

A Lesson On Indemnification Clauses And Relitigation

Law360, New York (April 02, 2015, 1:04 PM ET) --

Lessons learned from *National Union Fire Insurance Company of Pittsburgh PA v. Tokio Marine and Nichido Fire Insurance Company*, 233 Cal. App. 4th 1348 (2015), a recent opinion issued by the California Court of Appeal, Second Appellate Division, illustrate how a subtle change to a standard indemnification clause might save product manufacturers, product sellers and their insurers from costly relitigation. It is possible that, had the parties to the indemnification agreement at issue in *National Union* agreed to broader discovery rights in a secondary battle after the underlying action went away, they may have been able to side step a costly four-year appeal.

In *National Union*, a 2001 vehicle rollover crash left the driver, Daer, a quadriplegic. Daer sued Costco Wholesale Corp. and Yokohama Tire Corp., alleging that a defect in a tire sold by Costco and manufactured by Yokohama caused Daer's injuries. In July 2005, shortly before trial, Daer settled with Costco for \$5.5 million and Yokohama for \$1.1 million. In October 2006, Costco's primary insurer, National Union filed a separate action seeking indemnification or contribution from Yokohama and its insurer, Tokio Marine. The indemnity trial commenced in August 2011.



Richard M. Brodsky

To prevail on its indemnity claim, National Union needed to establish, among other things, that Yokohama defectively manufactured the tire. To establish a manufacturing defect, National Union retained a tire defect expert, Cottles. However, shortly before trial, the lower court ruled in limine that Cottles' opinions demonstrating a tire defect were inadmissible. Instead, National Union was bound by the opinions developed by plaintiff's expert in the underlying case as to whether the tire was defective. The lower court found that National Union could not expand the record beyond the point at which the underlying matter settled to prove that Yokohama manufactured a defective tire. Because even National Union acknowledged the weakness of the tire defect theories available to it in the indemnification action, the trial court granted Yokohama a nonsuit.

National Union appealed the trial court's decision to exclude Cottles' opinions, and California's Second Appellate Division narrowed the issue considered on appeal to whether an indemnitee which settled a third-party claim could present evidence acquired post-settlement, or instead was limited to the underlying plaintiff's evidence of liability. In evaluating this issue, the appellate court made the following findings: (1) Cottles' tire defect testimony was relevant to the dispute over whether the tire had a

defect; (2) National Union clearly was prejudiced because the trial court likely would not have granted a nonsuit had it considered the full scope of Cottles' opinion; and (3) restricting experts in indemnity matters to the opinions advanced in the underlying case would require businesses sued for products liability to marshal evidence (against their own proprietary interests) as to their liability to the injured plaintiff or risk impairing their indemnity rights vis-a-vis another culpable party. In light of these findings, the court in February 2015 reversed the trial court's limitation of Cottles' testimony to those opinions he shared with plaintiff's expert.

One may be tempted to dismiss National Union as merely a one-off case, where the appellate court disagreed with the discretion exercised by the lower court. However, the implications of National Union are potentially more far-reaching. Indeed, by crafting indemnification clauses with an eye toward avoiding the dispute in National Union, it is possible that future litigants may avoid expending considerably more resources and funds than necessary in reaching resolution. One option may be to craft indemnity provisions to reserve the rights of the signatories to reasonably investigate and conduct discovery into ultimate liability issues in an indemnity action, in addition to that performed in the underlying action.

Notably, it is not just product sellers, such as Costco in National Union, that could be forced to shoulder the costs of litigating an indemnification clause that failed to provide for additional investigation and discovery. Product manufacturers must also be wary. Varying the facts in National Union illustrates this point.

Assume that a retailer subjected the tire like the one that Daer purchased to sharp temperature shifts or otherwise improperly stored it for an extended period before the sale. Assume that the improper handling or storage resulted in the tire becoming susceptible to a blowout. Finally, assume the manufacturer has very deep pockets, while the seller has much shallower pockets. In the underlying lawsuit in this hypothetical, plaintiff's tire defect expert might focus a great deal of attention to establishing a manufacturing defect and virtually none to showing that a perfectly manufactured tire failed due to the seller's post-manufacture actions. The injured party's case settles with this imbalance in the plaintiff expert's focus and before the manufacturer could explore the conduct of the seller. Reversing the roles in National Union, assume that it is now the tire-maker's insurer pursuing indemnification from the seller and its insurer. This time the tire maker obtains the services of a new tire defect expert, who investigates and opines that the tire failed as a result of post-manufacture mishandling. The seller then moves in limine to preclude the tire-maker's expert from offering this new opinion, arguing that it goes beyond those opinions offered in the underlying lawsuit. The trial court agrees and concludes as follows:

"The claim stops when plaintiff's case settled. At that point, indemnity is set. This case was settled on the day of trial so we know what was going to be tried, so that's where we put an end to things. That's the be all and end all of what the knowledge was."

An appeal ensues and the hypothetical appellate court decides that the trial court erred by precluding the new expert from offering his full opinion as to why the post-manufacture actions of the seller caused the defect that directly caused the plaintiff's injuries. Although the tire maker, the indemnitee in this hypothetical, ultimately prevails on appeal, it does not feel very "victorious" after adding up the added costs. Could the matter have been handled more economically and with less risk and uncertainty?

Fortunately, the initial ruling in the hypothetical possibly may have been avoided by carefully drafting

the indemnity clause with National Union in mind. Under appropriate circumstances, both indemnitors and indemnitees can work toward securing an agreement that provides the signers with a reasonable opportunity to investigate and conduct discovery as part of an indemnification action, separate from and in addition to, that performed in the underlying action. In light of the widely recognized principle that indemnity agreements govern the rights and obligations of parties thereto and the National Union court's decision to permit additional discovery in an indemnity action, parties can possibly use such an agreement to overcome a motion similar to that filed before the trial court in National Union, thus avoiding extensive briefing and a lengthy appellate process.

The circumstances under which indemnity agreements are formed vary too greatly for there to be a one-size-fits-all clause to present here. One needs to be mindful of the lessons learned from National Union that might be used by both indemnitees and indemnitors to avoid the type of problems that arose in that case.

—By Richard M. Brodsky, Miles & Stockbridge PC

Richard Brodsky is an associate in Miles & Stockbridge's Baltimore office.

The opinions expressed are those of the authors and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.