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How to Avoid Liability When a Dealer or Distributor Fails to Instruct Consumers Properly

By Timothy R. Freeman

Manufacturers that monitor the product representations made by dealers and distributors are more likely to avoid litigation.

Dealers and distributors are necessary components in the chain of commerce that takes products from factories to consumers, and they are often essential to promote consumer satisfaction. Moreover, dealers are statutorily required for certain industries in certain states. Problems arise, however, when their incentives are not entirely aligned with manufacturers, or when they do not have complete information as to why certain instructions and information must be conveyed to consumers. In the end, it is mutually beneficial for dealers and distributors to work with manufacturers to mitigate litigation risk.

A notable example of the problems that can arise in the manufacturer/dealer relationship is when dealers do not adequately convey information regarding product improvements, safety enhancements, or optional safety features to consumers. In a recent high-exposure lawsuit, a manufacturer client provided a dealer with information regarding an optional safety feature, but the dealer did not provide that information to its customers. A laborer got into a horrific accident and sued both the dealer and the manufacturer for not designing the product with the optional safety feature as a standard feature and/or not providing sufficient notice to consumers that the optional safety feature was available. In that case, slightly better communication during the sales transaction could have avoided a long and enormously expensive lawsuit that ensnared both the manufacturer and the dealer.

Another recent example involved a distributor that did not want to alienate a

■ Timothy Freeman is an attorney at Tanenbaum Keale LLP in Newark, New Jersey. His practice is focused primarily in the areas of product liability and catastrophic personal injury. His clients include manufacturers of heavy equipment, home appliances, and consumer products, as well as transportation companies and individuals. He regularly provides counsel to clients in high-exposure, complex litigation from the moment a complaint is filed until the final appeal is resolved.

contractor (who was also a large customer), so it avoided direct communication to tell the contractor that it made an installation error that needed to be corrected in order for the product to function properly. The longer the problem festered, the more damage was caused and the manufacturer ended up in a costly litigation that could have been avoided if the distributor had just provided clear instructions to the contractor and warned of the consequences of failure to follow its instructions.

The above examples are all too common in the world of product liability litigation, and the disputes could have been avoided if there had been clear, unambiguous communication between the manufacturer, dealer/distributor, and consumer at the outset. This article will explore the basic legal principles involved in the manufacturer/dealer/distributor relationship, discuss particular legal problems that arise, and offer possible solutions to prevent litigation before it starts and enhance consumer satisfaction.

Agency and Apparent Authority

The relationship between a dealer or distributor of a product and the manufacturer does not, standing alone, create an agency relationship merely because the dealer/distributor was authorized to market the manufacturer's products. *See, e.g.*, *Jesmer v. Retail Magic, Inc.*, 863 N.Y.S.2d 737, 744 (2d Dep't 2008) (the authorized distributor of software system did not have apparent authority to act as the agent of the manufacturer, in the absence of evidence of acts by the manufacturer directed to the plaintiff demonstrating the distributor's apparent authority); *L.S. & Sons Farms, LLC v. Agway, Inc.*, 837 N.Y.S.2d 448, 449 (4th Dep't 2007) ("exclusive regional distributor" of a manufacturer's agricultural seeds did not have apparent authority to act as the agent of the manufacturer where there was no evidence of "any words or conduct on the part of supplier demonstrating distributor's apparent authority"); *In re Scotts EZ Seed Litigation*, No. 12 CV 4727, 2013 WL 2303727 at *8 (S.D.N.Y. May 22, 2013) (authorized retailers of a manufacturer's grass seed did not have apparent authority to act as agents of the manufacturer where "Plaintiffs have failed to allege any conduct on the part of [manufacturer] that could give rise to a plausible inference that [manufacturer] had an agency relationship with [retailers]").

The essence of an agency relationship is control. In order for an agency relationship to exist, the principal must have "the right to control the conduct of the agent with respect to matters entrusted to him." Restatement (Second) of Agency §14 (1958). *See also Harris v. Keys,* 948 P.2d 460, 465 (Alaska 1997) ("the Restatement's requirement that an agent act 'on the principal's account' should be interpreted as requiring action *under the principal's control,* rather than merely action which serves the principal's purposes.") (citing *Nava v. Truly Nolen Exterminating,* 683 P.2d 296, 299 (Ariz. App. 1984) (emphasis added)).

The necessary element of "control" has led courts across the United States overwhelmingly to hold that the existence of a formal licensing or dealership agreement does not create an agency relationship unless the manufacturer exercises significant control over the details of the dealer's work. *See, e.g., Bushendorf v. Freightliner Corp.,* 13 F.3d 1024, 1026 (7th Cir. 1993) ("an automobile dealer or other similar type of dealer, who merely buys goods from manufacturers or other suppliers for resale to the consuming public, is not his supplier's agent."); *Coffey v. Fort Wayne Pools, Inc.,* 24 F Supp. 2d 671, 678 (N.D. Tex. 1998) ("courts in other jurisdictions have also determined that a retailer or dealer of goods is not an agent of the manufacturer."); *Malmberg v. American Honda Motor Co.,* 644 So.2d 888, 890 (Ala. 1994) (finding that the plaintiff presented no evidence that the manufacturer reserved the right to control the dealer's day-to-day operations); *McLemore v. Ford Motor Co.,* 628 So.2d 548, 551 (Ala. 1993) (no agency relationship existed because, among other reasons, the car dealer sold cars of all types); *Bunting v. Koehr,* 865 S.W.2d 351, 352 (Mo. 1993) (a "dealership that purchases a manufacturer's products for resale, performs warranty work on a manufacturer's products and who, as part of the sale of a manufacturer's products, extends the manufacturer's warranty to the consumer" is not an agent of the manufacturer by virtue of such activities); *Chevron, U.S.A., Inc. v. Lesch,* 570 A.2d 840, 844 (Md. 1990) (a station owner was not the agent of oil company, despite the use of signs and advertising); *Wood v. Shell Oil,* 495 So.2d 1034, 1037 (Ala. 1986) (no agency relationship existed where there was no evidence that "Shell Oil retained any right of control over the manner in which [its dealer] performed in order to meet the requirements of the lease and dealer agreement").

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Apparent Authority

In order to demonstrate that a purported agent possesses apparent authority to act on behalf of an alleged principal, a claimant must allege and prove that the words or actions of the principal, and not those of the agent, led the claimant to believe that an agency relationship existed. "Essential to the creation of apparent authority are words or conduct of *the principal*, communicated to a third party, that give rise to the appearance and belief that the agent possesses authority to enter into a transaction." *Standard Funding Corp. v. Lewitt*, 656 N.Y.S.2d 188, 191 (1997) (quoting *Hallock v. State of New York*, 485 N.Y.S.2d 510, 513 (1984) (emphasis in original)). "The agent cannot by his own acts imbue himself with apparent authority." *Hallock*, 485 N.Y.S.2d at 513; *see also*, *e.g.*, *Imburgio v. Toby*, 920 N.Y.S.2d 43 (1st Dep't 2011)

("While plaintiffs asserted that defendant's employee was vested with apparent authority based upon the employee's representations concerning the transaction at issue, such authority may arise only from the conduct of the principal, not the agent"); 56 *East 87th Units Corp. v. Kingsland Group, Inc.,* 815 N.Y.S.2d 576, 577 (1st Dep't 2006) ("It is axiomatic that apparent authority must be based on the actions or statements of the principal.").

When manufacturers rely on dealers/distributors to install safety features, they may become liable if the safety device is not installed, or is installed improperly.

Nevertheless, manufacturers should be aware that certain actions can create apparent authority. For example, in *Morris Aviation, LLC v. Diamond Aircraft Industries, Inc.*, 730 F. Supp. 2d 683, (W.D. Ky. 2010), the court held that apparent authority of an aircraft distributor to act as the aircraft manufacturer's agent was sufficiently established to survive a motion to dismiss where the manufacturer purportedly told plaintiffs that "working with [distributor] is the same as working directly with [manufacturer]."

Insignia and Trademarks

Displaying a manufacturer's trademarks and insignia at a dealer/distributor's place of business generally does not create an agency relationship. For example, the Seventh Circuit has held that permitting a dealer to use a manufacturer's name and trademark in advertisements does not make the dealer an agent of the manufacturer "just as every bar which advertises that they sell a particular brand of beer is not the agent of the brewery whose name they advertise." *Leon v. Caterpillar Indus. Corp.,* 69 F.3d 1326, 1336 (7th Cir. 1995). Most other courts have reached the same conclusion. In *Sprague v. Tesoro Alaska Petroleum Co.,* 1994 WL 792539 (Alaska Sup. Ct. Jun. 30, 1994), the court held that a service station was not the agent of the company whose gasoline it bought and sold, and the "common use of advertising and insignia… cannot establish an agency relationship and numerous courts have so held."

Manufacturers May Be Liable if They Rely on Dealers to Incorporate Safety Devices

When manufacturers rely on dealers/distributors to install safety features, they may become liable if the safety device is not installed, or is installed improperly. In *Caporale v. Raleigh Industries of America,* 382 So.2d 849, 850 (Fla. App. 1980), the plaintiff sued a manufacturer and dealer for personal injuries resulting from a fall while riding a Raleigh bicycle after the quick release mechanism, which was allegedly misassembled by the dealer, failed. The New Jersey Court of Appeals held that the manufacturer clearly contemplated that the bicycle would be fully assembled by its authorized dealer, and as such it "cannot now disclaim liability for injuries to the ultimate purchaser of a product where the manufacturer knowingly relies on its dealer to put the product in a finished state." *Id.* at 851 (citing *Sabloff v. Yamaha Motor Co.,* 113 N.J. Super. 279 (App. Div. 1971) and *Vandermark v. Ford Motor Co.,* 391 P.2d 168 (Cal. 1964)).

Similarly, in *Sabloff v. Yamaha Motor Co.,* the court was asked to decide whether a manufacturer could be liable to a purchaser for the acts of its dealer in failing to tighten the nut on an axle bolt properly. 113 N.J. Super., at 281. The court held that reversible error was committed in entering a directed verdict in favor of Yamaha because it did not deliver its motorcycles to the dealer ready to be driven away by the ultimate purchaser, but rather relied on its dealer to finish and assemble the product. *Id.* The court reasoned, "If the jury should find that the dealer's lack of sufficient tightening of the particular nut was the cause of the front wheel's failure to rotate, then the jury might also visit responsibility upon the defendant manufacturer for the function delegated by it to be performed by the dealer and not being properly performed." *Id.*

In *Vandermark v. Ford Motor Co.,* the plaintiff bought a new Ford automobile from an authorized Ford dealer. 391 P.2d at 169. The plaintiff was subsequently injured when the brakes apparently malfunctioned. *Id.* at 170. Among other things, the dealer removed the power steering unit before selling it to the plaintiff. *Id.* at 171. The Supreme Court of California held that Ford could be liable for portions of the manufacturing process that it delegated to third parties, reasoning as follows:

> [i]t appears in the present case that Ford delegates the final steps in that process to its authorized dealer. It does not deliver cars to its dealers that are ready to be driven away by the ultimate purchasers but relies on its dealers to make the final inspections, corrections, and adjustments necessary to make the cars ready for use. Since Ford, as a manufacturer of the completed product, cannot delegate its duty to have its cars delivered to the ultimate purchaser free from dangerous defects, it cannot escape liability on the ground that the defect in Vandermark's car may have been caused by something one of its authorized dealers did or failed to do.

Id. at 171.

In *Alverez v. Felker Manufacturing,* 41 Cal. Rptr. 514 (1964), the plaintiff was injured while operating a concrete cutting machine. The machine was equipped with a "Felker" blade, which was supplied by a local dealer. *Id.* at 517–18. The court held that strict liability may extend to a manufacturer even though the defect was caused by a dealer that was not the agent or employee of the manufacturer. *Id.* at 520. Put another way, the court held that the liability of the manufacturer for defects caused by the dealer, when the manufacturer delegates some work on the product that must be completed prior to delivery to the user, is not dependent upon the existence of an agency relationship between the manufacturer and the dealer. *Id.* Thus, manufacturers must carefully consider which features to install themselves and which features can be left as dealer-installed options.

Manufacturers Who Rely on Dealers to Make Inspections, Corrections, or Adjustments May Incur Liability

Manufacturers are generally not liable for the negligence of authorized dealers and distributors. For example, in *Zwingman v. Kallhoff,* 507 N.W.2d 894 (Neb. 1993), the Nebraska Supreme Court affirmed summary judgment in favor of a farming equipment manufacturer alleged to be vicariously liable for its dealer's negligence in using the wrong type of screws for a repair covered under the manufacturer's warranty. The court found no evidence that the manufacturer "either had a right to control or in fact exercised any control over [the dealer] with respect to warranty service work." *Id.* at 897. Similarly, in *Ely v. General Motors Corp.,* 927 S.W.2d 774 (Tex. App. 1996), summary judgment was affirmed, absolving General Motors of liability for injuries that occurred when a mechanic lost control of a Cadillac on a test drive after warranty work on the vehicle. The determining factor was control: "Texas courts have required specific control over the injury-causing activity to impose vicarious liability." *Id.* at 778.

If such specific and detailed allegations of control over the operations of a dealer are insufficient to create an agency relationship, it is unlikely that requiring a dealer to present customers with detailed warnings, instructions, and information regarding safety features will create an agency relationship.

However, when a manufacturer relies on its dealer to complete assembly of the product, or to inspect and make corrections to the product, it can be liable for the dealer's negligence in doing so. *See Vandermark, supra,* 61 Cal.2d 256 (1964). Liability in that context often turns on whether the product was delivered to the dealer in a fully assembled state. For example, in *Leon v. Caterpillar Indus. Corp.,* 69 F.3d 1326, 1338 (7th Cir. 1995), the Seventh Circuit held that the manufacturer of a fork lift that had been substantially altered by its authorized dealer could not be held strictly liable to the ultimate consumer because, among other reasons, the fork lift was not defective when it left the manufacturer's control. The Seventh Circuit distinguished *Vandermark* and its progeny on the ground that in each of those cases, "the manufacturer sent the product to the dealer in an unfinished state," whereas in *Leon* "Caterpillar delivered a fully assembled product" to its dealer. *Id.* at 1340.

Similarly, in *Hull v. Eaton Corp.,* 825 F.2d 448, 450 (D.C. Cir. 1987), the manufacturer delivered to its dealer a completed forklift and the dealer installed a new counterweight (which later malfunctioned) to increase the forklift's carrying capacity. The D.C. Circuit affirmed summary judgment in favor of the forklift manufacturer on the issue of vicarious liability for the dealer's installation services. *Id.* at 457–58. The D.C. Circuit distinguished a Florida case similar to *Vandermark,* relied upon by the plaintiff, on the ground that the manufacturer in that case had "knowingly relied on the retailer to assemble" its product, whereas in the *Hull* matter, the manufacturer had fully assembled the product prior to delivery. *Id.* at 457–58.

Contractual and Common Law Indemnification of Dealers and Distributors

Indemnification of dealers and distributors is often not a significant issue in product liability litigation because plaintiffs usually assert separate negligence claims that are designed to create independent exposure for dealers and distributors. However, if there is no basis for an independent negligence claim against the dealer/distributor and the plaintiff's claims are based solely on alleged design and/or manufacturing defects, the dealer/distributor will be entitled to indemnification regardless of whether the dealer/distributor agreement contains an indemnification clause. In practice, dealers/distributors often tender the defense of the case early on, and manufacturers typically deny it because the facts and circumstances of the incident are still under investigation, and there are independent allegations of negligence against the dealer/distributor. If it eventually becomes apparent that the only viable claim related to the product is a design or manufacturing defect, manufacturers should accept the dealers/distributor's tender or risk being liable for attorneys' fees that dealers/distributors incur in defending the lawsuit after the tender has been made.

Potential Solutions and Best Practices

Dealers and distributors are necessary partners for many manufacturers, and it is mutually beneficial to avoid creating an adversarial relationship. Perhaps more importantly, dealers and distributors interact with consumers, and it is in everyone's interest to ensure that the ultimate customers are happy with the product and related service. With that in mind, how do manufacturers and dealers/distributors work together to minimize liability and litigation risk? After all, manufacturers and dealers/distributors both have a strong incentive to avoid litigation. Potential solutions are discussed below.

Disclaimers

Disclaimers are written warnings and instructions that must be presented to customers regarding, among other things, proper installation and the availability of optional safety features. The idea here is to remove any ambiguity and instruct dealers/distributors to provide specific information to customers. But, by instructing dealers to provide specific information to consumers, is an agency relationship created?

Probably not. By way of example, in *Ocana v. Ford,* 992 So. 2d 319 (Fla. 3d DCA 2008), the court concluded that, in order to demonstrate that a Ford dealership was the agent of Ford, the plaintiff had to prove the following: 1) acknowledgement by the manufacturer that the dealer was acting as its agent; 2) acceptance of the under-

taking by the dealership; and 3) control by the manufacturer over the dealer's day-to-day activities during the course of the agency. *Id.* The plaintiffs in *Ocana* alleged that Ford had control over 1) dealer location, size, and number of dealer logos on dealer's premises; 2) prizes given to dealer's employees; 3) the number of bathrooms dealer must make available to the public; 4) training and certification of sales and service personnel; 5) a requirement that dealers use manufacturer-supplied computer software; 6) report vehicle sales and sales details, including name and address of purchaser and related information, to the manufacturer; 7) provision of warranty service paid for by Ford; and 8) Ford had the right to enter the dealer's business premises to audit the records and operations of the dealership as to sales and service. *Id.* The *Ocana* court held that these allegations were insufficient to establish an agency relationship. *Id.* If such specific and detailed allegations of control over the operations of a dealer are insufficient to create an agency relationship, it is unlikely that requiring a dealer to present customers with detailed warnings, instructions, and information regarding safety features will create an agency relationship.

Similarly, in *DaimlerChrysler Motors Co. v. Clemente*, 668 S.E.2d 737 (Ga. App. 2008), the plaintiff sued a Chrysler dealer for misrepresenting the condition of the vehicle she purchased and for failing to pay off the outstanding loan on the vehicle she traded in. *Id.* at 741. The dealership subsequently went out of business, and the plaintiff claimed that Chrysler Motors and Chrysler Financial were vicariously liable for the dealership's actions. *Id.* The Georgia Court of Appeals rejected the plaintiff's claim, noting that although the dealer agreement contained minimum standards and termination provisions for non-compliance with such standards, it did not "contain any provisions giving Chrysler Motors supervisory control over the day-to-day activities of Metro… and [it] expressly stated that neither party was the agent of the other." *Id.* at 745–46. The court further noted that "Chrysler Motors had no authority to hire, fire or evaluate Metro's employees, had no control over which creditors Metro chose to pay or how Metro spent its funds, had no authority over vehicle financing, and was not involved in the trading in of used vehicles." *Id.* at 746. Moreover, Chrysler Motors had no role in the sale of the subject vehicle or its financing. *Id.* Thus, the court ruled that the plaintiff had failed to show that Chrysler Motors had sufficient control so as to create an agency relationship.

In *Coe v. Esau*, 377 P.2d 815, 818 (Okla. 1963), the Oklahoma Supreme Court rejected a claim that an independent service station was the agent of the defendant petroleum company, Continental d/b/a Conoco. In rejecting the plaintiff's agency theory, the court held that the following facts were insufficient to establish an agency relationship: (a) Conoco owned the premises on which the station was situated, (b) the Conoco trademark was "prominently displayed upon the station premises," (c) the Conoco trademark appeared on advertisements for the station, (d) the station was listed in the telephone directory under "Conoco Service Stations," (e) the station operator accepted Conoco credit cards and the customer were billed directly by Conoco, (f) the station operator received advice and suggestions from Conoco regarding the standard of cleanliness, (g) the station operator paid Conoco one and one-fourth cents on each gallon of gasoline sold, and (h) the station operator, although controlling his own business hours, was required to occupy the premises and operate the station, or he would lose such right. If the above actions by Conoco, which reflect a significant degree of control over the service station, are insufficient to create an agency relationship, it is likely that manufacturers can direct dealers/distributors to provide specific and detailed warnings and information regarding safety features to consumers without creating an agency relationship.

It is also important to note that no agency relationship exists between a manufacturer and a dealer/distributor by virtue of the fact that the manufacturer trains the dealer/distributor's employees. *See Spiegel v. Sharp Electronics Corp.,* 125 Ill. App. 3d 897, 901, 466 N.E.2d 1040, 1044 (1st Dist. 1984). The fact that dealers are required to use specific forms and instructed on the use of those forms also does not establish an agency relationship. *See Luck v. Primus Automotive Financial Services, Inc.,* 763 So. 2d 243, 246–47 (Ala. 2000). The preceding cases demonstrate that manufacturers can exercise a great deal of control and authority over dealers/distributors without creating an agency relationship.

Parting Thoughts

It is important to create a seamless bridge between corporate operations and on-the-ground sales and marketing. Manufacturers that are directly involved in messaging at the ground level have a much better chance of stopping inaccurate information or omissions before they spread and lead to litigation. Manufacturers should spend the time to keep a close eye on what dealers/distributors are telling consumers about the product and the representations that they are making. When complaints are made about a dealer/distributor's conduct, they should be investigated thoroughly and all appropriate actions should be taken. It is often helpful for manufacturers to provide detailed training and instruction to dealers/distributors about new products and best practices with respect to sales and marketing on a regular basis. By working together and shaping a consistent and clear message regarding product warnings, instructions, and information, manufacturers and dealers/distributors can advance the mutually beneficial goals of decreasing litigation and increasing consumer satisfaction.

It is also important to note that no agency relationship exists between a manufacturer and a dealer/distributor by virtue of the fact that the manufacturer trains the dealer/distributor's employees.