

Fresh Coat and Products Claims in Construction Defect Litigation

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. *Fresh Coat, Inc. v. K-2, Inc.*, 2010 Tex. LEXIS 610 at 11 (Tex. 2010). 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. See *Crawford v. Weather Shield Mfg., Inc.*, 44 Cal. 4th 541, 548 (Cal. 2008). Moreover, at least one other state, Oklahoma, has a statute very similar to the manufacturer's indemnity statute in Texas. See Okla. Stat. tit. 12, Sec. 832.1.

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. *Id.* at 1. The contract required Fresh Coat to indemnify Life Forms regardless of any fault on the part of Life Forms. *Id.* at 14. K-2 manufactured the EIFS synthetic stucco component. *Id.* at 1. With the aid of K-2's direction and guidance, Fresh Coat purchased and installed K-2's EIFS. *Id.* at 2. 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. *Id.* 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. *Id.*

Chapter 82 of the Texas Product Liability Act (TPLA) regulates a manufacturer's indemnity obligations extending from products liability claims. Tex. Civ. Prac. & Rem.

Code § 82.001 (LEXIS 2010). 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. *Fresh Coat, Inc. v. K-2, Inc.*, 2010 Tex. LEXIS 610 at 16. 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." Tex. Civ. Prac. & Rem. Code Ann. § 82.001(2). 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." Tex. Civ. Prac. & Rem. Code Ann. § 82.001(3). 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." Black's Law Dictionary 1245 (8th ed. 2004).

The Texas Supreme Court concluded that EIFS is a "product" as that word is used in the text of Chapter 82 of the TPLA. *Fresh Coat, Inc. v. K-2, Inc.*, 2010 Tex. LEXIS 610 at 6. 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. *Id.* at 5. 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. *Id.* at 6.

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. *Id.* at 10. 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. *Id.* at 11. 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. *Id.*

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. *Id.* at 14. 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. *Id.* at 15.

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. *Id.* 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. *Id.* at 17. Further, the court held that "a manufacturer is not exempt from *any* loss for which a seller is independently liable." *Id.* at 20. 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.” *Id.*

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. *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. However, even these statutes have been interpreted to have an exception for component part manufacturers. *See Bostrom Seating Inc. v. Crane Carrier Company*, 140 S.W.3d 681 (Tex. 2004). 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. *Id.* 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. 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).

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." *Bostrom*, 140 S.W.3d at 682 (emphasis added). Therefore, unless evidence is presented that the component part was "itself defective," indemnity cannot be obtained from the component part manufacturer. *Id.* 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.

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.

The Authors:

David V. Wilson II is a shareholder in the Houston-based law firm of Hays, McConn, Rice & Pickering who practices in both Texas and Nevada. He is Vice Chair of the DRI Construction Law Committee.

Amoree N. Joe is a law student and extern at the law firm of Hays, McConn, Rice & Pickering located in Houston, Texas. She will be taking the February 2011 bar exam.