SUPREME COURT OF KENTUCKY

No. 2009-SC-485 and
No. 2009-SC-825

GIDDINGS & LEWIS, INC., et. al., APPELLANTS/ CROSS-APPELLEES

vs.

On Appeal from the Court of Appeals
No. 2007-CA-002163-MR
(Civil Action No. 99-CI-240)

INDUSTRIAL RISK INSURERS, et. al. APPELLEES/ CROSS-APPELLANTS

REPLY BRIEF OF APPELLEES/CROSS-APPELLANTS, INDUSTRIAL RISK INSURERS, et. al.

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C.R. 76.12 Certifications

The undersigned does hereby certify that copies of this brief were served upon the following named individuals by Federal Express Overnight Delivery on September 29, 2010: Mr. Sam Givens, Clerk, Court of Appeals, 360 Democrat Drive, Frankfort, Kentucky 40601; The Honorable Timothy C. Stark, Graves County Circuit Court, 100 E. Broadway, Mayfield, Kentucky 42066; and John L. Tate, Jamie K. Neal, Stites & Harbison PLLC, 400 West Market Street, Suite 1800, Louisville, Kentucky 40202. The undersigned does also certify that the appellees/cross-appellants did not withdraw the record on appeal.

KIMBERLY A. HARTMAN

STATEMENT OF POINTS AND AUTHORITIES

PREFATORY STATEMENT

Ingersoll-Rand Company and its insurers (collectively "IRI") file this Reply Brief in support of cross-appeal. The brief is limited to the two issues raised in IRI's cross-motion for discretionary review: (1) should Kentucky adopt the economic loss rule in this case; and (2) does Kentucky recognize the destructive or calamitous event exception to the rule?

INTRODUCTION

Giddings & Lewis, Inc. and its parent company (collectively "G&L") seek to escape any and all liability for the catastrophic accident that occurred when a vertical turning lathe ("VTL") it designed and manufactured suddenly malfunctioned and threw 5,000 pounds of spinning metal through an occupied factory room. G&L denies liability, not on the basis that it was not negligent in causing the accident, but because it claims that the economic loss rule—a doctrine rooted in contract law—shields it from tort liability. It thereby urges this Court to deny IRI the tort protections generally afforded by this State's products liability, negligence, negligent misrepresentation and fraud law.

For support, G&L engages in a "blame the victim" tactic. It argues that Ingersoll-Rand should have anticipated and contracted against the risk that materialized. Incredibly, it asserts that Ingersoll-Rand should have foreseen and protected itself from the sudden and explosive malfunction of the VTL, a product that G&L charged Ingersoll-Rand $750,000.00 to design and build. It suggests that if Ingersoll-Rand wanted a better or safer product, it should have paid more or purchased an extended warranty. And it criticizes IRI's pursuit of this action, emphasizing that the insurance companies in particular have a financial stake in the outcome. But there is no basis for treating a

business and its insurance carriers differently than any other plaintiff trying to recover its losses from a responsible tortfeasor. IRI expects to be treated the same as any other litigant appearing before this High Court.

ARGUMENT

I. The Economic Loss Rule Should Not Be Adopted Or Applied In This Action For Catastrophic Property Damages.

G&L incorrectly states that IRI "agrees that Kentucky should formally adopt the Economic Loss Rule." (G&L's Response and Reply Brief, p. 1) As G&L well knows, nothing could be farther from the truth. Instead, IRI has always maintained that the doctrine should not be recognized or applied in this case. This was recently reiterated when IRI asked this Court to reverse the Court of Appeals' partial application of the rule. (*See generally*, IRI's Appellee Brief) Indeed, there can be no question that IRI has consistently argued that the economic loss rule—even in its broadest form—does not limit claims where a defective product damages "other" property. (*See* IRI's Appellee Brief, pp. 9-11)

G&L does not challenge this statement of law, other than to say that IRI has not previously argued that property other than the VTL and/or cell diffuser system were damaged in the accident. (G&L's Response and Reply Brief, pp. 14-15) G&L's position is not supported by the record. The First Amended Complaint states that a "pallet, chuck and part were released from the VTL during operation while the table was rotating, and were violently propelled at a high rate of speed through the Ingersoll-Rand Mayfield, Kentucky plant causing severe and extensive damage to the VTL and other property of Ingersoll-Rand." (R. 150-65, Count I, ¶ 3, count II, ¶ 17, Count VI, ¶ 18 and Count VII, ¶ 18) That the accident damaged "other" property, including the workpiece, chucks,

remote Q stand, cables and concrete factory floor has never been in dispute. These damages were disclosed in the post-accident Service and Installation Report[1] and depositions of Charles Allen and David Fowler. (R. Memo[2], Ex. G; Allen Dep. Tr.; Fowler Dep. Tr.) On this record, IRI urged the trial and appellate courts not to apply the economic loss rule to any of its tort claims. (R. Memo. pp. 9-12; IRI's Court of Appeals Appellants' Brief, pp. 23-25)

Because G&L does not present contrary evidence, there can be no question as to the existence of "other" property damages. And by admitting that tort protection "applies when a product damages other property" (G&L's Appellants' Brief, p. 9), G&L necessarily acknowledges that the economic loss rule—even in its broadest form—does not apply here. All of IRI's tort claims should thus be reinstated and remanded for a trial on the merits.

II. If Adopted And Applied Here, The Economic Loss Rule Should Be Limited By The Calamitous Or Destructive Event Exception.

G&L argues against the calamitous or destructive event exception to the economic loss rule, claiming that "there is no logic in letting the speed at which an event occurs dictate the application of economic loss principles." (G&L's Response and Reply Brief, p. 2) For support, it cites to *East River Steamship Corp. v. Transamerica Delaval*, 476 U.S. 858 (1970) and its progeny. *East River* did not involve a calamitous or destructive event. *Id.* at 867-68. Its cursory rejection of the exception was therefore made without any factual context or analysis. Courts which have followed *East River*

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[1] G&L claims that this report, which was created by G&L's own service mechanic, is difficult to read. (G&L's Response and Reply Brief, p. 15) It does not, however, dispute that the report states that the concrete floor was gouged in the accident, or that the cell equipment, remote Q table, chucks, cables and other machines were "destroyed," "crushed" and otherwise damaged. (R. Memo, Ex. G.)(*See* FN 2, below)

[2] Plfs.' Memo of Law in Opposition to Defs.' Motion for Summary Judgment is found in a separate folder at the end of the paginated Record. References to this document are cited as "R. Memo" in this brief.

have likewise failed to articulate how the safety concerns of tort law are adequately protected by contract law when a product catastrophically fails and suddenly explodes and/or breaks apart. G&L thus places too much emphasis on a majority/minority dichotomy, without providing a reasoned basis for why contract law should govern these types of accidents. Indeed, it is telling that almost all of G&L's supporting case citations on this issue are listed in footnotes without any parenthetical discussion. This is in stark contrast to IRI's cases, which are discussed at length in IRI's Appellee Brief, pp. 15-19.

Lincoln Gen. Ins. Co. v. Detroit Diesel Corp., 293 S.W.3d 487 (Ten. 2009), one of only two cases relegated to the body of G&L's brief, also lacks persuasive guidance. Like *East River*, *Lincoln Gen.* involved a self-contained product malfunction—a bus fire. There was no explosion, no flying parts and no "other" property damages. *Id.* at 488. *Lincoln Gen.* thus held that the action essentially concerned "the failure of the purchaser to receive the benefit of its bargain-traditionally the core concern of contract law." *Id.* at 491. In contrast, the instant case arose out of an explosive accident which involved the ejection of 5,000 pounds of spinning metal. This is clearly not a case of lost product value, but rather, a case of an endangered consumer, who, like any other member of the public, should be afforded the protections of tort law.

Undeterred, G&L claims that "regardless of whether a product fails with a bang . . . or with a whimper. . . manufacturers have an undiminished incentive to sell safe products." (G&L's Response and Reply Brief, p. 8) Even assuming, *arguendo*, that this is true, adoption of the calamitous or destructive event exception would provide manufacturers with an even greater incentive to sell products that don't bang. This additional incentive is important—because products that fail with a bang are much more

dangerous and cause much more harm than those that fail with a whimper. This case is a perfect example. Imagine how different the lawsuit would look if the VTL had quietly stopped working.

Finally, G&L notes that the calamitous or destructive event exception is not embraced by the Rest. (Third) of Torts § 21. It thereby places undue emphasis on hornbook commentary which has not been adopted by Kentucky. The question before this Court must be framed in terms of the rules and principles recognized in this State. The answer should not be controlled by what other jurisdictions or the Third Restatement have endorsed. Besides, even the Third Restatement acknowledges that "[a] plausible argument can be made that products that are dangerous, rather than merely ineffectual, should be governed by the rules governing products liability law." Rest. (Third) of Torts § 21, cmt. d.

In sum, G&L has acknowledged that "[p]roducts liability law developed out of a public policy judgment that contract law, and specifically warranty law, did not adequately protect consumers from dangerous products." (G&L's Appellants' Brief, p. 8) It has further explained that because of "safety concerns," products liability protection "applies when a product damages other property" because "public policy demands that responsibility be fixed wherever it will most effectively reduce the hazards to life and health inherent in defective products that reach the market." (*Id.* at p. 9)(*quoting East River*, 476 U.S. at 866-67) IRI is accordingly asking this Court to recognize these well-established principles, and apply the protections of tort law here. This does not result in an expansion of products liability law, but rather provides equal protection to purchasers without regard to their sophistication, wealth or insurance. To argue otherwise implies

that the safety and lives of Ingersoll-Rand's employees are less valuable than those of the general public. G&L's contrary argument should be rejected for what it is: an attempt by a manufacturer to hide behind contract law to avoid liability for designing and selling an unreasonably dangerous product.

III. Adoption Of The Calamitous Or Destructive Event Exception To The Economic Loss Rule Is Supported By Kentucky Precedent.

G&L correctly notes that the Court of Appeals implicitly rejected the calamitous or destructive event exception in *Falcon Coal Co. v. Clark Equip. Co.*, 802 S.W.2d 947 (Ky. App. 1990). (G&L's Response and Reply Brief, p. 4) But it largely overlooks and misinterprets this Court's subsequent opinion in *Real Estate Marketing v. Franz*, 885 S.W.2d 921 (Ky. 1994). *Franz* expressly rejected *Falcon Coal*'s limitation on the recovery of economic damages in products liability cases, stating:

> We do not go so far as the Court of Appeals' opinion in *Falcon Coal Co. v. Clark Equipment Co.*, limiting recovery under a products liability theory to damage or destruction of property "other" than the product itself. But we recognize that to recover in tort one cannot prove only that a defect exists; one must further prove a damaging event.

Id. at 926 (*internal citations omitted*).

G&L cannot avoid *Franz* by reading distinctions into the case which either do not exist or do not limit *Franz*' application here. *First*, both *Falcon Coal* and *Franz* involved damage only to the defective product itself. In *Falcon Coal*, the property was plaintiff's truck. 802 S.W.2d at 947-48. In *Franz*, the property was plaintiff's home. 885 S.W.2d at 923. Application of economic loss principles were considered in both cases, and ultimately rejected in *Franz*. *Id.* at 926. *Second*, G&L overstates the significance of the lack of privity between the parties in *Franz*, but not here. The economic loss rule, when adopted, is typically applied in two types of cases—products liability and negligent

construction—the latter of which often arises outside of privity. As stated by a former Justice of this Court, "the crux of the doctrine is not privity." *Presnell Constr. Mgrs., Inc. v. EH Constr., LLC*, 134 S.W.3d 575, 583 (Ky. 2004)(Keller, J, *concurring*). *Third*, although *Franz* was not a products case, it rejected *Falcon Coal*'s implicit application of the economic loss rule in a products case between two commercial entities. In rejecting *Falcon Coal*, *Franz* also cited to the Rest. (Second) of Torts § 402A and *Dealers Transp. Co. Inc. v. Battery Distrib. Co.*, 402 S.W.2d 441 (Ky. 1965). *Franz*, 885 S.W.2d at 926. These citations further demonstrate *Franz*' application in products cases like the one at bar.

G&L also relies too heavily on the federal courts which have predicted that this Court would adopt a broad economic loss rule.[3] The overwhelming majority of such cases either: (1) do not involve a sudden or calamitous accident; or (2) do not explain how the tort concern for "safety" is reduced when a product malfunctions, but only injures itself. The single federal case discussed by G&L—*Mt. Lebanon Personal Care Home v. Hoover Universal*, 276 F.3d 845 (6th Cir. 2002)—is no exception. *Mt. Lebanon* held that the economic loss rule applied to bar a commercial plaintiff's products claim, not because it found that safety concerns were adequately protected by contract law, but because a "majority" of jurisdictions have applied the rule to business purchases. *Id.* at 848. In so holding, *Mt. Lebanon* recognized that *Franz* "answers in the negative the question of whether the economic loss doctrine applies to consumer purchases in Kentucky." *Id.* at 849. But it declined to extend *Franz* to commercial transactions. In so holding, it mistakenly overlooked that *Falcon Coal* involved a business purchase. *Franz*'

[3] Under the doctrine of stare decisis, once the Sixth Circuit predicted that Kentucky would recognize the economic loss rule, without exception, all future federal courts were required to perpetuate the same error.

rejection of *Falcon Coal* was thus a rejection of the economic loss rule in commercial cases.

The Supreme Court's rejection of *Falcon Coal* is in line with its prior decisions in *C.D. Herme, Inc. v. R.C. Tway Co.*, 294 S.W.2d 534 (Ky. 1956) and *Dealers Transp. Co., Inc. v. Battery Distrib. Co., Inc.*, 402 S.W.2d 441 (Ky. 1965). *C.D. Herme* held that "if the duty [of reasonable care] has been violated, the mere fact that the actual injury in the particular case happens to be *property* only, does not relieve the offender from liability." *Id.* at 537 (*emphasis in original*). *Dealer's Transport* adopted the Rest. (Second) of Torts § 402A, permitting plaintiffs to recover economic damages for a defective product under a strict liability theory. 402 S.W.2d at 445-47. *Williams v. Fulmer*, 695 S.W.2d 411 (Ky. 1985) again recognized a manufacturer's "universal duty of reasonable care owed to all, separate from contractual duty," stating that it "became part of Kentucky law through *C.D. Herme, Inc.* . . . and *Dealer's Transport.*" *Id.* at 414 (*internal citations omitted*).

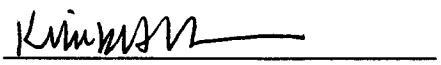
Clearly, this Court's precedent supports the recognition of products liability law as separate and independent of contract law. The economic loss rule should therefore not be used as an impediment to IRI's product claims, which arose out of a sudden and damaging event.

CONCLUSION

The economic loss rule should not be adopted and applied in this action for catastrophic property damages arising out of a sudden and destructive accident. At the very least, the rule should not bar IRI's claims for damages to "other" property and those arising out of G&L's negligent misrepresentation and fraud. IRI accordingly asks this Court to reverse those claims not remanded by the appellate court, such that all of IRI's

tort claims—strict liability, negligence, negligent misrepresentation and fraud—are reinstated and remanded for a trial on the merits.

Respectfully submitted,



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