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## **“It's Not All About Faulty Workmanship”**

This roundtable will address managing product liability exposure in construction litigation. The claim that a construction product is defective is quite often made by the Plaintiff(s) in a construction defect action. This claim could be about the windows, the siding, the roof tiles, fire sprinklers, or a plumbing fitting, for instance, or all of these products. However, the laws that apply regarding products liability is not the same in many respects as the laws that apply to builders and subcontractors. Although sometimes intertwined with faulty workmanship, product manufacturers, suppliers and distributors have unique exposure created by the strict liability, breach of warranty and negligent design and manufacturing claims that they face. The panel will discuss the classic battle between an installer and a product manufacturer/supplier. Defense and coverage strategies will be explored.

### **I. Product Claims in Construction Litigation: Types of Claims and Defense Strategies for Those Whom Are Exposed**

#### What are the Primary Type of Claims and Who Has Exposure?

Primary types of product claims in construction litigation cases generally fall into two categories: claims regarding workmanship (problems with the contractor or installer) and product defect claims. When the claims arise from problems with the product itself, the individuals or companies that are exposed to liability are not limited to the product manufacturers, suppliers and distributors, but can also include the installers and contractors as well.

#### What Matters in Determining Liability for Workmanship vs. Product Claims?

Depending on the type of claims asserted, liability can fall onto the general contractor, subcontractor, installer, supplier, or manufacturer (or all of the above). Typically, where the claims arise from allegations that damages were caused by a failure to follow installation guidelines or improper sequencing, liability will fall to the contractor, subcontractor or installer that performed the alleged negligent or improper workmanship.

But, where the claims lay with a design issue, maintenance issue or warranty problems, the liability issue becomes murky. Indeed, depending on the jurisdiction in which the action is brought, liability can be attributed to not just the manufacturer or supplier, but can include the installer, subcontractor and general contractor.

#### Causes of Action Alleged in Product Liability Construction Defect Cases

### Strict Liability:

A manufacturer, distributor or retailer can be held strictly liable in tort if a defect in the manufacture or design of its product causes injury while the product is being used in a reasonably foreseeable way. Strict liability has been invoked for three types of defects – manufacturing defects, design defects, and "warning defects" i.e., inadequate warnings or failure to warn.

In construction defect litigation, courts across the United States have applied strict liability to manufacturers, producers, installers and even general contractors and subcontractors where damage occurred due to a defective product. Depending on the jurisdiction, the issue of liability for each of those individuals/companies will vary.

#### *Manufacturing Defect*

A manufacturing defect occurs when an item is manufactured in a substandard condition. A manufacturing or production defect is readily identifiable because a defective product is one that differs from the manufacturer's intended result or from other ostensibly identical units of the same product line.

#### *Design Defect*

A design defect exists when the product is built in accordance with its intended specifications, but the design itself is inherently defective. A defective design supporting products liability may be established under two theories: (1) the consumer expectations test, which asks whether the product performed as safely as an ordinary consumer would expect when used in an intended and reasonably foreseeable manner; or (2) the risk/benefit test, which asks whether the benefits of the challenged design outweigh the risk of danger inherent in the design.

### Negligence:

A designer/manufacturer is negligent if it fails to use the amount of care in manufacturing or designing the product that a reasonably careful designer/manufacturer would use in similar circumstances to avoid exposing others to a foreseeable risk of harm. In determining whether the defendant used reasonable care, the jury should balance what defendant knew or should have known about the likelihood and severity of potential harm from the product against the burden of taking safety measures to reduce or avoid the harm.

### Breach of Warranties:

Express warranties are created by the express language of the written contract or purchase order. However, express warranties can exist even when there is no written contract and no discussion of warranty during the sale of the product. Manufacturers typically expressly warrant that a product is suitable for a particular use. Thus, the manufacturer whose product does not meet representations may be liable under a breach of warranty theory if the product is not suitable for its intended use.

There are two implied warranties that may apply to a product manufacturer in a construction defect case: (1) the implied warranty of merchantability, and (2) the implied warranty of fitness for particular purpose.

## What Are the Defense Strategies Utilized in Cases Alleging Product Liability in Construction Litigation?

Defenses to construction defect product cases include those typically asserted in general construction defect actions, including but not limited to: sophisticated use, failure to notify, lack of privity, innocent seller, alteration of product and statute of limitations. The most notable of defenses in construction defect product liability cases is the Economic Loss Rule ("ELR").

### What is the Economic Loss Rule?

The Economic Loss Rule ("ELR") is a judicially created doctrine that prohibits recovery for traditional tort claims in situations where a product defect causes damage only to itself. Most jurisdictions provide that only economic damages will be available unless defects or failures of the product have caused damage to person or other parts of property. In short, the majority provides that claims against a product manufacturer arising from situations where the product has damaged only itself rest in contractual warranty claims for repair, not in negligence or strict liability.

#### Damages Allowed:

Where a product has damaged only itself, under the ELR, the measure of damages is only what it costs to repair or replace the damaged property. An example would be the use of defective windows in a home or business that may fog or rust without causing damage to the framing, curtain walls or other portions of the property. Rather than allow damages for consequential issues, such as loss of use, loss of business income to close the business, mental anguish or diminished value, the damages are the cost to satisfy the warranty claim through repair or replacement. It can be very advantageous in construction defect cases for homes, ships, cars, commercial structures, and so forth, to argue that the damages are limited to the product or portion of the component products that are causing the problems with the property.

#### "Other Property"

Most states look at whether the defective product has caused damage to anything other than itself. If the defective product, a vehicle, for example, causes personal injury, then the ELR is not going to be applied. The grey area in construction contexts, however, is in how jurisdictions view the incorporation of a component part of construction into a larger product. Many jurisdictions view the incorporation of a component part into a building as a resulting new product. If possible, it is a good strategy to try to isolate the specific product that is causing damage, or that is of concern, to argue that it is the only item that needs to be repaired or replaced as opposed to framing the issue as the entire property needing to be repaired.

In addition, questions often arise as to whether the installer can be liable outside of the ELR restrictions to the product manufacturer. In some instances, courts have determined certified installers to be the seller of the product with limited damages while in others, the installer, as well as general contractor, may be providing a service. In situations where it is determined they are selling the service of installation instead of selling a package installed product, it may be difficult to exclude tort claims.

### *Minority Approach*

The minority approach, which was borne from *Santor v. A & M Karaghensian*, 207 A.2d 305 (N.J. 1965), rejects the Economic Loss Rule. Even though *Santor* was overruled and abrogated in New Jersey in 1997, there are five states that continue to follow the rule. See *Alloway v. Gen. Marine Industries*, 695 A. 2d 264 (N.J. 1997). The *Santor* court determined that the U.C.C. did not provide an exclusive remedy for claims resulting out of commercial transactions, in effect allowing a plaintiff to proceed with a tort (strict liability, negligence) action or warranty claim (contract). The rationale of the minority approach rests on the premise that the risk of injuries or damages are better absorbed and protected by the manufacturer of a product as opposed to the end user or purchaser that is in an economically disadvantaged position. In short, the minority rule relies on the premise that the risk of additional liability and damages will encourage manufacturers to make a better, more dependable, safer product.

### *Majority Approach*

At almost the same time as the *Santor* decision, the court in California wrestled with almost the identical question. In *Seely v. White Motor Co.*, 403 P. 2d 145 (Cal. 1965), the plaintiff sought damages under a tort/strict liability theory for claims relating to damages from a car he purchased. The damage was limited to the vehicle itself and did not extend to other property or to personal injury. While the minority view expressed concern that consumers were not adequately protected, that policy concern is not present when there is injury solely to the property. The court provided:

A consumer should not be charged at the will of the manufacturer with bearing the risk of physical injury when he buys a product on the market. He can, however, be fairly charged with the risk that the product will not match his economic expectations unless the manufacturer agrees that it will. Even in actions for negligence, a manufacturer's liability is limited to damages for physical injuries and there is no recover for economic loss alone.

(*Seely*, 403 P. 2d at 15.)

In addition to twenty-eight states, the United States Supreme Court adopted California's rule in *East River Steamship Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858 (1986). In *East River*, the steamship company brought claims against Transamerica relating to Transamerica's propulsion systems that were design and manufactured for four supertankers. The propulsion systems failed, causing damages only to themselves. *East River* sought claims under negligence and product liability theories, seeking compensation for the repairs and the lost income while the ships were out of service. The Court determined that a manufacturer has no duty under negligence or strict liability theories to prevent a product from injuring itself, extinguishing any claim for damages other than repair of the system. *Id.* at 867

### *Intermediate Approach*

In some jurisdictions, a hybrid approach has developed which focuses on the nature of the defect and how the harm occurs. Some of these developments have been as a result of a simple erosion for the majority approach to allow recovery when the damage is

as a result of a dangerous defect. Some states provide that tort damages will be allowed the damage to the product is “sudden and calamitous” while others ask whether there has been an “unreasonable risk of injury”. The aim of the hybrid rule is to protect victims of accidents.

#### State Breakdown as to Approach

Although there may be nuances to each state’s application (or exceptions), the states generally fall into the following categories:

Majority: Alabama, Delaware, Florida, Hawaii, Idaho, Indiana, Kansas, Kentucky, Maine, Minnesota, Mississippi, Missouri, Nebraska, Nevada, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, South Carolina, South Dakota, Tennessee, Texas, Vermont, Wisconsin, Wyoming

Intermediate/hybrid: Alaska, Arizona, California, Georgia, Illinois, Iowa, Maryland, Massachusetts, Michigan, Montana, New Hampshire, Oregon, Rhode Island, Utah, Washington, West Virginia

Minority: Arkansas, Colorado, Connecticut, Louisiana, Virginia

## **II. Case Examples**

### Mass Production of Homes as Basis for Imposing Strict Liability

Some courts have found that mass production of homes is analogous to mass production of other consumer products and therefore apply the doctrine of strict liability in the same manner.

California: In a 1969 California decision, a homebuilder used coated steel tubing for the construction of a radiant heating system. After eight years, the system failed as a result of corrosion of the steel pipe. The court held that the contractor *was liable* to the second purchaser of the home under a theory of strict liability since the radiant heating system, as installed, was defective. The court pointed out that the builder was a mass producer of housing; therefore, the doctrine of strict liability should apply just as it would apply to a mass producer of personal property. (*Kriegler v. Eichler Homes, Inc.*, 269 Cal. App. 2d 224, (1st Dist. 1969).)

Illinois: Likewise, in 1985 a district court in Illinois held that the doctrine of strict liability applied to mass produced, prefabricated, factory-built homes in a case where a baseboard electric heater in a new home was defective and caused a fire. (*Bastian v. Wausau Homes Inc.*, 620 F. Supp. 947 (N.D. Ill. 1985).)

### Chain of Production/Stream of Commerce as Basis for Imposing Strict Liability

California: In 1996, a class action was brought by individual homeowners against builders, contractors, plumbing subcontractors, wholesalers, and manufacturers for damages from defective ABS drain, waste, and vent pipes installed in their residences. The court held that in a product liability action *every supplier in the stream of commerce or chain of distribution is potentially liable*, since the purpose of strict liability is to impose the cost of defective products on all engaged in the overall producing and

marketing enterprise. (*Edwards v. A.L. Lease & Co.*, 46 Cal. App. 4th 1029, (1st Dist. 1996).)

Missouri: In a 1985 Missouri case, a subcontractor and a sub-subcontractor used defective metal clevises to suspend refrigeration lines in a subterranean refrigeration facility which collapsed. The subcontractor and sub-subcontractor were held liable on a theory of strict liability. Both defendants had the duty to see that the clevises were free of defects and properly installed. Therefore, the Court held that both defendants were in the same position as a seller who sells a product and places it in commerce. (*Commercial Distribution Center, Inc. v. St. Regis Paper Co.*, 689 S.W.2d 664 (Mo. Ct. App. W.D. 1985).)

#### Component Parts Doctrine as a Defense to Product Liability

Utah: In a 1994 Utah case, homebuyers sued a construction company, its president, and original homeowner. A year after the construction was completed, the plaintiffs purchased the house under an "as is" agreement, which contained an integration clause. Within six months of moving into the house, plaintiffs began experiencing problems with water penetration. The court held that doctrine of strict liability applies only to sellers or manufacturers of a product and reasoned that the construction company merely used component parts to construct a residence and even though the price of those parts was specifically included in the price of the home, the construction company was not the seller of component parts. The Utah doctrine of strict liability applies only to products that are unreasonably dangerous. (*Maack v. Resource Design & Const., Inc.*, 875 P.2d 570 (Utah Ct. App. 1994).)

Alabama: In a 1985 Alabama Supreme Court decision, a defective fireplace caused a fire. The court held that a fireplace, once installed, becomes a part of the house and is not a product for purposes of strict products liability. (*Wells v. Clowers Const. Co.*, 476 So. 2d 105 (Ala. 1985).)

### **III. Case Studies**

#### Design Defects – Consumer Expectations vs. Risk Utility Test

##### Florida: Consumer Expectations Test

Recently, the Florida Supreme Court clarified that the test used to adjudicate design-defect claims in product liability cases is the "consumer expectations" test. In *Aubin v. Union Carbide Corp.* (2015 WL 6513924) (Fla. Oct. 29, 2015.), the Florida Supreme Court resolved the conflict amongst Florida's intermediate courts regarding whether the proper test was the "risk utility" test or the "consumer expectations" test in evaluating design-defect cases.

In *Aubin*, the plaintiff filed an action against an asbestos manufacturer for negligence, strict liability for defective product design and failure to warn after he was diagnosed with a fatal form of cancer from inhaling dust as a construction supervisor in the 1970s. The Supreme Court confirmed that the proper test to employ was the "consumer expectation test" wherein a product is deemed defectively designed if the plaintiff is able to demonstrate that the product did not perform as safely as an ordinary

consumer would expect when the product is used in the intended or reasonably foreseeable manner. The Court explained that the "risk utility" test imposes a higher burden on consumers to prove a design defect by requiring the consumer to prove that a reasonable alternative design was available to the manufacturer. Instead, the Court reasoned that the proper test is the "consumer expectation test" because the cost of injuries resulting from defective products should be borne by the makers of the products who put them in the channels of trade rather than by the injured individuals who are normally powerless to protect themselves. This may result in more product liability cases being initiated because of the lower threshold required for plaintiff to prove a design defect existed.

#### South Carolina: Risk Utility Test

In 2010 the South Carolina Supreme Court decided to adopt the "risk utility test" for plaintiffs bringing a design defect claim, requiring the plaintiff to make a showing of a reasonable alternative design in order to hold a manufacturer strictly liable for harm caused by the alleged defective design. In *Branham v. Ford Motor Co.* (390 S.C. 203, (2010)), the plaintiff was a passenger in an SUV that rolled over. The plaintiff claimed that the vehicle's rollover propensity was due to the handling and stability design defect. At the trial court level, the case was submitted to the jury on both a consumer expectations test and a risk utility test. The South Carolina Supreme Court reversed and remanded for a new trial, determining that the exclusive test in a product liability design defect case is the risk utility test. The Court ruled that "a plaintiff will be required to point to a design flaw in the product and show how his alternative design would have prevented the product from being unreasonably dangerous. This presentation of an alternative design must include consideration of the costs, safety and functionality associated with the alternative design." (*Id.* at 225.)

#### Component Parts Defense – Application

Ohio: In a 2014 case, *Zager v. Johnson Control, Inc.* (18 N.E.3d 533 (2014)), the Court of Appeals of Ohio for the Twelfth District reaffirmed application of the component parts doctrine as an affirmative defense to a product liability claim. The plaintiff in *Zager* filed an action against the manufacturer of a rear seat in a Chrysler 300m sedan after the plaintiff suffered personal injuries from a motor vehicle accident. Despite plaintiff's allegations that only the seat was defective, the Court found that the defect complained of only existed once the seat was integrated into the automobile as a final product. Therefore, the Court determined that the component parts doctrine was available to the defendant as an affirmative defense. The Court examined plaintiff's argument regarding the "substantial participation" exception to the component parts doctrine but rejected the contention on the basis that while defendant had control over the design of the seat, it had no control over safety related decisions or overall design of the vehicle. This case evidences that while the component parts doctrine does not excuse the manufacturer of a defective component part, if the defect complained of arises when the component part is integrated into the final product, the component parts doctrine is still available as a defense.