulation and finishing systems, also called EIFS, in numerous homes.⁴ The contract required Fresh Coat to indemnify Life Forms regardless of any fault on the part of Life Forms.⁵ K-2 manufactured the EIFS synthetic stucco component.⁶ With the aid of K-2's direction and guidance, Fresh Coat purchased and installed K-2's EIFS.⁷ More than 90 homeowners sued K-2, Fresh Coat, and Life Forms claiming that the EIFS allowed water penetration that allowed structural damage to the walls, termite infestations, and mold.⁸ When the homeowners reached settlements with all the defendants, Fresh Coat sought indemnification from K-2 for its settlement with the homeowners and also its settlement with Life Forms, even though there was an indemnity provision in its subcontract.⁹

Chapter 82 of the Texas Product Liability Act (TPLA) regulates a manufacturer's indemnity obligations extending from products liability claims.¹⁰ Where the loss was not caused by the seller's actions, the statute imposes a duty on a manufacturer to indemnify

a seller and hold the seller harmless of claims against the manufacturer's products.¹¹ TPLA defines a "products liability action" as "any action against a manufacturer or seller for recovery of damages arising out of personal injury, death, or property damage allegedly caused by a defective product whether the action is based in strict tort liability, strict products liability, negligence, misrepresentation, breach of express or implied warranty, or any other theory or combination of theories."¹² The court pointed out that the statute defines "seller" as "a person who is engaged in the business of distributing or otherwise placing, for any commercial purpose, in the stream of commerce for use or consumption a product or any component part thereof."¹³ Lastly, the court used Black's Law Dictionary to define "product" as "something that is distributed commercially for use or consumption and that is usually (1) tangible personal property; (2) the result of fabrication or processing; and (3) an item that has passed through a chain of commercial distribution before ultimate use or consumption."¹⁴

The Texas Supreme Court concluded that EIFS is a "product" as that word is used in the text of Chapter 82 of the TPLA.¹⁵ The Court rejected K-2's argument that products placed into the stream of commerce lose their status as products when they become integrated into real property even if they were "products" beforehand.¹⁶ Instead the court pointed out that at least as to Fresh Coat's transaction with Life Forms, the EIFS was "used" as a result of commercial distribution thus placing it within the meaning intended under Chapter 82.¹⁷

The Court rejected K-2's argument that even if EIFS is a product, Fresh Coat is not a seller, but merely a service provider that installed a product.¹⁸ Instead, the Court agreed with Fresh Coat's argument that it *did* provide EIFS installation services, but it

was a product seller *and* a service provider, and since it did both it may be considered a product seller under Chapter 82.¹⁹ The Court's conclusion was consistent with the Third Restatement of Torts, that Chapter 82's definition of "seller" does not exclude a seller who is also a service provider, nor does it require the seller to only sell the product.²⁰

Moreover, the Texas Supreme Court held that Fresh Coat was entitled to repayment of monies it paid in settlement to Life Forms regardless of K-2's argument that there was an indemnity provision in Fresh Coat's subcontract.²¹ Because Fresh Coat's settlement with Life Forms "arose out of a products liability action" from underlying homeowner claims against Life Forms that were settled, the action for damages allegedly caused by a defective product was appropriate.²²

The Court further noted that section 82.002 does not provide K-2 with an exception from its indemnity obligation just because Fresh Coat is contractually liable to another.²³ Moreover, the Court observed that section 82.002(e) expressly provides that the manufacturer's duty to indemnify is in addition to any duty to indemnify created by law, contract or otherwise.²⁴ Further, the court held that "a manufacturer is not exempt from *any* loss for which a seller is independently liable."²⁵ The court reasoned that the statute limits this exception to indemnity losses "caused by the seller's tortious or otherwise culpable act or omission for which the seller is independently liable."²⁶

Retailers and distributors of building products have been frequent defendants in construction defect litigation. Both of those groups routinely pursue indemnity from the manufacturers of the products they placed into the stream of commerce which ended up in the subject building. In view of this decision, retailers and distributors will likely experience a rise in indemnity claims from contractors and other service providers who

sell and install products. Certainly, this opinion will be a powerful tool for distributors to obtain indemnity and avoid EIFS litigation.

In an attempt to support retailers, some state's statutes providing for manufacturer's indemnity have been drafted to require indemnity, even if the product is ultimately determined to not have been defective.²⁷ However, even these statutes have been interpreted to have an exception for component part manufacturers.²⁸ In *Bostrom*, a component part manufacturer from whom indemnity had been sought by a product liability defendant obtained a directed verdict at trial. The court of appeals reversed the directed verdict and the Texas Supreme Court granted review. Taking up the issue for the first time, the Texas Supreme Court held that strict products liability does not apply to component part manufacturers who do not participate in the integration of the component into the finished product.²⁹ In so doing, the Court pointed out that courts around the United States have previously followed this rule for decades. Numerous courts outside of Texas have also held likewise.³⁰

According to the Texas Supreme Court, "if no evidence exists to indicate that the component part itself was defective, the component part manufacturer should be relieved of any liability for a . . . defect in the final product, including any action for indemnification."³¹ Therefore, unless evidence is presented that the component part was "itself defective," indemnity cannot be obtained from the component part manufacturer.³² The result is that when issues of indemnity are litigated, retailers and distributors argue that the "product" that is the subject of the product liability action is the window, cladding, etc. designed, created, or supplied by the manufacturer, not the building itself. If they are successful in doing so, they are relieved of the burden of proving that product

defective in order to recover indemnity as called for by the Restatement or even the strictest schemes of statutory indemnity.

Statutory Developments in Risk Transfer

On June 17, 2011, Texas Governor Perry signed new anti-indemnity legislation applicable to non-residential construction contracts which will, in effect, ban broad form indemnification clauses and limit the types of additional insurance (“AI”) endorsements that can be utilized to shift risk in construction contracts. The statute is broken down into the following subchapters:

- Subchapter A: Providing definitions for various terms;
- Subchapter B: Imposing a minimum duration for general liability insurance coverage for completed operations;
- Subchapter C: Banning construction contract terms which provide indemnification and/or additional insurance for an indemnitee’s/additional insured’s negligence;
- Subchapter D: Prohibiting the contractual waiver of any provision of the legislation.

Prior to the enactment of H.B. 2093, Texas law permitted parties to a construction contract to shift the risk of liability for of one party’s negligence to another contracting party through the use of broad form indemnity provisions and/or additional insured provisions (described *infra*). See e.g., *XL Specialty Ins. Co. v. Kiewit Offshore Services, Ltd.*, 513 F.3d 146, 149 (5th Cir. 2008). H.B. 2093 will prohibit the use of both of these types of provisions, and consequently, require contractors to bear the risk for their own negligence.

Previously, Texas was among a minority of states that still permitted parties to

utilize broad form indemnity provisions in most construction contracts. The disfavor towards broad form provisions stems from a “traditional reluctance” to “cast the burden of negligent actions upon those that were not actually at fault.” *U.S. v. M.O. Seckinger*, 397 U.S. 203, 211 (1970).

Texas, however, permitted the use of broad form indemnity provisions pursuant to the “express negligence rule” rather than ban contracting parties from utilizing such provisions altogether. *XL Specialty Ins. Co.*, 513 F.3d at 149. The “express negligence rule” requires that “contracting parties seeking to indemnify one party from the consequences of its own negligence must express that intent in specific terms, within the four corners of the document.” *Id.* To state alternatively, parties were permitted to agree to broad form indemnity provisions as long as its terms were stated clearly and unambiguously.

Following the enactment of H.B. 2093, Texas will join the majority of states with similar anti-indemnity statutes prohibiting the use of a broad form provision in its entirety. Texas had previously banned the use of such provisions in construction contracts with registered architects or licensed engineers, as well as certain oil, gas, and mineral contracts. See Tex. Civ. Prac. & Rem. Code § 130.002 (prohibiting provisions which would either indemnify a registered architect or licensed engineers from liability for damages caused by defective design, plans, specifications, and/or professional negligence or indemnify an owner for its own negligence) and Tex. Civ. Prac. & Rem. Code §127.003. H.B. 2093 will now expand the ban to apply to any provision in a “construction contract” as it will be defined in Texas Insurance Code §151.001(5) and will apply to the contracts between general contractors and their subcontractors. H.B.

2093 (to be codified as Tex. Ins. Code §151.102).

The ban on broad form indemnity will not apply to any provision requiring indemnity for claims of bodily injury or death of an employee of the indemnitor (or its agent or subcontractor). H.B. 2093 (to be codified as Tex. Ins. Code §151.103).

Conclusion

Because construction defect litigation has been a constant for homeowners, retailers, and contractors in the United States for some time, the *Fresh Coat* decision has made it even more important for a manufacturer to prove the contractor's independent liability either through the contractor's negligence or other culpable acts to avoid its possible indemnity obligation.

ENDNOTES

¹ *Fresh Coat, Inc. v. K-2, Inc.*, 2010 Tex. LEXIS 610 at 11 (Tex. 2010).

² See *Crawford v. Weather Shield Mfg., Inc.*, 44 Cal. 4th 541, 548 (Cal. 2008).

³ See Okla. Stat. tit. 12, Sec. 832.1.

⁴ *Id.* at 1.

⁵ *Id.* at 14.

⁶ *Id.* at 1.

⁷ *Id.* at 2.

⁸ *Id.*

⁹ *Id.*

¹⁰ Tex. Civ. Prac. & Rem. Code § 82.001 (LEXIS 2010).

¹¹ *Fresh Coat, Inc. v. K-2, Inc.*, 2010 Tex. LEXIS 610 at 16.

¹² Tex. Civ. Prac. & Rem. Code Ann. § 82.001(2).

¹³ Tex. Civ. Prac. & Rem. Code Ann. § 82.001(3).

¹⁴ Black's Law Dictionary 1245 (8th ed. 2004).

¹⁵ *Fresh Coat, Inc. v. K-2, Inc.*, 2010 Tex. LEXIS 610 at 6.

¹⁶ *Id.* at 5.

¹⁷ *Id.* at 6.

¹⁸ *Id.* at 10.

¹⁹ *Id.* at 11.

²⁰ *Id.*

²¹ *Id.* at 14.

²² *Id.* at 15.

²³ *Id.*

²⁴ *Id.* at 17.

²⁵ *Id.* at 20.

²⁶ *Id.*

²⁷ See *Meritor Automotive, Inc. v. Ruan Leasing Company*, 44 S.W. 3d 86 (Tex. 2001); Tex.Civ.Prac. & Rem. Code Sec. 82.002; Okla. Stat. tit. 12, Sec. 832.1.

²⁸ See *Bostrom Seating Inc. v. Crane Carrier Company*, 140 S.W.3d 681 (Tex. 2004).

²⁹ *Id.*

³⁰ See *Cipollone v. Yale Indus. Prods., Inc.*, 202 F.3d 376, 379 (1st Cir. 2000); *Port Auth. of N.Y. & N.J. v. Arcadian Corp.*, 189 F.3d 305, 313 (3d Cir. 1999); *Childress v. Gresen Mfg. Co.*, 888 F.2d 45, 49 (6th Cir.1989); *Zaza v. Marquess & Nell, Inc.*, 144 N.J. 34, 675 A.2d 620, 634 (N.J. 1996); *Buonanno v. Colmar Belting Co.*, 733 A.2d 712, 716 (R.I. 1999); *Davis v. Komatsu Am. Indus. Corp.*, 42 S.W.3d 34, 43 (Tenn. 2001). This is also the rule enunciated in the Restatement (Third) of Torts: Products Liability sec. 5 (1998).

³¹ *Bostrom*, 140 S.W.3d at 682 (emphasis added).

³² *Id.*

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