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Managing Liability Due to Defective Products

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Is an HVAC contractor legally responsible for damage caused when a product (such as a condensate pump) fails due to a manufacturing defect? Generally, the answer is "yes." Even though the installer committed no error in selecting or installing the product, the law in most states imposes liability not only on the manufacturer of the defective product, but on each participant in the supply chain.

This article analyzes the potential bases of liability for defective products that HVAC contractors supply and install. It also makes recommendations for reducing risk by 1) modifying work practices to include backup or redundant protection in the event of product failure; 2) purchasing liability insurance, 3) evaluating the risks and benefits of contractual language, and 4) considering legal recourse.

Potential Bases of Liability

Though perhaps self-evident, the first basis of liability is a contractor's own negligence. Negligence is the failure to exercise reasonable care, which causes harm to another. All contractors have a duty to exercise reasonable care. When contractors hold themselves out as specialists in HVAC systems, they are held to a higher duty, i.e., any failure to perform in a manner consistent with a reasonably prudent HVAC contractor, subjects the HVAC contractor to potential liability.

The second basis of a contractor's liability is premised on the contractor's sale of a product. Under a products liability theory, liability can occur without any negligence. The focus is on the product and whether it was defective. Although state law varies, most states allow purchasers of a product to recover from anyone who participated in the "chain of distribution" of the defective product. This chain includes manufacturers, distributors, supply houses, retailers, and any other kind of seller. Courts cite larger societal goals as the reason for imposing liability without fault. They conclude that public policy favors consumers rather than sellers of products. They also note that sellers can purchase liability insurance and incorporate the cost into their pricing.

Only products the installer supplies typically trigger the installer's liability. If the customer purchases a product that later fails due to a manufacturing defect, the HVAC contractor who installed it generally would not bear any liability for a defect in the product. Thus, who purchased the equipment the product was purchased is important. If, for example, an HVAC contractor supplied a condensate pump, the pump was defec-

tive, and the defect caused water damage to a building, the HVAC contractor would likely be liable for the cost of replacing the defective pump and for repairing the water damage.

The third basis of a contractor's liability is the contract itself. When HVAC contractors bid on commercial jobs, they often do so based on project specifications. These specifications may contain language by which one party promises to compensate another who may suffer a future loss. This language is referred to as an "indemnification clause." Any written document between the parties, including purchase orders, might contain this type of clause.

Although indemnification clauses vary significantly, one example is as follows:

The Contractor shall indemnify and save harmless the Property Owner, its officers, employees or agents, from all claims for damage to property or person (including death) arising out of the supply and installation of products by the Contractor.

Courts interpret indemnification clauses consistent with the parties' intentions at the time of the contract. Such clauses typically obligate the party offering indemnification to also provide a legal defense. This obligation includes hiring attorneys and paying costs, such as for experts.

Managing the Risk

Although there is no way for HVAC contractors to protect themselves completely from liability, the following steps can reduce the risk.

1. Modify Work Practices: One of the best ways to manage liability is to modify work practices to include backup or redundant protection in the event of product failure. When providing equipment, consider recommending options or accessories that experience has shown facilitate maintenance or improve system operation and performance. For example,

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an HVAC designer could recommend emergency overflow drains and float-controlled shut-off switches to reduce the risk of water damage. Working proactively not only reduces the risk that products will cause damage, but also builds trust in the relationship with the customer. At the same time, avoid inadvertently assuming additional liability by recommending actions beyond the scope of your responsibility, such as proposing design changes during routine preventive maintenance work.

2. Comprehensive General Liability Insurance: Insurance protects against unexpected losses. A comprehensive general liability insurance policy provides coverage for all risks except those specifically excluded. One benefit of liability insurance is that the insurance company will hire a lawyer and pay the costs to defend the case, in addition to paying any settlement or adverse judgment.

Companies should read their insurance policies and work with their insurance agents to determine what their policies cover. Depending on the policy, claims for damage due to defective products that are part of completed work might not be covered. Separate coverage called “products liability and completed operations insurance” pays for the damages due to unintentional bodily injury or property damage caused by installed products and completed work. Even though the primary focus of a contractor’s business may be installation and not sales, if products are sold, consider purchasing products liability and completed operations coverage.

3. Indemnification Clauses: Before entering into any deal, contractors should closely examine all proposed contract documents to see what indemnification language is proposed. Any written document may contain indemnification language, but such language is frequently found in specifications, bid documents and purchase orders. This does not mean contractors should always avoid doing business with companies

that insist on indemnification clauses.* Rather, the willingness to indemnify can be a valuable bargaining chip in the negotiating process. There may also be other legitimate financial or business reasons to agree to indemnification. Make decisions about indemnification consciously and know the risks of indemnification before agreeing to it.

4. Legal Recourse: If an HVAC contractor is sued for damage caused by a defective product, whether the product manufacturer is among the parties sued or not, the contractor should attempt to convince the manufacturer to protect the contractor from liability. To accomplish this, the contractor should “tender” the claim to the manufacturer by sending a letter by certified mail return receipt requested. In this letter, identify the claim, enclose copies of the relevant documents and demand that the manufacturer “defend and indemnify” the contractor. Even if this letter does not convince the manufacturer to take over the contractor’s defense, it will help the contractor’s future claim for reimbursement by the manufacturer.

When the manufacturer is not among the parties sued, the contractor can either bring the manufacturer into the same lawsuit or file a second lawsuit against the manufacturer. Either way, the HVAC contractor will base the claim or lawsuit on theories of indemnification or contribution. These theories essentially demand that the manufacturer reimburse the contractor if the contractor is ordered to pay damages that were the fault of the manufacturer.

There are, however, risks to filing lawsuits like these. First, the lawsuit may harm the continuing business relationship between the contractor and the manufacturer. Second, it is generally not possible to recover the legal costs of such a claim. Thus, it is crucial that the ultimate utility of such a claim be fully analyzed beforehand.

Conclusion

Whenever an HVAC contractor supplies and installs a product, even if that

installation is perfect, there is a risk that the product will be defective and that the HVAC contractor will be liable for damages caused by the defect. To manage this risk, the HVAC contractor can consider modifying its work practices to include redundant protection to prevent property damage, purchasing liability insurance, and paying close attention to indemnification clauses. If an HVAC contractor is sued for damage arising from a product defect, the HVAC contractor should consider “tendering” the defense of the case to the manufacturer. Finally, if it is ordered to pay damages to the purchaser, the HVAC contractor may sue the manufacturer to recover these damages. Caution should be exercised, however, to determine whether such a claim makes sense from both a business and financial perspective.

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* Some types of indemnification clauses should be avoided. For example, indemnification provisions that require the contractor to indemnify the owner for someone’s negligence other than his own (or the negligence of his employees or subcontractors) can lead to liability that is unlimited, uncontrollable and not covered by insurance (insurance contracts typically exclude liabilities assumed by contract that the insured would not otherwise have).

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