IADC Committee Newsletter

PRODUCT LIABILITY

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IN THIS ISSUE

Robert G. Smith outlines the innocent seller statutes in several states and discusses some of the liability considerations when deciding whether a manufacturer should agree to defend and indemnify a seller.

Innocent Sellers and Such

ABOUT THE AUTHOR



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ABOUT THE COMMITTEE

The Product Liability Committee serves all members who defend manufacturers, product sellers and product designers. Committee members publish newsletters and *Journal* articles and present educational seminars for the IADC membership at large and mini-seminars for the committee membership. Opportunities for networking and business referral are plentiful. With one listserv message post, members can obtain information on experts from the entire Committee membership.

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A product manufacturer can be found liable for defective products under the theories of strict liability, negligence, breach of warranty, and other causes of action in most courts in the United States. Many states have "innocent seller" statutes that require a manufacturer to defend and indemnify sellers of their products, unless there is independent liability for the seller. The rationale for such statutes is that the manufacturer knows the most about its product and is in the best position to design its products without defects and correct any problems that arise.

For upstream manufacturers an innocent seller statute can be significant. If a company's product is used as a component in a second product which is then incorporated into yet another product and sold through a fourth company, the original manufacturer may be required to defend and indemnify all of the entities downstream of it.

A common exception to the manufacturer's duty to defend and indemnify the seller is when the seller knows about a product defect or is involved in the design of the product, the seller modified or assembled the product in a way that caused the harm, the seller created a warning or instruction that was inadequate and caused harm, or the seller made misrepresentations about the product. *See, e.g.*, Tex. Civ. Prac. & Rem. Code §82.003.

Problems With Innocent Seller Statutes

A manufacturer's decision of whether and when to accept the defense and indemnity of a seller can be significant. The fact that some statutes require the manufacturer to indemnify the seller even without regard to how the matter is concluded, such as where a lawsuit is successfully defended and the product is not found defective, seems unfair to the manufacturer. *See* Tex. Civ. Prac. & Rem. Code §82.002(e)(1).

Innocent seller statutes also require manufacturers to basically insure sellers in situations where the manufacturer has little control over sales of its products after the initial transaction and may not know who will sell the products to the end consumer. The manufacturer may also have no input into the training, instructions, and associated literature that accompanies its products downstream.

The manufacturer may have a conflict of interest paying for the defense of a seller where the two entities may argue at trial that the other one is liable.

Where a seller could settle a case for a reasonable amount, it may have an incentive to proceed with a costly defense where it hopes to resolve the case with no settlement or judgment in its name and the manufacturer may be required to pay the associated litigation costs.

There are many instances where a claimant may want to sue a seller or distributor in addition to a manufacturer, such as to maintain an action in state court and prevent removal to federal court or for venue purposes. While product liability and innocent seller statutes are intended to protect consumers from dangerous products and at the same time balance the rights of manufacturers and sellers or distributors, it is sometimes difficult to determine the most effective strategy for defending a manufacturer under these statutes. These issues have only become more complex with the rise in products manufactured outside the U.S.

Innocent Seller Statutes Around the U.S.

In Arizona where a manufacturer refuses to defend a seller, the manufacturer must indemnify the seller for any judgment plus attorney fees and costs unless the seller knew about the product defect or the seller modified or installed the product such that its modification or installation was a "substantial cause of the incident giving rise to the action," and the seller's action was not authorized or requested by the manufacturer and not in compliance with the directions from the manufacturer. Ariz. Rev. Stat. §12-684(A). If the claimant receives a judgment and a seller is granted indemnity against the manufacturer, the claimant must first attempt to satisfy the judgment from the manufacturer in the State of Arizona or where the manufacturer's principal business is located and by making a demand to the manufacturer's liability insurance carrier. Ariz. Rev. Stat. §12-684(B). If it is determined the manufacturer shall be indemnified by the seller for any judgment rendered against the manufacturer, it can also recover fees and costs where the seller provided the plans or specifications for the manufacturer of the product and such plans or specifications caused the defect and the product was manufactured in compliance therewith. Ariz. Rev. Stat. §12-684(C).

In Colorado, the law simply states that no product liability action shall be commenced or maintained against the seller of a product unless jurisdiction cannot be obtained over the manufacturer of the product or part alleged to be defective, in which case the product will be deemed to be manufactured by the seller over which the court can obtain jurisdiction. Col. Rev. Stat. §13-21-402(2).

In Louisiana, a seller who did not know he sold a defective product must repair or correct the defect and if he is unable to do so he must return the purchase price to the buyer with interest plus expenses related to the sale. The seller thereafter can recover from the manufacturer of the defective product if the defect existed when it was delivered by the manufacturer to the seller. Such recovery by a seller from the manufacturer cannot be limited by contract. La. Civ. Code Art. 2531.

In Mississippi, the product liability statute specifies that the manufacturer or seller of a product can be liable, but requires that the claimant prove the manufacturer or seller knew or should have known about the danger that caused claimant's damage. Miss. Code Ann. §11-1-63(f)(i). A manufacturer who is found liable for a defective product shall indemnify a product seller for litigation costs, attorney's fees and damages unless the seller "exercised substantial control over that aspect of the design, testing, manufacturing, packing or labeling of the product that caused the harm for which the recovery of damages is sought." Miss. Code Ann. 11-1-63 (g)(i). The seller of a product other than the manufacturer shall not be liable unless the seller exercised substantial control over the design, testing, manufacturing, packing or labeling of a product that caused the harm, altered or modified the product such that it caused the harm, or had knowledge of the defect at the time of sale. Miss. Code Ann. §11-1-63(h).

In Missouri, an innocent seller can be dismissed from a product liability action where the only allegation related to placing the product in the stream of commerce, and only in a product liability claim "in which another Defendant, including the manufacturer, is properly before the court and from whom total recovery may be had for Plaintiff's claim." Mo. Rev. Stat. §537.762.

In Oklahoma, the manufacturer shall indemnify and hold harmless a seller against matters arising out of product liability other than related to the seller's negligence, intentional misconduct or other act or omission such as negligently modifying the product giving rise to the seller's independent liability. 12 Okla. Stat. §832.1(A). The manufacturer's duty to indemnify applies without regard to how the matter is concluded. 12 Okla. Stat §832.1(E).

Texas' product liability statute specifies that a manufacturer shall indemnify and hold harmless a seller against losses "arising out of a products liability action," except for any loss caused by the seller's negligence, intentional misconduct, or other act or omission, such as negligently modifying or altering the product, for which the seller is independently liable. Tex. Civ. Prac. & Rem. Code §82.002(a). However, in Texas there is a separate statute setting out that a non-manufacturing seller can be liable where the claimant shows the seller participated in the design of the product, altered or modified the product such as to cause the harm, the seller installed the products such that it caused the harm, the seller exercised substantial control over the content of the warning or instructions accompanying the product and such was inadequate thereby causing the claimant's harm, or the seller made express misrepresentations about the product where the seller actually knew about the defect and the claimant's harm resulted from the defect, where the manufacturer is insolvent or not subject to the jurisdiction of the court. Tex. Civ. Prac. & Rem. Code §82.003(a). Additionally, if a non-resident manufacturer is served through the Secretary of State and fails to answer or make an appearance in the lawsuit, it is assumed the manufacturer is not subject to the jurisdiction of the court. Tex. Civ. Prac. & Rem. Code §82.003(c). This would cause the seller to be liable under §82.003(a)(7)(B) which specifies the seller can be liable where the manufacturer of the product is "not subject to the jurisdiction of the court."

Outsourcing Liability?

For a manufacturer that has decided to have its product designed and/or manufactured overseas, such product liability statutes can be a boon or bane depending on the circumstances. The original manufacturer may hope to be an innocent seller, but may still be responsible for product liability actions if it designed the product it is having made overseas or created the warnings or instructions that lead to an injury. Under most product liability statutes the original manufacturer would not be an "innocent seller" where it designed the product. *See, e.g.,* Tex. Civ. Prac. & Rem. Code §82.003(a). While the original company may have reduced its cost in having a product manufactured overseas, it may still be responsible for strict liability and other product liability related claims, under circumstances where it is not in control of the manufacturing standards for the product.

Where the local company gets sued for a product liability action and requests defense and indemnity from the overseas manufacturer, the overseas company often will not respond or agree to defend or indemnify the American company. Multiple product liability statutes include provisions that where the manufacturer is outside the jurisdiction of the local court, the seller is responsible for the product liability claims. *See, e.g.,* Ariz. Rev. Stat. §12-684(B); Col. Rev. Stat. §13-21-402(2); Mo. Rev. Stat. §537.762(2); Tex. Civ. Prac. & Rem. Code §82.003(a)(7)(B) & (c). In these instances, the local seller or "manufacturer" may be left holding the bag and responsible for all

damages related to claims arising from a product defect.

Role in the Litigation

A company should consider its role in any litigation as to whether it is the manufacturer, supplier, and/or seller. The company's role in any subsequent product liability litigation may vary depending on whether it manufactured and sold a completed product to the end consumer, designed and manufactured a component product that is sold to another company for incorporation into a completed product, or whether it simply contracted with another company to design and manufacture a product to sell under its label, etc.

The party that perceives itself to be the "innocent seller" will likely demand defense and indemnity at the onset of any litigation. The putative manufacturer must decide whether to accept the defense of the seller at the outset of the litigation or not. There are risks involved with accepting the defense of the seller at the outset, including;

1) Discovery could reveal facts that show the seller modified the product, installed the product incorrectly, provided additional warnings or instructions to the purchaser such that it would be independently liable in the case, and then the putative manufacturer's counsel would likely have to withdraw from the defense of both parties unless appropriate waivers of conflict had been signed;

2) To the extent the claimant continues to argue independent theories of liability as to the manufacturer and seller, the manufacturer could be paying for the defense of the seller whose incentive is to increase the manufacturer's liability, which is obviously a conflict;

3) The manufacturer may avoid defending and indemnifying the seller altogether if in the course of litigation the claimant or the manufacturer can show independent liability on behalf of the seller. Note in Texas at least, a manufacturer's duty to defend and indemnify a seller arises by the claimant simply pleading product liability against the seller. *Fitzgerald v. Advanced Spine Fixation Systems, Inc.*, 996 S.W.2d 864 (Tex. 1999). However, a manufacturer seeking to establish the seller's independent liability must do more than simply plead the seller's independent culpability, and establish that the seller caused the loss in order to avoid the requirement to defend and indemnify the seller. *Meritor Automotive, Inc. v. Ruan Leasing Company*, 44 S.W.3d 86 (Tex. 2001).

The discrepancy in the standard between the duty to defend and indemnify arising simply upon claimant's pleading a product liability action against the seller and the requirement that a manufacturer actually prove a seller was involved such that the seller is independently liable can cause problems. In a situation where the manufacturer believes the seller acted inappropriately and assembled the product incorrectly, or failed to pass along the manufacturer's warnings and instructions, a manufacturer may not believe it owes defense and indemnity to the seller. The claimant rarely cares who pays for his damages as long as they are paid. At mediation the claimant may make separate demands to the manufacturer and the seller. The seller may settle independently, or stand firm on its demand for defense and indemnity from the manufacturer. Sometimes the injured claimant does not want to settle with the manufacturer unless the seller settles as well. While the

manufacturer may feel confident it could prove the seller's independent liability at a trial, especially where the claimant is making similar allegations, it is likely more difficult for the manufacturer to prevail over the seller where the claimant has settled with all defendants and is no longer present at trial, where the only claims remaining are between the defendants. There are many situations like this where a manufacturer may end up paying the seller's portion to defend and/or resolve a claim even where it should not have to do so.

This author was involved in a case defending a "manufacturer." The dealer was a co-defendant and demanded defense and indemnity from the "manufacturer." Discovery revealed that the "manufacturer" had an overseas company design and manufacture the product. Plaintiff counsel added the overseas manufacturer to the suit and it hired an attorney and appeared in the lawsuit. This author was then able to demand defense and indemnity from the true manufacturer, because his client was actually an innocent seller after all.

Sometimes there may be a benefit to assuming the defense and indemnity of the seller at the outset of litigation because the manufacturer's counsel could have better control over the defense of the case, avoid paying for a separate attorney in the end, and perhaps get a lower overall settlement than where the claimants negotiated with the defendants separately and the manufacturer had to pay for all counsel.

In summary, oftentimes a manufacturer's decision is to pay now or pay later regarding any arguable liability on behalf of the seller of its product, because there is often too much expense and risk involved to prove the exceptions to innocent seller statutes, related to direct liability on behalf of the seller. The specific facts of each case must be evaluated in light of the applicable statute, and any overriding strategic considerations.

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