Cost Recovery Actions Involving Old Products

Issues to Consider When Demanding Indemnification

By Patrick F. Hickey and Timothy M. Kuhn

Attorneys practicing commercial litigation in Michigan, particularly within the automotive industry, may find themselves presented with the following scenario. You receive a phone call from your client—either an original equipment manufacturer or one of its suppliers—advising you that an old product line, which has been out of production for more than four years, is being recalled because it contains a part alleged to be defective. Facing significant recall costs (e.g., notice to customers, accelerated production of replacement parts, and storing recalled parts for evidence in future proceedings) and the expense of defending personal injury and property loss actions concerning the recalled part, the original equipment manufacturer is demanding reimbursement from the Tier 1 supplier who sold the allegedly defective part who, in turn, is demanding reimbursement from its suppliers. Your client tells you it is exploring its business options, but wants to negotiate from a position of strength. Your client has turned to you for advice regarding its legal options in the event its current negotiations fail.

Given that the product being recalled has been in the stream of commerce for more than four years, you recognize your client's options are limited. For example, claims for breach of express or implied warranties are likely time-barred.[1] Indemnification may be your client's only option. This article addresses the circumstances under which indemnification may be an option as well as the legal defenses you should anticipate from your opposition so your client can maximize its financial recovery.

Indemnity under Michigan law

Michigan law recognizes three types of indemnity: common-law indemnification, implied contractual indemnification, and express contractual indemnification.[2] Common-law indemnity is available to one whose liability to a third party arises solely as a result of the wrongful conduct of another (i.e., liability arises vicariously or by operation of law).[3] It exists "only where a claimant alleges and proves that he is without personal fault, that he is not the best suited to insure preventive measures and that his negligence, if any, was only passive negligence."[4] Put differently, a party has no claim for common-law indemnity if it is subject to a claim of active negligence.[5]

Implied indemnity arises from "a special relationship between the parties or a course of conduct whereby one party undertakes to perform a certain service and impliedly assures indemnification."[6] Something more than a commercial transaction is necessary

to generate the "special relationship" to support an implied indemnity claim.[7] An example may be found in *Hill v Sullivan Equipment Company*.[8] In *Hill*, the Michigan Court of Appeals held that a third-party plaintiff had adequately pleaded a claim for implied indemnity by alleging that the third-party defendant had not only rejected a proposed protective cover for the machine that injured the plaintiff, but also had situated the equipment such that the protective cover was inaccessible to workers operating the machine: "[B]y expressly rejecting the proposed cover and undertaking to situate the conveyor so that it would be inaccessible, [the indemnitor] may have impliedly agreed to indemnify [the indemnitee] should [the indemnitee] be held liable for [the indemnitor's] rejection of the cover or failure to use the machine as proposed."[9] Like its common-law counterpart, an implied indemnity claim is only available to a party who is free of negligence or fault.[10]

Contracts containing an indemnification clause are described as express contracts for indemnification.[11] These contracts are "construed in the same fashion as are contracts generally," and their unambiguous terms will be enforced as written.[12] Thus, the terms of the operative contract will dictate whether, and to what extent, your client has a claim for indemnification against its supplier(s).

Typically, contracts in the automotive industry include provisions regarding indemnity, so express contractual indemnification is likely your client's best legal option for recovering costs in the scenario presented. To the extent your client designed or is alleged to have designed the part being recalled, common-law indemnity and implied indemnity may not be available simply because your client would struggle to prove passive negligence. If the contract includes a provision regarding indemnity, then your client may also struggle to maintain an implied indemnity claim because Michigan law precludes parties from pursuing claims based on an implied contract where an express contract governs their relationship.[13] Of course, nothing will prevent your client from pleading all three indemnity claims in the alternative,[14] but your strongest of the three claims will likely be express contractual indemnification.

FAST FACTS

A potential indemnitee cannot pursue a claim for common-law or implied contractual indemnification unless it can plead and prove freedom from fault or active negligence.

A party who intends to pursue a claim for express contractual indemnity arising from a contract for the sale of goods should provide the indemnitor with notice of the claim before it is filed; otherwise, the would-be indemnitee risks having its claim dismissed for failure to abide by MCL 440.2607.

The accrual date for a claim of express contractual indemnity will depend on whether the contract provides for indemnification against loss or indemnification against liability.

Legal defenses to an express contractual indemnity claim

Before you and your client file a lawsuit for breach of an indemnity contract, you should be prepared to address and overcome at least three legal challenges to your claim: notice, the statute of limitations, and claim accrual.

Notice

For sales contracts, Michigan law requires that a buyer provide its seller with notice in order to preserve its right to seek any remedy under the contract,[15] including the right to indemnity. In *American Bumper & Manufacturing Company v Transtechnology Corporation*,[16] the Michigan Court of Appeals held that claims for express contractual indemnity based on a contract for the sale of goods are absolutely barred if the plaintiff fails to provide the defendant with proper notice of the claims against it within a reasonable time:

> To the extent that plaintiff argues that the "any remedy" language [in MCL 440.2607] applies only to any remedy under the UCC and does not include its claims of express and implied indemnification, we disagree. MCL 440.1201(34) broadly defines "remedy" as "any remedial right to which an aggrieved party is entitled with or without resort to a tribunal." Further, MCL

> 440.2607(3)(a) also clearly states that if notice of the breach is not given within a reasonable time, the buyer is "barred from any remedy." It does not state "any remedy under the UCC" as plaintiff contends. Here, the statute plainly and unambiguously states that notice must be given or the buyer is barred from *any* remedy. Further, the indemnification claims here should be included as "any remedy" where the indemnification claims are based on the underlying breach of warranty claims for which the buyer also seeks a remedy.[17]

What constitutes sufficient notice will depend on the facts of each case. Indeed, courts have interpreted the notice requirement differently.[18] However, Official Comment 4 to MCL 440.2607 states that notice will be sufficient if it "let[s] the seller know that the transaction is troublesome and must be watched." The notification "need only be such as informs the seller that the transaction is claimed to involve a breach, and thus opens the way for normal settlement through negotiation."[19] Before filing a claim for contractual indemnity, your client should advise its supplier as soon as practicable that it is subject to litigation or that the parties' contract is claimed to involve a breach such that the parties can begin to negotiate a settlement. Failure to do so could expose your client to dismissal of its claim for lack of notice.

Statute of limitations

Under the common law, the statute of limitations for breach of contract is six years.[20] Under the Uniform Commercial Code, however, claims for breach of contract are subject to a four-year limitations period, which begins to run at the tender of delivery.[21] Federal courts applying Michigan law have predicted that the Michigan Supreme Court would apply the six-year statute of limitations, and not the four-year period, to indemnity claims arising from sales contracts.[22] The Court has not directly addressed this issue, but recently held that a claim for an open account related to the sale of goods is "distinct and independent from the underlying transactions giving rise to the antecedent debt" and, therefore, not subject to the four-year limitations period under MCL 440.2725.[23] This separate and distinct analysis has been applied to indemnity claims concerning sales contracts by the majority of courts addressing the issue;[24] however, there is authority to the contrary.[25] Thus, you and your client should anticipate opposition to any claim for indemnity related to transactions that are more than four years old.

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Claim accrual

Michigan law distinguishes indemnity against loss from indemnity against liability. For example, in *Bralko Holdings, Limited v Insurance Company of North America*,[26] the court held that an agreement to "indemnify and hold harmless [the indemnitee] 'from and against any losses,'" indemnified against only those losses actually sustained. In *Melbourne v Lawn Works*,[27] the court held that an agreement to indemnify against "liability which the contractor may accrue" offered protection against liability and loss: "[B]ecause the contract provides for indemnity when liability accrues, rather than when actual loss or damages are suffered, [the indemnitee] need not have suffered actual loss to trigger the indemnity obligation." The court also noted that "[a]lthough the indemnitee has not paid the judgment, [the indemnitor] is still obligated to indemnify. . . . The plain language of the contract does not require an actual loss; [the indemnitor] therefore acquired the obligation to pay when the judgment was entered against [the indemnitee]."[28]

The liability/loss distinction is important. Although a claim for indemnity against loss does not accrue until the indemnitee satisfies a judgment or settles a claim against it,[29] a claim for indemnity against liability accrues when the indemnitee's liability becomes fixed, regardless of whether the indemnitee suffers a loss.[30] Because it is possible for liability to become fixed before

entry of a final judgment, a claim for express contractual indemnity for liability may accrue long before the indemnitee suffers a loss.[31] For this reason, at the outset of your engagement, you and your client should determine the triggering event for the indemnity obligation you seek to enforce.

Conclusion

Maximizing cost recovery involving older products is not a legal dead end. Although filing breach of warranty claims may not be a viable option, your client can improve its negotiating position in the boardroom by knowing what steps it must take and what challenges it must overcome to prevail on an indemnity claim in the courtroom. ■

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ENDNOTES

1. MCL 440.2725(1) and (2).
2. *Turnbull v Andrew Crowe & Sons, Inc*, 572 F Supp 1254, 1256 (WD Mich, 1983), citing *Skinner v D-M-E Corp*, 124 Mich App 580; 335 NW2d 90 (1983).
3. *Skinner, supra* at 584–585, citing *Langley v Harris Corp*, 413 Mich 592; 321 NW2d 662 (1982).
4. *Cutter v Massey-Ferguson, Inc*, 114 Mich App 28, 33; 318 NW2d 554 (1982).
5. *Beck v Westphal*, 141 Mich App 136, 144; 366 NW2d 217 (1984) ("In order to determine whether the indemnitee was 'actively' or 'passively' negligent, we must look to the primary plaintiff's complaint. If that complaint alleges 'active' negligence on the part of the person seeking indemnification, such person is not entitled to common-law indemnity."); see also *LaFountain v Sears Roebuck & Co*, 872 F2d 1026 (CA 6, 1989) ("[T]his court cannot agree that the mere allegations of active negligence in the plaintiffs' complaint are sufficient to defeat . . . claims for common-law indemnity where recovery was also sought . . . based on vicarious liability or liability by operation of law. The critical inquiry is whether the proposed indemnitee is able to plead and prove freedom from active fault.").
6. *Skinner, supra* at 585, citing *Palomba v East Detroit*, 112 Mich App 209; 315 NW2d 898 (1982).
7. See, e.g., *Turnbull, supra* at 1256 (rejecting a special relationship between a swing set manufacturer and its rope supplier simply because the supplier sold the rope for the swing that injured the plaintiff).
8. *Hill v Sullivan Equip Co*, 86 Mich App 693; 273 NW2d 527 (1978).
9. *Id.* at 698.
10. See *Williams v Litton Sys, Inc*, 433 Mich 755, 760; 449 NW2d 669 (1989).
11. See *Ins Co of North America v Southeastern Elec Co, Inc*, 405 Mich 554, 556–557; 275 NW2d 255 (1979).
12. *Zurich Ins Co v CCR & Co*, 226 Mich App 599, 603, 604; 576 NW2d 392 (1997).
13. See, e.g., *Belle Isle Grill Corp v Detroit*, 256 Mich App 463, 478; 666 NW2d 271 (2003) ("[A] contract will be implied only if there is no express contract covering the same subject matter.").
14. See *McLouth Steel Corp v A E Anderson Constr Corp*, 48 Mich App 424, 431; 210 NW2d 448 (1973) (recognizing that where the indemnitee was not negligent in its own right "either the contractual agreement to indemnify, or common-law principles of indemnification provide an adequate basis for the judgment entered against [the indemnitor]"); see also *Prosky v Nat'l Acme Co*, 404 F Supp 852, 854 (ED Mich, 1975) (noting that "common law indemnity was an alternative basis for the [*McLouth*] court's decision since there was an express contract of indemnity running from the contractor to the owner").
15. MCL 440.2607(3).
16. *Am Bumper & Mfg Co v Transtechnology Corp*, 252 Mich App 340, 348; 652 NW2d 252 (2002).
17. Although this language seems to address only indemnity claims based on an underlying claim for breach of warranty, one commentator has suggested that the language is broad enough to extend beyond claims arising under Article 2. Klein, *Long-term contracts, breach, and the Uniform Commercial Code's notice requirement*, 86 Mich B J 28 (May 2007).
18. Compare *Fargo Mach & Tool Co v Kearney & Trecker Corp*, 428 F Supp 364, 375 (ED Mich, 1977) (finding that "notice of breach of warranty under the Code is intended to be less rigorous than that required by the former sales act" and concluding that the notice requirement was satisfied because the seller's actions demonstrated "an acute sense of awareness on seller's part that the buyer was not satisfied"), with *Eaton Corp v Magnavox Co*, 581 F Supp 1514, 1531–1532 (ED Mich, 1984) (barring warranty claims because the buyer waited eight months after learning of the nonconformity to give the seller notice, which notice did not explicitly state that there was a "breach" of warranty, but only implied it in a letter).
19. MCL 440.2607, Comment 4.
20. MCL 600.5807(8); *Ins Co of North America, supra* at 556–557.
21. MCL 440.2725(1) and (2).
22. *Procter & Schwartz, Inc v US Equip Co*, 624 F2d 771, 775 n 6 (CA 6, 1980); *Ameron, Inc v Chemische Werke Huls AG*, 760 F Supp 1234, 1236–1238 (ED Mich, 1991).
23. *Fisher Sand & Gravel Co v Neal A Sweebe, Inc*, 494 Mich 543, 548; 837 NW2d 244 (2013).
24. See *City of Willmar v Short-Elliott-Hendrickson, Inc*, 512 NW2d 872, 875 n 5 (Minn, 1994) (noting that "[c]ourts in 13 jurisdictions have held that the U.C.C. statute of limitations does not apply to contribution-indemnity actions," and that only "[f]ive jurisdictions have held to the contrary").
25. See, e.g., *Farmers Nat'l Bank v Wickham Pipeline Constr*, 114 Idaho 565, 570–571, 759 P2d 71 (1988); *Perry v Pioneer Wholesale Supply Co*, 681 P2d 214, 219 (Utah, 1984).
26. *Bralko Holdings, Ltd v Ins Co of North America*, 193 Mich App 157, 159–161; 483 NW2d 929 (1992).
27. *Melbourne v Lawn Works*, unpublished opinion per curiam of the Court of Appeals, issued March 6, 2007 (Docket No. 263783).
28. *Id.*
29. *Insurance Co of North America, supra* at 556–557; see also *Ameron, supra* at 1237; *Penn Cent Corp v Checker Cab Co*, 488 F Supp 1225, 1230–1231 (ED Mich, 1980).
30. See, e.g., *Melbourne, supra* at *15.
31. See, e.g., *Yolton v El Paso Tenn Pipeline Co*, unpublished opinion and order of the U.S. District Court for the Eastern District of Michigan, issued October 17, 2007 (Docket No. 02-75164) (noting that the entry of a preliminary injunction against the indemnitee triggered the indemnitor's obligation to indemnify against any liability incurred).