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High Court to Decide Indemnity Issue in Construction Case

by MARY ALICE ROBBINS

The last case in which the Texas Supreme Court heard arguments this year could have a significant impact on products liability litigation in the construction industry.

A key issue in *Fresh Coat Inc. v. K-2 Inc.*, argued Dec. 17 before the state's highest civil court, is whether a manufacturer of an allegedly defective stucco-like product must indemnify a subcontractor for the subcontractor's settlement with the homebuilder, pursuant to a contract, for qualifying losses under Chapter 82 of the Texas Civil Practice & Remedies Code.

Kevin Jewell, attorney for Fresh Coat and a shareholder in Houston's Chamberlain, Hrdlicka, White, Williams & Martin, told the Supreme Court during arguments, "This case is about a seller's right to indemnity from the manufacturer of a defective product."

Jewell contended that the 9th Court of Appeals' decision in *Fresh Coat* "constitutes a significant encroachment on those indemnity rights" under Chapter 82.

Beaumont's 9th Court concluded in 2008 that Fresh Coat could not recover the amount it paid to settle with Life Forms Homes Inc., the homebuilder, as a result of a contractual indemnity obligation.

Jewell says that if the Supreme Court affirms the 9th Court's decision, that would impact almost every contractor who works with products

MARK MATSON

From left to right: Kevin Jewell represents Fresh Coat Inc. and Thomas C. Wright represents K-2 Inc.

in the construction industry, because subcontractors typically agree to indemnify the general contractor or homebuilder.

"You'd be hard-pressed to find a contractor's agreement that does not have an indemnity agreement in it," Jewell says.

In its March 11 brief to the Supreme Court, Fresh Coat, the subcontractor that installed stucco-like cladding on the exterior walls of houses, identifies itself and Life Forms as "sellers" under Chapter 82, the state's products liability statute. K-2, also known as Finestone, characterizes Fresh Coat as a "service provider" in its brief to the Supreme Court, also filed on March 11. According to K-2's brief, Finestone and other companies manufactured component parts that went into the synthetic stucco cladding, known as an Exterior Insulation and Finish System (EIFS).

Chapter 82 creates a statutory duty of indemnification in products liability litigation that "is in addition to any duty to indemnify established by law, contract, or otherwise." The statute places a duty on the manufacturer of a defective product to indemnify an innocent seller of that product unless the manufacturer can show that the seller caused the loss and is independently liable.

During the Dec. 17 arguments, some justices on the Supreme Court seemed uncertain whether the EIFS is a product under Chapter 82.

"Can I go to Home Depot or Lowe's and purchase this product?" Justice Don Willett asked Jewell.

"I don't believe you could," Jewell said.

Justice David Medina commented, "There are a lot of products that go into the assembly of homes that you can't buy at Home Depot."

But Thomas C. Wright, attorney for K-2 and a partner in Houston's Wright Brown & Close, argued that Chapter 82 should not apply to residential construction.

"I believe the best course of action would be to say that a house is not a product and anything incorporated into the structure of a house is not a product," Wright told the court.

According to the briefs that Fresh Coat and K-2 filed with the Supreme Court, their dispute stems from *Brunson, et al. v. Finestone, et al.,* a suit that homeowners in The Woodlands filed in 2000 for damages allegedly caused by water penetration in their homes on which the IEFS had been installed.

The 9th Court's opinion provides the following background on the case: Finestone, Life Forms and Fresh Coat settled with the homeowners. Fresh Coat also settled with Life Forms and cross-claimed for indemnity from Finestone. The 221st District Court jury in Montgomery County awarded Fresh Coat more than $1 million in damages for its settlement payments to the homeowners, more than $1.2 million in damages for the settlement Fresh Coat made with Life Forms and $726,642 for attorneys' fees. Finestone appealed to the 9th Court, which modified the trial court's judgment by deleting the portion of the award attributable to Fresh Coat's contractual payment to Life Forms.

"The provisions of Chapter 82 do not provide a seller with a right of indemnity — under the circumstances in the record presented here — against a product manufacturer for that seller's independent liability under a contract," Justice David Gaultney wrote for the 9th Court. Chief Justice Steve McKeithen and Justice Hollis Horton joined in the decision.

As noted in its opinion, the 9th Court concluded that under Chapter 82, the EIFS is a product and Fresh Coat is a seller. The 9th Court further concluded that Fresh Coat is entitled to almost $1.8 million for its loss as a result of the products liability claims.

Fresh Coat and K-2 petitioned the Supreme Court for review of the 9th Court's decision.

In its brief, Fresh Coat asks the Supreme Court to reverse that part of the 9th Court's decision that eliminated Fresh Coat's recovery from K-2 for the settlement with Life Forms. Fresh Coat asserts in its brief that Civil Practice & Remedies Code §82.002(a) provides exceptions to a seller's right to indemnity only when a loss is "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." Until the 9th Court's decision, the seller's right to indemnity never has been curtailed because of an independent contractual obligation, Fresh Coat argues.

In its brief, K-2 asks that the Supreme Court reverse the trial court's judgment and render that Fresh Coat take nothing based, in part, on K-2's arguments that Fresh Coat is not a seller and that the synthetic stucco cladding is not a product under Chapter 82.

At one point during the oral arguments, Justice Nathan Hecht told Jewell, "It seems like one impact of this is that some contractors will be liable for indemnity in faulty construction cases."

"That is one of a number of adverse consequences facing contractors," Jewell said.

"Do you think that's well under-

stood in the construction industry?" Hecht asked.

Jewell replied, "I do think if it is not now, it certainly would be were this court to adopt the court of appeals' opinion. . . . You can't get a job as a subcontractor unless you agree to indemnify somebody else."

Under the 9th Court's decision, Jewell said, a subcontractor is "at extreme risk" of losing its indemnity rights against a manufacturer if the subcontractor settles a product defect case with the general contractor and there are indemnity provisions involved.

Will It Stand?

Dallas solo Walker M. Duke, whose practice includes construction law but who is not involved in *Fresh Coat*, says indemnity contracts are "pretty common" in the construction industry.

Duke says, "Subcontractors already are on the hook for builders' mistakes." Under an indemnity contract, a subcontractor must settle with the builder or provide the builder a defense, regardless of whether the builder's negligence caused the damage cited in a suit, he says.

"If the court of appeals opinion is allowed to stand, I think the subcontractor is going to get squeezed," Duke says, noting that a subcontractor would have to settle with the builder without being able to recover from the manufacturer.

Duke says subcontractors often are "mom and pop" businesses that are in the worst position to withstand that type of financial strain.

Dallas solo Walker M. Duke says if the 9th Court's opinion is allowed to stand, "the subcontractor is going to get squeezed."

However, Wright argued to the Supreme Court that Fresh Coat made an independent decision to sign an agreement that indemnified the homebuilder even if the homebuilder is solely negligent. Referring to Fresh Coat, Wright said, "This is not an innocent seller, at least when they have decided to sign a broad indemnity agreement and pay under that indemnity without regard to any other legal obligation."

In an interview, Wright says Chapter 82's indemnity is designed to protect an innocent seller, such as a retailer, who bought a product and put it on his shelves. If a claim is made that the product is defective, that seller can seek indemnity from the manufacturer, he says.

Wright contends that not only is a house is not a product, the materials that form the structure of a house are not a product and a subcontractor hired to do work — in this case, installing a stucco-like insulation system on the wall of a house — is not a seller. So Chapter 82's indemnity should not apply to residential construction, he says.

In the interview, Wright also points out that homeowners can bring claims about defects in their houses under the Residential Construction Liability Act, enacted by the Texas Legislature in 1989 as Chapter 27 of the Texas Property Code. Under the RCLA, the general contractor is liable only for its own negligence, so there is no need for the indemnity provisions under Chapter 82, Wright says.

Jewell says in an interview that if the Supreme Court were to hold that the EIFS is not a product, the ruling would be used to argue that other products that are made part of permanent structures are not products.

Notes Jewell, "The notion that Chapter 82 does not apply to residential construction would be a significant exception. . . . The Legislature made no provision that residential construction would not come under Chapter 82." TNL

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