HUNTON& WILLIAMS

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Fifth Circuit Rules that Vendor's Endorsement in Manufacturer's Policy Provides Coverage to Seller of Product

Vacating the district court's ruling in a products liability action and remanding for further proceedings, the United States Court of Appeals for the Fifth Circuit held that, under Louisiana law, a claims-made products/completed operations liability insurance policy issued by an insurer to a manufacturer of a product provided coverage to a seller of that product pursuant to the policy's vendor's endorsement. The Court of Appeals also ruled that two of the policy's exclusions to the vendor's endorsement did not apply. *Weaver v. CCA Industries, Inc. v. New York Marine & General Insurance Company*, No. 07-30597, 2008 U.S. App. LEXIS 11382 (5th Cir. May 27, 2008).

Background

The plaintiff initiated a products liability lawsuit to recover for injuries he allegedly sustained from ingesting an over-the-counter diet drug marketed and sold by the seller. The plaintiff alleged that the diet drug was unreasonably dangerous due to defective manufacture and design, the diet drug failed to conform to the seller's express warranty, the seller failed to provide an adequate warning regarding the risks associated with the diet drug, and the seller negligently failed to adequately and properly test the diet drug.

The manufacturer produced the diet drug using a formula provided by the seller. The manufacturer combined the component ingredients of the diet drug in its factory and then shipped the product in bulk to the seller to be packaged and labeled. The seller marketed the diet drug for sale to the general public at retail outlets.

The insurer had in effect a claims-made products/completed operations liability insurance policy (the "policy") affording liability coverage to the manufacturer and other insureds. The seller was not a named insured under the policy. The policy contained a vendor's endorsement affording coverage to vendors of the named insured's products. The plaintiff asserted claims against the seller but did not assert any claim against the manufacturer directly. The seller made demands on the manufacturer's insurer for defense and indemnification of any damages it might have to pay the plaintiff. The insurer denied coverage.

The seller filed a third-party complaint against the insurer for defense and indemnification, asserting that the policy's vendor's endorsement afforded liability coverage to the seller for any liability arising out of its sale of the diet drug manufactured by the manufacturer.

The insurer filed a motion for summary judgment. Granting summary judgment in favor of the insurer and dismissing the seller's third-party complaint, the district court found that the seller was not an additional insured under the vendor's

endorsement because the claims were based on the seller's independent negligence and, under Louisiana law, the vendor's endorsement only extends coverage for claims involving strict liability. The district court further ruled that even if the seller could otherwise qualify for coverage under the vendor's endorsement, several exclusions to the vendor's endorsement precluded coverage. The seller appealed.

The Decision of the Court of Appeals

Two issues were presented on appeal: whether the seller qualified as an additional insured under the policy's vendor's endorsement and; whether two policy exclusions to the vendor's endorsement precluded coverage for the plaintiff's claim.

Before discussing the merits of the appeal, the Fifth Circuit explained that, the insurance policy, because it is a contract between the parties, should be construed by using the general rules of interpretation of contracts set forth in the Louisiana Civil Code. Words and phrases in an insurance policy are to be construed using their plain, ordinary and generally prevailing meaning, unless the words have acquired a technical meaning. The Court of Appeals also set forth the appropriate standard with respect to the duty to defend under Louisiana law: an insurer's duty to defend suits brought against its insured is determined by the allegations of the injured plaintiff's petition, with the insurer being obligated to furnish a defense unless the petition unambiguously excludes coverage.

Turning to the first issue on appeal —whether the seller qualified as an additional insured under the policy's vendor's endorsement—the Court first examined the relevant language of the policy's vendor's endorsement, which provided: "it is hereby agreed that the definition of insured is amended to include any person or organization designated as a vendor but only with respect to the distribution or sale in the regular course of the vendor's business in [manufacturer's] products…." The Court noted that the district court had correctly found that the seller qualified as a "vendor" under the endorsement.

Next the Court examined the plaintiff's allegations to determine whether the insured had a duty to defend. Under Louisiana law, vendor's endorsements have been interpreted as providing coverage where the vendor is found strictly liable for selling a defective product and excluding coverage where the vendor is found to be independently negligent. Contrary to the district court's finding, the Court of Appeals found that the plaintiff's complaint asserted a strict liability claim under the Louisiana Product Liability Act ("LPLA") based on the allegation that the product was unreasonably dangerous in construction or composition.

The Court of Appeals stated that the seller could be held liable under the LPLA as a manufacturer due to the fact that it labels the product and sells it on its own. The Court reasoned that plaintiff's claim under the LPLA therefore could potentially visit liability on the seller based on strict liability for the manufacturer's actions. For example, if the manufacturer deviated from the formula or failed to follow the formula in manufacturing the product, the seller could potentially be liable as a manufacturer under the LPLA despite its lack of fault. Accordingly, the Court of Appeals concluded that under the vendor's endorsement the seller qualified as an additional insured on the plaintiff's claim under LPLA, unless a specific exclusion to the endorsement precluded recovery.

The Court of Appeals then discussed the two relevant exclusions. The first exclusion provided that "[t]he insurance with respect to the vendor does not apply to...bodily injury or property damage arising out of...products which after distribution or sale by the named insured have been labeled or relabeled or used as a container, part or ingredient of any other thing or substance by or for the vendor." The insurer argued that this exclusion excluded coverage for plaintiff's claim because the seller "labeled" the product after the manufacturer sold the product in bulk to the seller.

The Court found that the seller's packaging, labeling, and marketing of the product after it arrived in bulk from the manufacturer is not enough to trigger the exclusion. For the exclusion to apply, the injury must arise out of the seller's labeling or other alteration of the product and the plaintiff's injury. Although the Court of Appeals noted that Louisiana courts have not addressed the precise issue of whether an insurer must show this nexus between the labeling or alteration of the product and the injury, it predicted that Louisiana would require such a nexus.

The plaintiff's complaint asserted a number of product liability theories in support of recovery, some of which arguably had a nexus to the seller's labeling and some that had no nexus to the labeling. Because some of the theories had no nexus to the labeling—and a defense is owed even if only some of the claims are covered—the Court of Appeals ruled that the district court erred in determining that the exclusion defeated the seller's claim for coverage against plaintiff's claim.

The second exclusion stated that: "[t]he insurance does not apply to any person or organization, as insured, from whom the named insured has acquired such products or any ingredient, part or container, entering into, accompanying or containing such products." The insurer argued, and the district court agreed,

that the formula provided by the seller to the manufacturer was an "ingredient" for the purposes of this exclusion.

The Court of Appeals disagreed, stating that there is a logical, common sense distinction between the formula—a list of ingredients—and the ingredients themselves. Using a dictionary, the Court explained that a "formula" is defined as "a prescription of ingredients in fixed proportion," where as an "ingredient" is defined as "[a] constituent element of a mixture or compound." Finding that the formula for a product is different from the ingredients used to create the product, the Court held that the district court also erred in finding that exclusion applicable.

Accordingly, the Court of Appeals vacated the district court's judgment and remanded the case to the district court for further proceedings.

Implications

The holding by the Fifth Circuit Court of Appeals in *Weaver* confirms that, under Louisiana law, a vendor's endorsement in a claims-made products/completed operations liability insurance policy will be interpreted to provide coverage under a duty to defend where the allegations in the complaint assert a strict liability claim, unless a policy exclusion applies. In addition, the Fifth Circuit's prediction that Louisiana courts interpreting a "labeling" exclusion under a vendor's endorsement in such a policy would likely adopt a "nexus" requirement between the relabeling and the injury would bring Louisiana law in-line with the majority position, which recognizes that an injury must arise out of the relabeled or altered product in order for coverage to be excluded. *See, e.g.*, Mattocks v. Daylin Inc., 452 F.Supp. 512 (W.D. Pa 1978) (subsequent history omitted) (holding that changes in product made by vendor must cause plaintiffs' injuries before the vendor is excluded from coverage under the endorsement); *Sears, Roebuck and Co. v. Reliance Ins. Co.*, 654 F.2d 494 (7th Cir. 1981) (same).