

INSURING VENDORS FOR THEIR OWN NEGLIGENCE:
THE MANUFACTURER'S
ADDITIONAL INSURED
ENDORSEMENT
FOR VENDORS

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The underlying scenario is commonplace: a manufacturer wishes to bring a new product to market and will distribute the product through a network of vendors. The product is often displayed prominently at the retailer's property, perhaps on an endcap or featured in some other special location. Occasionally, promotional signs, planograms, and custom-designed display stands are shipped to the store to market the product. For its part, the vendor complies by demonstrating, selling, installing, and servicing the item, and both manufacturer and vendor benefit from the sale. Unfortunately, accidents occasionally arise from the sale of the product; the question is whether the insurer for the manufacturer or the insurer for the vendor will bear the exposure for any liability.

One could argue that the manufacturer should be covered by the vendor's policy, because the product has left the manufacturer's hands and is now within the complete control of the vendor, who could modify, misuse, or misrepresent the item. On the other hand, the vendor took no part in designing, manufacturing, or packaging the goods, and should not be responsible for a defective product where the vendor merely handled and sold the product.

THE VENDOR'S ENDORSEMENT

So how does the insurance industry allocate responsibility? The Insurance Services Office, or ISO, produces an additional insured endorsement entitled "Additional Insured – Vendors," numbered as form CG 20 15, which appears to immediately give away ISO's answer to the threshold question of who bears the loss. This form adds as insureds to the manufacturer's policy, named vendors or products (or "as required by written contract"), for damages arising out of the manufacturer's products that are distributed or sold in the regular course of business. There are also certain exceptions to coverage.

The function of the endorsement is – to the extent possible – to place risk where it belongs. While the endorsement contemplates coverage for the vendor for faulty products, it also, generally speaking, covers the vendor's activities that arise out of selling the manufacturer's product.

The typical vendor's endorsement lists activities it excludes from coverage, but then in some cases tempers those exclusions with exceptions that allow for coverage. Among the exclusions, the vendor's endorsement excludes unauthorized warranties or significant changes to the product or repackaging done by the vendor. The endorsement also excludes demonstrations, installation, service, or repair of the item, *unless* these are done at the vendor's premises in conjunction with the sale of the product.

Similarly, while the endorsement initially excludes damages arising out of the "sole neg-

ligence” of the vendor or its employees, the endorsement also contains an exception to this negligence exclusion, so that the exclusion does not apply to “inspections, adjustments, tests or servicing” that the vendor normally undertakes in the regular course of business in conjunction with the distribution or sale of the products. Moreover, the exclusion is for “sole negligence,” not just “negligence.” So this is by no means a complete exclusion of coverage for a vendor’s negligence.

These exceptions are significant, and as a result, this endorsement covers the vendor’s inspection, adjustment, service, demonstration, installation, or repair of the product, even where the vendor is negligent. Much litigation occurs where the vendor was negligent, and acted within an enumerated coverage exclusion, but the vendor’s actions leading up to the accident also could fall into one of the exceptions to the exclusion.

Generally speaking, the vendor must establish that it was the manufacturer’s vendor, that the alleged injuries arose in the regular course of business, and that the alleged injuries arose out of the distribution or sale of the manufacturer’s product. Whether the vendor’s actions are encompassed by an exception to the exclusion becomes the coverage issue.

CASE LAW EXAMPLES

The first examples involve product displays. In the first case, Nintendo manufactured and distributed Game Boy devices to a retailer. Nintendo retained a third party to manufacture a six-foot high interactive display unit to house a television monitor and display Game Boy units. While on display at the retail outlet, the 218-pound unit fell onto the five-year old plaintiff as he was attempting to play the game. In the ensuing coverage action, Nintendo’s carrier claimed the vendor was negligent, and moreover, the product did not cause the injury; rather, the display stand did. In a straightforward application of the Additional Insured – Vendors endorsement, the Massachusetts court ruled that, by common understanding, marketing is part of selling the product, and thus the vendor was covered under the additional insured endorsement.

In the second case, a display cabinet containing decorative rugs tipped over and fell on a woman at a Home Depot. Home Depot sought coverage under the rug manufacturer’s policy, which included a vendor’s endorsement. Despite the carrier’s arguments that Home Depot was negligent by failing to bolt down the display unit, the Texas court found that the injury arose out of the distribution or sale of the manufacturer’s rugs.

Some jurisdictions could disagree with these courts. In fact, in most instances the product itself must cause the injury. So in another example, a court reviewed a question of whether an allegation that a “colorful and distracting” display at a school book sale, which caused a plaintiff to trip and fall on a defect in the floor, triggered the vendor’s endorsement. An Arizona appeals court reversed a lower court’s ruling declaring coverage, holding that the vendor’s endorsement is triggered only when the product itself causes the injury; it is not intended to cover negligently maintained premises.

In other instances, the loss may be directly related to the product, but the retailer is not the “vendor.” In one example, a tire manufacturer added vendors as insureds. One such vendor acted not as a retail seller, but as a middle-man, and subsequently sold the tires to a retailer. One of the tires exploded when an employee of the retailer was mounting it, injuring him at the retailer’s premises. The retailer sought coverage under the vendor’s endorsement, but the court denied coverage because the installation was not consistent with the exception to the endorsement, having been performed on the retail installer’s premises, rather than the vendor’s premises.

INDEPENDENT NEGLIGENCE

The exceptions to the exclusionary language are significant because by virtue of the exceptions, the vendor’s endorsement provides coverage even if the vendor committed an independent negligent act. For example, in 1996, K-Mart agreed to purchase wrought iron patio furniture sets from the manufacturer. The manufacturer obtained the Additional Insured – Vendors endorsement, in favor of K-Mart. In order to display and promote the units, K-Mart employees assembled floor models. Beginning in 1997, K-Mart received 84 claims in which a customer sat in a display chair in the store, and the chair collapsed. K-Mart apparently admitted negligence, but sought coverage under the exception for the vendor’s demonstration. K-Mart issued a “Notice of Safety Recall,” and acknowledged that if the assembly directions were not followed precisely – including, apparently, by K-Mart’s own employees – the chairs could collapse.

The manufacturer’s carrier claimed that the endorsement “covers only product defects and not instances of ‘active negligence’ by the vendor” while the vendor acts as a mere conduit for the product; negligent assembly of the display furniture is not an enumerated exception. The Michigan court disagreed with the carrier, ruling that the in-

surer’s exclusionary language, construed strictly against the insurer, was not specific enough to negate coverage for K-Mart.

CAVEATS

In certain circumstances, the manufacturer is unable or unwilling to cover vendors. When a “third-party manufacturer” builds a product for someone else, based on that party’s design and specifications, the manufacturer may have no input regarding quality control, warning labels, or instructions. “Drop ship” arrangements, where the vendor sells the product but it ships directly from the manufacturer, may lack the formality of insurance. Likewise, products manufactured outside the United States, from drywall to toys to microchips, often come from a foreign manufacturer that is unable or unwilling to provide insurance for the vendor, leaving the domestic vendor a likely target.

It may go without saying, but for the vendor, it is critical to obtain written indemnity and insuring agreements in its favor, to request an Additional Insured – Vendors endorsement, with a certificate of insurance. Then, consistent with the endorsement, the vendor should not change, modify, misrepresent, or repackage the product, and all sales-related work should be done on the vendor’s premises.

CONCLUSION

The ISO “Additional Insured – Vendors” endorsement places risk where it belongs. If the vendor markets, sells, and services a product within the regular course of its business, at its premises, the endorsement should extend coverage to the vendor and any fault in the product or liability arising from the sale of the product lies with the manufacturer. If, on the other hand, the vendor goes outside these parameters, the vendor assumes responsibility for loss, and coverage is excluded by the endorsement.



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