

Outsourcing Risk

Overview of Civil Liability Theories

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1. **Tort Liability to Customer**
 - a. **Negligent Entrustment**
 - b. **Negligent Supervision and Hiring**
 - c. **Premises Liability**

- a. **Negligent Entrustment**

The key elements in a negligent entrustment claim are an entrustment of a chattel, to a person incompetent to use it, with knowledge that the person is incompetent, and the entrustment is the proximate cause of injury or damages to another. In Privette v. CSX Transportation, Inc. (unreported opinion) 79 Fed.Appx. 879 (USCA 6th Cir. 2003), a widow brought an action against CSX relating to her husband's death which occurred while the husband was attempting to remove a cable from a moving railcar. The husband was employed by an independent contractor and while he was in the process of using a front end loader to ease a railcar off of a scale, the husband unsuccessfully attempted to remove a cable from a moving railcar, causing his death. One of the claims brought against CSX by the widow was a negligent entrustment claim. The widow contended that CSX had entrusted a dangerous instrumentality (a railcar) to employees who were not competent to use the railcar cable method safely and that as a result of this entrustment, the plaintiff's husband was killed. The court set forth the Restatement definition of negligent entrustment:

"One who supplies directly or through a third person a chattel for the use of another whom the supplier knows or has reason to know to be likely, because of his youth, inexperience, or otherwise, to use it in a manner involving unreasonable risk of physical harm to himself and others whom the supplier should expect to share in or be endangered by its use, is subject to liability for physical harm resulting to them." Restatement (Second) of Torts §390 (1965). "The focus of the tort of negligent entrustment is the degree of knowledge the supplier of the chattel has or should have concerning the trustee's propensity to use the chattel in an improper or dangerous fashion." 79 Fed. Appx. @ 889.

After reviewing the elements of a negligent entrustment claim, the court held, as a matter of law, that the plaintiff widow could not maintain a negligent entrustment action because there was no evidence to show that the operators of the railcar were “incompetent” or had not received proper training with respect to the proper safe use of the cable cars.

A somewhat different analysis was used by the court with respect to a negligent entrustment claim in City of Philadelphia v. Beretta U.S.A. Corp. et al. 277 F.3d 415 (USCA 3rd Cir. 2002). In this rather unusual case, the City of Philadelphia brought an action against numerous gun manufacturers to recover costs associated with the criminal use of handguns, claiming that the gun industries’ methods for distributing guns negligently allowed criminals to obtain guns which were subsequently used in crimes. In discussing the negligent entrustment claim by the City of Philadelphia, the court set forth this definition of negligent entrustment:

“Negligent entrustment involves permitting a third person to use a thing or to engage in an activity which is under the control of the actor, if the actor knows or should know that such person intends or is likely to use the thing or to conduct himself in the activity in such a manner as to create an unreasonable risk of harm to others.” 277 Fed.3d @ 422.

The Third Circuit affirmed the Trial Court’s dismissal of the City of Philadelphia’s negligent entrustment claim on the basis of remoteness. The court concluded that there was, at best, a weak causal connection between the gun manufacturers’ conduct and the City’s injuries. The court found that the gun manufacturers did not intend to harm the plaintiffs; that the plaintiffs’ claims were “entirely derivative of those of others who would be more appropriate plaintiffs; that tort law preferred a more balanced approach to recovery; and that plaintiffs’ damages were too speculative to permit recovery.”

b. Negligent Supervision and Hiring

Negligent supervision and hiring claims normally arise in the context where the “negligent act” committed by an employee or agent of the principal is outside the course and scope of the business for the principal and outside the scope of the duties and responsibilities of the employee. Therefore, traditional theories of vicarious liability on the part of the principal for the actions of the employee will not apply. So, in order to hold the principal liable, the injured party must establish that the principal was negligent in hiring or supervising the offending employee. An interesting discussion of negligent supervision and hiring is found in Doe v. The Newbury Bible Church, 2005 WL 1862118 (USDC VT. 2005). In this case, the District Court in Vermont analyzed a negligent supervision/hiring claim brought against the Newbury Bible Church for the actions of a pastor employed by the church who allegedly molested children who he came in contact with during his duties as pastor. The court first noted that under traditional principles of vicarious liability, the church could not be held liable for the actions of the pastor because

any inappropriate touching of the children was clearly outside of the pastor's duties and responsibilities as a pastor for the church. The court then analyzed the plaintiff's negligent supervision and hiring claim by adopting the definition of negligent hiring/supervision, or retention as found in Restatement (Second) of Agency §213:

"A person conducting an activity through servants or other agents is subject to liability for harm resulting from his conduct if he is negligent or reckless... in the employment of improper persons or instrumentalities in work involving risk of harm to others: in the supervision of the activity; or... in permitting, or failing to prevent, negligent or other tortious conduct by persons, whether or not his servants or agents, upon premises or with instrumentalities under his control." Restatement (2d) of Agency §213.

The court then held that there was no evidence that the church defendants knew or should have known of the pastor's propensity to molest young boys. The court went on to hold that an employer is under a duty to control his employees from intentionally harming others only when he "knows or should have known of the necessity and opportunity for exercising such control". Citing Restatement (2d) of Torts §317(b)(ii). The court found that the church did not know of the pastor's propensity for violating the children, and therefore, the church was under no duty to protect the children from the pastor's volitional criminal acts.

Another interesting case involving the issue of negligent hiring/supervision is Seidl v. Greentree Mortgage Company, 30 F.Supp. 2d 1292 (USDC CO. 1998). In the Seidl case, the registrant of an internet domain name sued a mortgage company, which had conducted a bulk electronic mail (e-mail) advertising campaign. The plaintiff claimed damages because of the bulk e-mailing that was done. The mortgage company had hired another company to conduct the bulk electronic mailing. One of the theories against the defendant mortgage company was that it negligently supervised and hired the company who actually sent out the e-mails. In analyzing this claim, the court held that claims of negligent supervision and hiring applied only to employees or agents of the principal and would not apply to independent contractors.

c. Premises Liability

The concept of premises liability is that the owner of property owes a duty to exercise ordinary care for guest or invitees who are on the property. Premises liability does not involve issues of privity. Normally, the duty owed by a property owner to invitees or guests is established by statute. There are numerous exceptions and defenses that the property owner can have, even assuming that a duty is found with respect to guests and invitees. In Scaccianoce v. Hixon Manufacturing and Supply Company, 57 F.3d 582 (USCA 7th Circ. 1994), the court discusses one such exception. In the Hixon Manufacturing case, a surveyor's helper was injured when his aluminum surveyor's prism pole accidentally struck an uninsulated overhead power line owned by the defendant electric company. The court held that a premises liability theory could not be sustained against the power company who owned the property because of the "open and

obvious” danger of the overhead power line. The court held that this open and obvious defense would be applicable not only in a premises liability context, but also in a product liability context.

Another decision discussing the open and obvious defense in a premises liability setting is Monk v. Virgin Islands Water and Power Authority, 53 F.3d 1381 (USCA 3rd Cir. 1994). In the Monk decision, an independent contractor’s employee was seriously injured when a steel beam he was holding touched an overhead power line at the Virgin Islands Power Authority plant. The court held that although the Virgin Islands had adopted premises liability against a property owner, the risk encountered by the plaintiff was open and obvious and therefore the plaintiff could not recover under a premise liability theory.

2. Contract Liability

- a. **Breach of Warranty (express/implied)**
- b. **Third Party Beneficiary to Contract**
- c. **Indirect Liability to Customer – Agent (apparent – ostensible) and Borrowed Servant**

a. Breach of Warranty (express/implied)

Warranties are generally of two distinct categories, express warranties where the contract sets forth whatever warranties might apply and implied warranties imposed by operation of law. In Tompkin v. Philip Morris USA, Inc., 362 F.3d (USCA 6th Cir. 2003), the court discussed the elements for a claim based on breach of implied warranties. The Tompkin case was part of the infamous tobacco litigation. The plaintiff was the administratrix of the estate of a gentleman who had died of lung cancer allegedly from smoking cigarettes. One of the numerous claims brought against the tobacco company was breached of implied warranty. The court discussed the necessary elements of an implied warranty claim. First, the existence of a defect in the product manufactured and sold by the defendant; second, the defect existed when the product left the hands of the defendant; and third, the defect was a direct and proximate cause of the plaintiff’s injuries. The court went on to explain that a product is normally considered defective if it is “dangerous to an extent beyond the expectations of an ordinary consumer when used in an intended or reasonably foreseeable manner”. In the context of the tobacco litigation, the court held that in order to find against the cigarette manufactures, a jury would have to find not only that the cigarettes were defective in that they were dangerous to the consumer, but that the cigarettes were dangerous to an extent beyond that which would be contemplated by the ordinary consumer who purchases them with the ordinary knowledge common to the community as to their characteristics.

Another instructive case concerning implied warranties is Hollister v. Dayton Hudson Corporation 201 F.3d 731 (USCA 6th Cir. 2000). In the Hollister decision, the court was dealing with a situation where a purchaser of a shirt was severely burned when the shirt caught fire upon contact with a hot stove burner. The court held that a cause of action for

breach of implied warranty could be stated on the grounds that the manufacturer of the shirt failed to warn the consuming public of the fire danger associated with the product.

Implied warranties may be disclaimed and if a manufacturer correctly disclaims any and all implied warranties that may attach by operation of law, then the manufacturer may not be held liable for breach of implied warranties. See Erling v. American Allsafe Company, 230 F.3d 1362 (USCA 8th Cir. 2000).

b. Third Party Beneficiary to Contract

The concept of a third party beneficiary to a contract is to give a party, who was not involved in the contract negotiations and is not named as a party to the contract, the same rights as the actual party or parties to the contract. The third party beneficiary may sue for breach if he is the “intended beneficiary” of the contract. Most of the cases that discuss third party beneficiary contract issues follow the Restatement Law of Contracts §133. Under the Restatement, a person or other entity may be a third party beneficiary to a contract where the contract was made specifically to benefit, at least in part, the third party beneficiary. Most third party beneficiary cases arise in a donee beneficiary setting, a creditor beneficiary setting, or in an incidental beneficiary setting. An instructive case that discusses the legal requirements of establishing a right as a third party beneficiary is Waterman Steamship Corporation v. Dugan & McNamara, Inc., 264 U.S. 421 (1960). In the Waterman Steamship case, the U.S. Supreme Court held that a ship’s owner was a third party beneficiary to a contract between two other parties who were engaged in the shipment of goods.

3. Indirect Liability to Customer – Agent (apparent – ostensible) and Borrowed Servant

Under the concept of apparent agency, a principal can be held liable for the negligent actions of another who, under the terms of a contract, may in fact be an independent contractor as opposed to an employee or agent. In Unibridge Systems, Inc. v. Prudential Insurance Company of America, 43 F.3d 1484 (USCA 10th Cir. 1994), the Tenth Circuit Court of Appeals discussed the concept of apparent authority as follows:

“Apparent authority of an agent is such authority as the principal normally permits the agent to assume or which he holds the agent out as possessing. Three elements must exist before a third party can hold a principal liable for the acts of another on an apparent agency principle; a) conduct of the principal which would reasonably lead the third party to believe that the agent was authorized to act on behalf of the principal; b) reliance thereon by the third party; and c) change of position by the third party to his detriment.” 43 F.3d 1484 at 1485.

In Unibridge Systems, Inc., the court found that there was a jury issue stated as to whether or not Prudential would be liable to the plaintiff under an apparent agency theory

with respect to certain representations that an independent agent made concerning Prudential's policies.

The court in Hicks v. Ocean Drilling and Exploration Company, 512 F.2d 817 (USCA 5th Cir. 1975), discussed the concept of the Borrowed Servant Doctrine. In Hicks, the court held that the most universally accepted standard for determining whether someone was a borrowed servant of another is to ascertain who controls the servant in that employment and who has the power and the right to control and direct him in the performance of his work.

“In order to establish that the employee is a borrowed servant of another, the plaintiff must establish among other possible elements of proof, that the borrowing employer exercises control over the employee who has the right to control him. They may establish that the general employer has relinquished the right of control.” 512 F.2d 817 at 821.

4. Strict Liability

The concept of strict liability is liability against a manufacturer of a product without regard to whether the product was negligently manufactured. Strict liability is bottomed on the concept that the product had some defect in it which caused harm to a consumer, resulting in injury to the consumer. The court in Wankier v. Crown Equipment Corporation, 353 F.3d 862 (USCA 10th Cir. 2003), discussed the elements of strict liability. There, the court held that in order to establish a strict liability claim, a plaintiff has to show first, that it manufactured a product which, at the time it was sold, was in a defective condition that made the product unreasonably dangerous to the user; second, that the product reached the ultimate consumer without substantial change; third, that the defective condition of the product proximately caused the injury to the plaintiff; fourth, that at the time the product was sold, there was a safer and alternative design that was available for use.

Certain statutes give rise to strict liability such as environmental law statutes and consumer protection statutes. One recent statute that is getting some press is COPPA, Children's On Line Privacy Protection Act. For a discussion of the elements of this Act, see United States of America v. American Pop Corn Company, 2002 WL 32151631 (USDC N.D. Iowa 2002).