

**STATUTORY INDEMNITY FROM MANUFACTURERS
IN CONSTRUCTION LITIGATION**

THE 6TH ANNUAL CONSTRUCTION SYMPOSIUM

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STATUTORY INDEMNITY FROM MANUFACTURERS IN CONSTRUCTION LITIGATION

I. INTRODUCTION

Construction defect litigation typically involves claims concerning how the work in question was performed. More often than not, the work of more than one party is involved and often than there are numerous parties' work that is at issue. The claims take the form of both negligence and contract claims and the focus is on the deficiency of the work performed. That work can include the construction, design, or both.

The actual design and construction work, however, is not the only thing involved in construction. Materials are obviously being used and installed. Those materials are provided by suppliers and manufacturers. Sometimes, the construction deficiency or defect is created in whole or in part by the materials.

Problems with the materials lead to claims against the suppliers and manufacturers of those materials. Those types of claims are somewhat different than the typical construction defect claims involving alleged deficiencies in the design or construction work. There is a whole body of law involving products liability that comes into play once you start talking about the materials that have been used in the construction. That body of law, products liability law, is well developed. There is even a statute in the Texas Civil Practice & Remedies Code governing a manufacturer's duties and obligations when there is a claim involving an alleged defect of one of their products.

II. FRESH COAT, INC. v. K-2

While defective product issues in the form of defects in the materials used in construction is not unusual in a construction defect claim, the interplay between products liability law and standard construction defect claims has received little attention over the years. Recently, however, the Supreme Court directly addressed these issues and outlined how the marriage between products liability law and construction defect law is going to work.

The case in which the Supreme Court addressed this issue is *Fresh Coat, Inc. v. K-2, Inc.*,¹ The case arose out of a number of residential construction defect claims in the Houston area. The construction of the homes involved the installation of exterior insulation finish systems or "EIFS." EIFS has spawned a great deal of litigation both on the claims side as well as the coverage side, and has led to significant developments in both areas involving construction defect claims. In fact, several of the more significant coverage cases are EIFS cases. EIFS has also brought a number of other parties into construction defect litigation cases that typically were not involved before. Anyone creating a penetration in the EIFS system, all the way down to the satellite TV and security alarm contractors, can easily find themselves a party to a case involving water penetration in an EIFS system. It is, therefore, not surprising to see EIFS at the center of the landmark case applying products liability law to a construction defect claim.

The *Fresh Coat* case involved over ninety homeowners who had purchased homes from a homebuilder, Life Forms, Inc. EIFS was installed on the exterior of the homes by a subcontractor, Fresh Coat, Inc. K-2, Inc. manufactured the synthetic stucco components or EIFS and, through its suppliers, provided the EIFS to Fresh Coat. Fresh Coat purchased the EIFS from K-2 and its suppliers, and installed it in the residences for Life Forms. The classic EIFS claim later ensued, with the homeowners alleging that water penetration through and behind the EIFS caused structural damage, mold, termite, and other related problems to the residences. Claims were brought against the homebuilder, Life Forms, the subcontractor who installed the EIFS, Fresh Coat, and the manufacturer, K-2.

As with most construction defect cases, there were cross-claims filed among the parties. Included among those cross-claims were claims for indemnity. These included a claim by the builder against the subcontractor for indemnity based on a standard contractual indemnity

¹ 318 S.W.3d 893 (Tex. 2010)

provision in their contract. It also included a claim by the subcontractor, Fresh Coat, against the manufacturer, K-2, for statutory indemnity. Chapter 82 of the Texas Civil Practice & Remedies Code (“CPRC”) provides for indemnity of contractors by manufacturers in product-liability claims.

Ultimately, the claims of the homeowners were settled by Life Forms and Fresh Coat. Fresh Coat also settled with Life Forms, paying \$1.2 million to Life Forms to cover part of Life Forms’ settlement payment to the homeowners. Fresh Coat also paid over a million dollars to the plaintiffs directly as part of the settlement. The claims against K-2 proceeded to trial and the jury returned a verdict in favor of Fresh Coat and Life Forms. The claims by Life Forms against K-2 were settled. The verdict in favor of Fresh Coat, which included the amounts it paid in settlement to the homeowners and the amounts it paid in settlement with Life Forms, as well as \$726,642 in attorney’s fees, was appealed by K-2.

The issues on appeal presented some very interesting ones. The first of those was whether EIFS installed in a building or residence is a “product.” Another is whether a contractor who acquires materials from a supplier and then installs the materials into a facility can be considered a “seller” of those materials. Yet another is how the indemnity obligations under contracts between parties may impact the duties and obligations of a manufacturer to provide statutory indemnity under Chapter 82.

A. Is EIFS a Product under Chapter 82?

The first question that the court had to deal with was whether EIFS is a “product” in the first place. Chapter 82 provides the basis for the statutory indemnity obligation of a manufacturer in products-liability claims. Interestingly, however, Chapter 82 does not define what a “product” is. Instead, Chapter 82 provides that it applies to a products-liability action. Several definitions in Chapter 82 are pertinent and somewhat informative on the issues the court was dealing with. Those definitions include:

(2) “Products Liability Action”;

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, negligent misrepresentation, breach of express or implied warranty, or any other theory or combination of theories.

(3) “Seller”;

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 thereof.

(4) “Manufacturer”;

A person who is a designer, formulator, constructor, rebuilder, fabricator, producer, compounder, processor, or assembler of any product or any component part thereof and who places the product or any component part thereof in the stream of commerce.²

One could speculate on exactly how the legislature could have defined a “product,” but they did not include such a definition in the statute.

Looking beyond the statute itself, other Texas cases have applied Texas products liability law to materials or subcomponents of homes in various contexts. The Supreme Court took note of such cases in making its decision.³

² Tex.Civ.Prac.&Rem.Code § 82.001

³ *Fresh Coat* at 898, f.8, citing *Temple EasTex, Inc. v. Old Orchard Creek Partners, Ltd.*, 848 S.W.2d 724, 731-32 (Tex.App.-Dallas 1992, writ denied) (treating fiberboard as a product for purposes of products-liability claims); *Bennett v. Span Indus., Inc.*, 628 S.W.2d 470, 472 (Tex.App.-Texarkana 1981, writ ref ‘d n.r.e.) (noting that had there been a defect in a component installed in a building, that defect might have supported a legitimate claim of

Other Texas cases that were not even mentioned by the Supreme Court have also touched on and somewhat addressed EIFS and seemed to have at least implicitly treated it as a product.⁴

Looking more closely at the definitions it had available in the statute, the court sort of backs into a finding that EIFS is in fact a product. Looking more closely at the definition of “seller,” the court noted:

From that definition, a product is something distributed or otherwise placed, for any commercial purpose, into the stream of commerce for use or consumption.⁵

The EIFS that was used in the construction of the houses was, of course, placed into the stream of commerce by the manufacturer.

K-2 admitted, out of necessity probably, that it originally manufactured the EIFS as a product. K-2 argued, however, that the EIFS sort of lost its status as a “product” when it was incorporated into the residences. K-2 further argued or claimed that the inclusion or incorporation of the EIFS into the residences somehow meant there was no longer any EIFS product for purposes of Chapter 82. Looking closer at the statutory definitions, and specifically the definition of “manufacturer,” the Supreme Court disagreed. The definition of “manufacturer” as set forth above includes “any product or any component part thereof.”⁶ The

products liability); *Cupples Coiled Pipe, Inc. v. Esco Supply Co.*, 591 S.W.2d 615, 615-16, 618 (Tex.Civ.App.-El Paso 1979, writ ref'd n.r.e.); *Hovenden v. Tenbush*, 529 S.W.2d 302, 305-06 (Tex.Civ.App.-San Antonio 1975, no writ) (treating used bricks in a building as defective products after walls made with the bricks deteriorated).

⁴ *Pugh v. General Terrazzo Supplies, Inc.*, 243 S.W.2d 84, 93-95 (Tex.App.—Houston [1st Dist.] 2007, no pet.); *R. H. Tamlyn v. Scholl Forest Industries, Inc.*, 208 S.W.3d 85 (Tex.App.—Houston [14th Dist.] 2005, no pet.); *Hixon v. Tyco Int'l, Ltd.*, 2006 Tex.App. LEXUS 9494 at 12 (Tex.App.—Houston [1st Dist.] Oct. 31, 2006, no pet.)

⁵ *Fresh Coat* at 897.

⁶ *Id.* at 898. [Emphasis ours.]

court simply found that by being incorporated in the house, the EIFS was no different than a component part of the product, something specifically addressed by Chapter 82 and not something that would make the EIFS lose its status as a “product.” The Court declined to read the term “product” more narrowly than what is set forth in Chapter 82.

B. Was K-2 a “Seller”?

The court next looked at whether Fresh Coat was a “seller” for purposes of Chapter 82. Fresh Coat obtained the materials from K-2 by purchasing it from them to install in the residences for Life Forms. Chapter 82, as set forth above, defines a “seller” as follows:

(3) “Seller”;

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 thereof.⁷

K-2 argued that Fresh Coat did not actually place EIFS into the stream of commerce, but only applied it to the walls of the new houses being built by Life Forms. It tried to define Fresh Coat’s activities as a party providing a service as opposed to a product seller. Fresh Coat argued that it was both providing a service and selling a product.

Looking at other provisions of the statute, the court found support for the argument that Fresh Coat was in fact a “seller.” The statute provides that:

(d) For purposes of this section, a wholesale distributor or retail seller who completely or partially assembles a product in accordance with the manufacturer's instructions shall be considered a seller.⁸

Fresh Coat was engaged in the business of selling EIFS for the use that the manufacturer,

⁷ Tex.Civ.Prac.&Rem.Code 82.001(3)

⁸ Tex.Civ.Prac.&Rem.Code 82.002(d)

K-2, intended. Fresh Coat contracted and charged for providing not only the labor but also the materials needed to install the EIFS. The court found that Fresh Coat's applying EIFS to the houses (that Life Forms ultimately sold) was sufficient evidence of Fresh Coat placing K-2's product into the stream of commerce. The court noted that providing installation services would not preclude a company from also being a "seller." The statute does not require that the seller only sell the product. It anticipates that a seller may also provide services.

C. Contractor's "Independent Liability"

After determining that the EIFS was a "product" and that Fresh Coat was a "seller," the court tackled the more difficult and interesting issue. That is what impact does the basis for the contractor/seller's liability for which it seeks indemnity have on the application of Chapter 82? Fresh Coat's obligation to pay Life Forms for that portion of the settlement was the result of the indemnity obligation that Fresh Coat had in its contract with Life Forms. The jury found no negligence on the part of Fresh Coat. Therefore, the only basis or foundation for the award in favor of Fresh Coat on its settlement with Life Forms was the indemnity obligation in the contract with Life Forms, which was a typical "no fault" indemnity provision.

The relevant provision of Chapter 82 is found in the section requiring that a manufacturer indemnify a seller in a claim arising out of a products-liability action. More particularly, that provision provides an exception to the indemnity obligation for the seller's own actions. The scope of that exception is what was at the heart of the argument and was the focus of the court's analysis. That section provides:

- (a) A manufacturer shall indemnify and hold harmless a seller against loss 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.⁹

The liability for Fresh Coat in its settlement with Life Forms was again the indemnity obligation in its contract with Life Forms. The exception in Section 82.002(a) to the manufacturer's duty to indemnify a seller clearly applies to situations where the liability of the seller is the result of some fault or act on the part of the seller. The question before the court was whether Chapter 82 could be applied if the only basis for the "seller's" liability was an indemnity obligation. Is contractual liability to another party sufficient to fall within the exception? Does there have to be some showing or evidence of fault on the part of the seller to trigger the exception? What is necessary to show that the seller is "independently liable" in order to trigger the exception?

K-2, of course, argued that Fresh Coat's payment to Life Forms fell within the exception and there was, therefore, no duty triggered under Chapter 82 for it to indemnify Fresh Coat as a "seller" on Fresh Coat's settlement to Life Forms. K-2's principle argument was that Fresh Coat was "independently liable" to Life Forms because of its indemnity agreement and, as a result, fell squarely within the scope of the exception to Section 82.002(a). Interestingly, Fresh Coat's attorney testified at the underlying trial that the only reason that Fresh Coat paid Life Forms was because of its indemnity obligation and that it was a no-fault indemnity agreement. There was no evidence that Fresh Coat was admitting by way of its payment to Life Forms that it was in any way liable for the claims made against it. Further, the jury was instructed to exclude from its calculation of Fresh Coat's loss "any amount that constitutes loss caused by Fresh Coat's own negligence, intentional misconduct, or other act or omission, if any (such as negligently modifying or altering the product) for which Fresh Coat is independently liable." The jury did not find the exception applicable and awarded damages to Fresh Coat for its settlement with Life Forms.

⁹ Tex.Civ.Prac &Rem.Code 82.002(a)

The court of appeals was persuaded by K-2's argument on this issue and reversed the trial court's award of damages to Fresh Coat for its settlement with Life Forms.¹⁰ The court of appeals upheld the award of damages to Fresh Coat for its settlement with the plaintiffs. In addressing the applicability of the exception to Section 82.002(a), the court of appeals noted that the exception applied for any loss "for which the seller is independently liable." Fresh Coat's obligation to Life Forms, as admitted to by its own attorney, would not have existed but for the indemnity obligation in the subcontract. Fresh Coat had "independent liability" to Life Forms because of that obligation. The court of appeals therefore found that Chapter 82 does not provide a seller with the right of indemnity against a manufacturer for that seller's independent liability under a contract.

The Supreme Court, in its analysis, looked at the entire statute. The court noted that the "independently liable" language was not the only part of the exception in Section 82.002(a). There is specific language involving the type of acts for which the seller may be independently liable that precedes the language at the end of the exception. The court noted that the court of appeals had disregarded the twenty words in the exception between "any loss" and "for which" That language talks about a loss caused by the seller's "negligence, intentional misconduct, or other act or omission, such as negligently modifying or altering the product" There is no mention in the exception of contractual liability.

Referring to other provisions of Chapter 82, the court found that the indemnification duty for manufacturers under the statute was not affected by the mere creation of other contracts or obligations to indemnify. Specifically, Section 82.002(e) provides:

The duty to indemnify under this section:

(1) applies without regard to the manner in which the action is concluded; and

(2) is in addition to any duty to indemnify established by law, contract, or otherwise.¹¹

The court further noted that there were several specific acts of a seller that could trigger the applicability of the exception under Section 82.002(a) and lead to "independent liability" on the part of the seller. None of those acts enumerated in Chapter 82 included contractual liability. The court noted that it must "presume that the entire statute is intended to be effective." The court emphasized that it was important to focus not merely on whether the seller was independently liable but why the seller was independently liable in order to trigger the exception to Section 82.002(a). The manufacturer must show that the seller's liability is triggered by its own conduct. The court stopped short, however, of holding that the seller's own conduct must be tortious, specifically noting that the "other act[s] or omission[s]" could include conduct that is not necessarily tortious.

D. Impact

Fresh Coat v. K-2 is obviously an important case for construction defect claims where part or all of the cause of the problems is caused by a defective product or materials that are used in the construction. Chapter 82 requiring that manufacturers of products indemnify so-called innocent sellers has long been applicable in products-liability actions, but this is the first time that the Supreme Court has addressed its application in a construction defect claim. In the past it has not been unusual for manufacturers to be parties to a construction defect claim when there is an issue with respect to a product or materials in the construction. However, we may now be more likely to see more parties not only bringing manufacturers into a construction defect lawsuit, but also attempting to invoke

¹⁰ *K-2, Inc. v. Fresh Coat, Inc.*, 253 S.W.3d 386 (Tex.App.—Beaumont 2008)

¹¹ Tex.Civ.Prac.&Rem.Code 82.002(e) (emphasis added)

Chapter 82 and the indemnity protections provided therein.

With an anticipated increase in the number of manufacturers that are included in construction defect claims, we obviously can anticipate seeing more parties in what are already multi-party lawsuits. The addition of products liability claims also carry different burdens of proof, one of producing cause as opposed to proximate cause, making litigation of such claims even more complex. With the Supreme Court's ruling, we should also see a concerted effort by manufacturers who are brought into the litigation to put some liability or responsibility on the contractor or contractors who installed the product or materials in order to trigger the exception to the indemnity obligation.

What may be the most significant impact, however, is an increase in the tender of claims to manufacturers by the contractor(s) who purchased and/or installed the products or materials. Chapter 82 requires that a manufacturer not only indemnify a "seller" but to defend that "seller" against claims involving the product. Chapter 82 and the Supreme Court case law interpreting it provides that a party need only join a contractor as a defendant in the products-liability action to invoke the manufacturer's duty to indemnify that contractor. The obligation to indemnify is triggered by the pleadings. *General Motors Corp. v. Hudiburg*, 199 S.W.3d 249, 255-56 (Tex. 2006). Only a finding that the exception in the statute is applicable, that is a finding that the seller was independently negligent, will extinguish this indemnity requirement. From that perspective a manufacturer may be tempted to assume the defense of a contractor in order to reduce litigation costs.

Typically, however, any party who is sued in a construction defect case is sued for their own independent acts of negligence. If there is a product or material involved that is installed in the project, the contractors who installed it are generally sued from their own independent acts of negligence. Similar to additional insured tenders, manufacturers often ignore or refuse to assume the defense of the seller contractors and

each of the parties defend themselves in the litigation. The manufacturer and seller are often at odds and the manufacturer's best defense is often that the contractor's work caused the plaintiff's damages, not any defect in the product or material. Failure to defend and indemnify a contractor, however, could be costly for a manufacturer unless they can prove that the contractor itself contributed to the problem from its own actions. Smart plaintiff lawyers may use this as additional leverage by suing everyone in the supply chain when it can make a claim for a defect in the products or materials. This multiplies the manufacturer's potential defense costs due to their potential obligation to indemnify numerous parties. It will be interesting to see what sort of impact this decision has on construction defect litigation.