



Importance of Subcontractor/ Vendor Product Liability

By Thomas K. Coughlin, AAI, Air-Sur, Inc

Late in 1993, a new state record was set in Illinois that left few people cheering. That's because it wasn't set on a playing field but in a court of law, and the record was the amount of money awarded a plaintiff as the result of a fatal air crash.

But the fact that the decision gave one plaintiff \$55 million (topping the previous record of \$8.3 million by more than \$53 million) is less shocking than the way the payment of that award was assessed.

The Law Offices of John Hoff, Chicago, represented the owner operator, which was joined with the plane's manufacturer, Mitsubishi, in the suit. The crash was caused, Hoff said, because of ice on the plane's tail and wings. Five people died. The judgment placed 65% of the blame (\$41 million) on pilot error, with the remaining 35% of the assessed damages (\$21 million) the responsibility of the manufacturer. Though Hoff's client should have carried the bulk of the financial burden, that company didn't have the resources, including sufficient insurance indemnity. It carried only \$12 million worth of liability insurance. Because Mitsubishi has more resources, and thanks to the Illinois law of joint and several liability, Mitsubishi will likely be responsible for all the damages. Mitsubishi may be able to recover the available \$12 million from Hoff's client and may have to absorb the balance.

Time Tested Legal Principal Determines Who Pays.

At first glance what appears to be a terrible inequity on the part of the Illinois court actually is based on an often upheld principal of law known as joint and several liability. Under this principal, Hoff explains, courts can rule it is more just for a guilty defendant to pay more than his assessed share of the penalty than it would be for an innocent plaintiff to go with less than, or none of their just award.

The principal of joint and several liability exists in some form in every state, which means that no matter where a company is based, no matter where it does business, it can end up disabled or destroyed because of the vicarious liability or negligence of another.

Most smart business owners know that carrying products and completed operations liability insurance on their company can be a reasonable defense against devastation in the courts. But not enough of these owners know, Hoff said, that the imposition of liability due to

the anomalies of various state laws can leave them carrying the lion's share of an unfavorable judgment if the other negligent or liable parties carried too little or no liability insurance.

Innocence Not Always Enough.

John Murray, a partner with Thornton, David, Murray, Richard, and Davis, Miami, shares a variation on the first example to further clarify how joint and several liability can work against a business even when it wins a case. One of Murray's clients overhauls aircraft engines. After a Pratt & Whitney JT3D engine his client had overhauled exploded in flight, the client was named in the suit. Evidence clearly showed the blame was due to faulty work done by a subcontracting company that supplied compressor blades to the client. The blades were not properly X-rayed by the subcontractor before they were delivered. As a result, a bad electron beam welding job went undetected.

But the subcontractor did not have liability insurance, and the plaintiff's attorneys knew that company was a dry well. Any hope for compensation was connected to finding Murray's client liable, in any degree, of fault and letting the joint and several liability principal work for the plaintiffs.

The plaintiffs were unable, however, to convince the court, and Murray's client was free from any liability damages. Unfortunately, it cost the client several hundreds of thousands of dollars in legal fees, he said, just to get to that point. Even though those costs were covered by insurance, the cost burden ultimately reverts to the client in the form of higher premiums.

Examples like those cited above aren't isolated instances. Joint and several liability affects all aspects of American business. Because of the high cost of equipment in the aviation business, not to mention the human lives involved, the stakes are all the higher.

The best way to avoid such high risks is to make sure that everyone with whom you do business is as adequately covered for products and completed operations liability as you are. It's unfortunate that the pressures of a recession have convinced many small companies that to survive they will risk going bare on liability.

This means they give up the insurance in the hopes of staying afloat. Such owners know that in the case of



any disaster they won't be covered and will be forced to shut down, but many of them consider this a more viable alternative than paying for proper insurance.

Parts and service prices are high in the aviation business, Hoff said, because everyone in the chain of distribution has to carry adequate protection against liability.

A Low Bid Should Raise A Red Flag.

For this reason, you should be very cautious when any subcontractor or supplier offers you an unusually low price its competitors can't match. It often means the low bidder may not be paying the liability insurance premiums the other companies are paying.

As you saw in one of the earlier examples, doing business with the low bidder in a case like this could end up being one of the most costly deals you ever made.

The widespread adoption of Total Quality Management principals has made it common for companies to make sure its vendors and subcontractors meet strict manufacturing standards and quality control levels. In addition to this, many other companies, especially those in the aviation industry, have begun making sure the companies with which they deal also carry proper liability insurance.

Suppliers should be required to produce certificates of insurance before any contract is signed. An integral part of your continuous tracking system is to make sure, through contact with the insurance carrier, of any changes, cancellation, modification or non-renewal of the supplier/vendor's liability coverage.

This process may be a bit cumbersome at first. The alternative, however, could involve legal fees and court judgments that could destroy a company.

Building An Approved Vendor List

Tracking, unfortunately, is not a one time process. Not only will you need to remain in contact with the insurance carriers of current subcontractors and vendors, but you also must start the screening process anew each time you consider doing business with a new subcontractor or vendor. In time, a list of approved vendors develops; as you become more familiar with the tracking process and develop a business relationship with the carriers of liability insurance, the process streamlines.

There's a very practical payoff to building such a vendor list: lower premium rates for you. As with any other practical loss control program, establishing and then working from a list of liability protected vendors reduces a business's exposure to claims and will pay off by controlling insurance costs.

Limiting exposure in an increasingly litigious society to potentially devastating claims like those outlined by lawyers John Murray and John Hoff is a smart and sound business practice and one that should become a fundamental ingredient of a good risk management program because of the implication of joint and several liability.

We hope this latest installment of our Professional Client Care program has given you new insights into ways you can better protect your business against potentially devastating losses. We want to keep you ahead of the problems facing the aviation industry, and in doing so help your business continue to grow.

We know how to set up and maintain an effective tracking system and would be happy to share that expertise with you. If you have any questions or wish to talk further about your risk management programs, please call.