



Legal Beat

By MICHAEL SEAN QUINN

Liability and Independent Contractors

Principals are liable for the torts of their agents, if they are committed within the scope of the agency. Thus, employers are liable upon the theory of vicarious liability for the negligence of their employees, aka, servants, when that negligence occurs within the scope of the employment. In contrast, one who hires an independent contractor is not vicariously liable for torts.

In general, what makes a working relationship an agency relationship is the right of the principal to control the details of the agent's work. If a principal lacks that right, and if the working entity performs his work by his own methods, then the relationship is between a principal and an independent contractor. There are exceptions.

Such is the black-letter law. Recently, however, the Supreme Court of Texas, reminded us all that principals are not immune from liability when they use inde-

pendent contractors. Principals are still directly liable for the torts they commit, including omissions, even if—as a practical matter—those offenses occur as the result of torts committed by independent contractors. Two very recent cases make this point. Insurance companies and insurance intermediaries need to focus on these cases.

The facts of *Read v. The Scott Fetzler Company*, decided December 31, 1998, are disturbing. A Kirby vacuum cleaner salesman raped a young housewife in her living room while demonstrating his products.

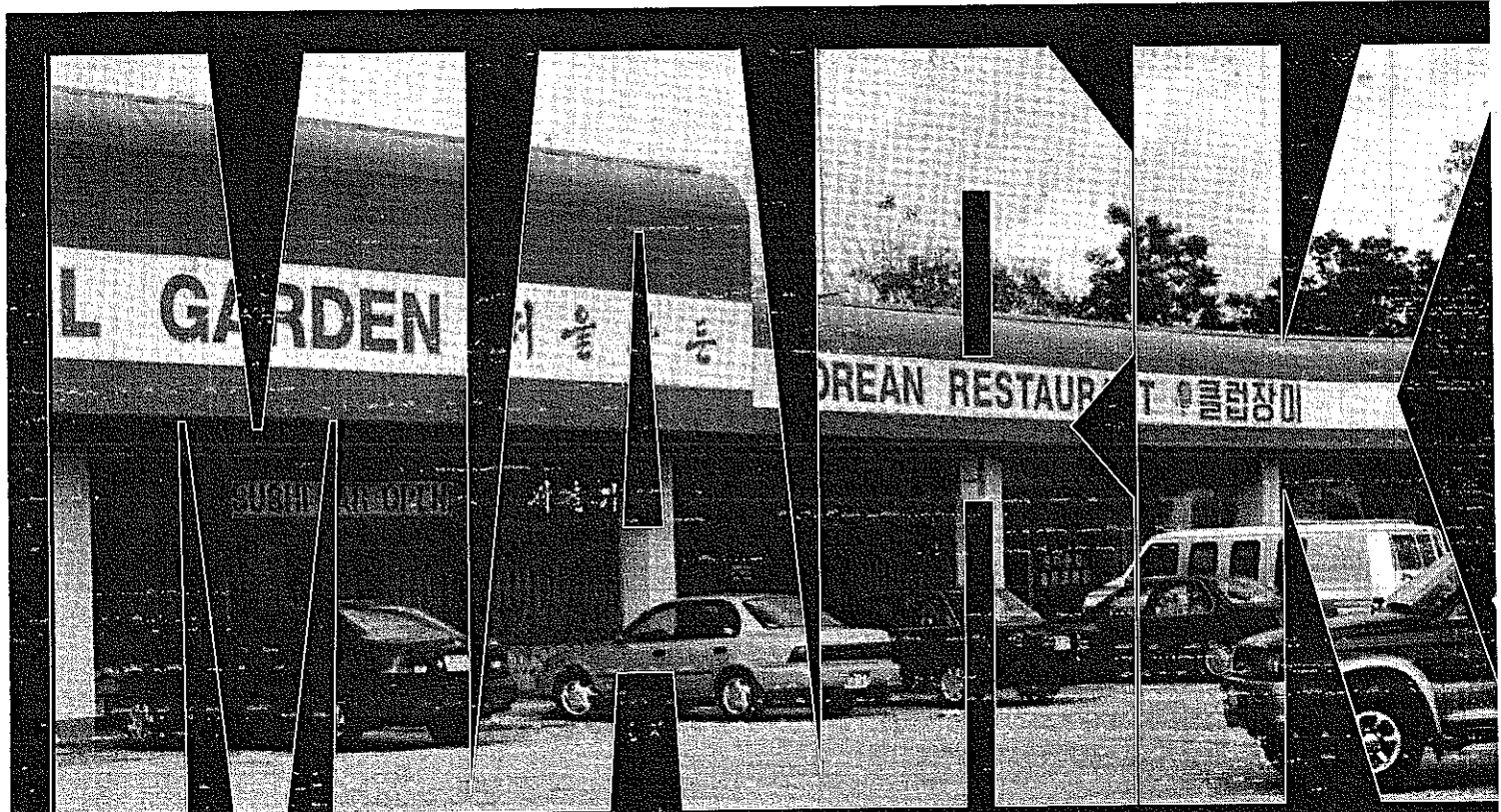
The Scott Fetzler Company, which does business as Kirby, manufactures vacuum cleaners and related products. It sells through local distributors, which are independent contractors. Each distributor main-

tains a sales force of door-to-door sales people, who are called dealers. Apparently, they too are independent contractors. Consequently, neither Kirby nor the distributor could be vicariously liable for the torts of a dealer, even those which are committed in the context of his activities.

But, Kirby requires that its vacuum cleaners be sold exclusively to end use consumers by means of in-home demonstrations. Distributors and dealers alike promise Kirby that its products will be sold in no other way. Thus, Kirby controls part of the work. Can Kirby be liable for how it exercises control? Can Kirby be liable for failing to control?

The plaintiff alleged that Kirby was negligent in the way it demanded and organized its in-home marketing system. In effect, it did not insist upon adequate safeguards to prevent dangerous men from joining the sales force. Thus, Kirby's exposure is not premised upon any theory of vicarious liability; rather, it is based upon the idea that Kirby is responsible for its own actions. The plaintiff thus claimed that Kirby created a situation which injured the plaintiff.

The key to the plaintiff's argument is that Kirby retained control over one area of work of both its distributors and its dealers. Kirby controlled how its products are sold,



general liability • commercial auto • garage liability • property

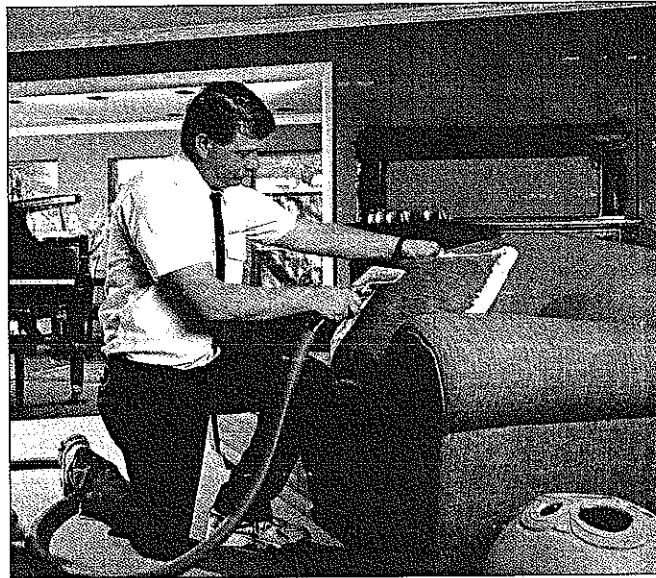
NS2

and because of that control, it had duties to the persons to whom the vacuum cleaners were demonstrated. (Kirby did not become vicariously liable because of this element of control. Instead, it became directly liable because it insisted on its own of method of marketing.)

The six person majority in *Read* was led by Justice Raul Gonzales, who recently retired from the court. He not only believed that Kirby had a duty to its customers but that its breach of this duty proximately caused the customer's injury. Kirby did not require its distributor to run any kind of background checks on sales force applicants. Had the distributor run any kind of background check on the dealer who committed the rape, it would have discovered the history of similar conduct, and the man never would have been hired.

Thus, said the court, there was some evidence that Kirby's omissions constituted a substantial factor in bringing about the rape. It is, furthermore, foreseeable that permitting sexual miscreants on an in-home sales force will result in injurious (sexual) misconduct every once in a while. Justice Gon-

zales based his decision on § 414 of the prestigious RESTATEMENT (SECOND) OF TORTS, which the American Law Institute promulgated and which has exercised enormous influence over American law.



In the Kirby case, a door-to-door salesman (an independent contractor) rapes a young woman while demonstrating vacuum cleaners. The Kirby manufacturer was deemed liable because it had not instituted background checks through distributors on its independent sales force. Insurance intermediaries need to be concerned about this newly expanded rule.

That section says this: "One who entrusts work to an independent contractor, but who retains the control of any part of the work, is subject to liability for physical harm to others for whose safety the employer owes a duty to exercise reasonable care, which is caused by his failure to exercise his control with reasonable care."

II

Justice Hecht, with whom Justice Owen joined, dissented for five reasons. Justice Abbott wrote a separate dissent in which Justice Owen—but not Justice Hecht—also joined.

First, although the distributor surely was liable for failing to use reasonable care in selecting its sales force, the manufacturer did not have a duty running to the ultimate customer to regulate the sales force of its distributor. After all, the distributor was competent at its economic function, and any marketing unit knows that it needs to check up on prospective sales persons. So, according to the dissent, the distributor had a duty to check, but the manufacturer had no duty to make him.

We specialize in stable markets, very competitive rates, superior service, and feature the strongest core of knowledgeable, multi-line underwriters.

Restaurants to bars and taverns...we can serve up a package policy with liquor liability for you. LEICHT GENERAL AGENCY has many "A" rated markets from "blue plate specials" to "Haute Cuisine."

Call for phone quotes or Fax your submissions today for immediate turn-around.

**We are committed to staying . . .
LEICHT . . . YEARS AHEAD**



HOUSTON
(281) 496-1100
(800) 237-8593
FAX: (281) 496-7894
P.O. Box 79286
Houston, Texas 77279-9286

DALLAS/METRO
(972) 481-1002
(800) 506-7779
FAX: (972) 481-1003
12200 Ford Rd., Suite 200
Dallas, Texas 75234

packages • inland marine • professional • umbrella • excess

Second, Justice Hecht thought that it was not foreseeable from Kirby's point of view that a failure to institute a background check requirement would lead to serious bodily injury. After all, he reasoned, Kirby knew of only one other incident of criminal sexual conduct, and it happened ten years before the events in this case. Moreover, there was no evidence in the record of the Read case that "door-to-door salesmen are more likely to sexually assault their customers than any other salesman."

Third, A has a negligence-based duty not

to expose B to the criminal propensities of C only if it is foreseeable that C might well criminally injure B. According to Justice Hecht, although "[t]wo sexual assaults is, of course, two tragedies too many[.]" two assaults in a decade do not add up to foreseeability. Thus, the record in Read "does not show that Kirby should have realized that if it did not require its distributors to check dealer applicants' backgrounds, a sexual assault was a foreseeable consequence."

Fourth, the dissenters' reasoned that the majority rule made poor policy. According

to them, the general principles enunciated by the majority "necessarily affect others in the direct sales industry as well as all who employ independent contractors." The dissenters expressly mention the sales operations of real estate firms, newspapers, apartment managers, in-home cosmetic firms, home and kitchen wares, encyclopedia firms and insurance.

Fifth and finally, the dissenters believe that the duty which the majority imposed upon such companies as Kirby were so weak as to be ineffectual in preventing the kind of injuries the plaintiff sustained.

Accordingly, it makes little sense to find big damages for the breach of a weak duty. The dissent implies that a stronger duty (which included a duty to inspect and enforce the fundamental duty) would be too expensive and complex to administer.

According to Justice Abbott's dissenting opinion, Kirby maintained control over where the sales work was to be performed; however, it did not maintain control over who was to perform that work. According to Justice Abbot, Kirby's failure to require background checks has to do with the who-element, and not the where-element.

Consequently, Kirby did not exercise the requisite sort of control and it should not be found directly liable.

III

Because of the clarity of § 414 of the RESTATEMENT, the position of the dissenters seems mostly weak.

Surely if a manufacturer requires in-house sales, it is reasonable that the manufacturer think about who should be conducting those sales and reasonable that it should buy the liability insurance to cover any problems.

No one who imagines, constructs and administers an in-home sales program can fail to consider the possibility of occasional assaultive criminality. The fact that not very many sexual assaults have actually been reported is unimportant.

Every woman I know worries about this kind of conduct on the part of house-to-house salesmen. If the women worry about it, the sales executives should anticipate the problem. The argument from infrequency is a lawyer construct. Moreover, where the sales take place dictates that restrictions should be placed on who does the selling.

At the same time, the dissent presents a significant argument. If *Read* is applied across the board, the administration of in-home sales programs will become more complex and expensive, and sales administration will be dramatically transformed. Unquestionably, *Read* will breed new law-

U.S. Risk Underwriters, Inc. introduces the new CGL Gap Policy[®]

MEMO
To all CSRs & Producers
Make sure we offer
the new CGL Gap Policy to
our customers before our
competitors do!
Mgt.

For information, call 800-232-5830

U.S. Risk Underwriters, Inc.
10210 N. Central Expwy. • Ste. 500
Dallas, Texas 75231
214-265-7090 • Fax 214-739-1421
www.usrisk.com

suits, and not all of them will be as meritorious as that of the plaintiff in Read.

IV

December 31, 1998, was a big day at the Texas Supreme Court. In addition to deciding Read, the court withdrew its previous opinion in *State Farm v. Traver*, issued a new opinion, and overruled motions for rehearing. Traver also addresses the liability of principals.

In *Traver*, State Farm had selected a lawyer to defend an insured. Apparently, the lawyer had botched the defense and the insured sought damages from both the lawyer and the insurance company that picked him. The lawyer declared bankruptcy, so the insured turned upon the insurance company.

Several years ago, in the case of *Ranger County Mutual v. Guin*, the Supreme Court observed that defense lawyers hired by insurance companies were sub-agents of the insurance company. Sub-agents are, of course, agents. Since that time, many have thought that insurers might be vicariously liable for the malpractice of the lawyers that they hire.

(This was not the holding in *Guin*. That case concerned bad faith. Liability carriers cannot be guilty of bad faith in conducting the defense of their insureds. However, they might be able to violate *Article 21.21*. Thus, the contemporary thrust of *Guin*, which has been substantially eroded, would be that defense lawyers could create *article 21.21* liability for the insurers which hired them.)

In *Traver*, Chief Justice Phillips, wrote for a seven-person majority. He demolished the notion that liability insurers are vicariously liable for the misconduct of defense lawyers. He held that a defense attorney, hired by an insurance company, is an independent contractor and hence that the insurance company is not vicariously liable for his misconduct.

This proposition is true, even though lawyers are generally taken to be the agents of their clients and even though insureds delegate to insurance companies the right to control the defense.

Chief Justice Phillips based his position on two considerations. First, an insurance company does not have the right to control the day-to-day details of the defense lawyers' work. This right, of course, is characteristic of the principal-agency relationship. Moreover, a defense lawyer hired by an insurance company "must at all times protect the interests of the insured if those interests would be compromised by the insurer's instructions."

In other words, defense lawyers hired and directed by insurers occasionally have a duty to disobey the insurer's instructions.



Experience.

It makes a difference. It gives us insight others don't have and the ability to respond quickly to changing market conditions.

It means better service, superior coverages and long term relationships. The kind of relationships that build financial stability.

If you'd like to put this kind of experience to work for your company then give us a call.

Since 1952 we've specialized in transportation insurance. We're rated 'A' (Excellent) by A.M. Best and we're ready to go to work for you.

"It's like I've been saying. We only hire experienced drivers. We only hire experienced mechanics.

And we only hire **experienced insurance companies.**"

Carolina Casualty Insurance Company

The Transportation Specialist

A member company of the W.R. Berkley Corporation

8381 Dix Ellis Trail • Jackson Building, Suite 400
Jacksonville, Florida 32256
(904) 363-0900 • Telecopier/Fax (904) 363-8098

Agents can never have a duty to disobey the lawful instructions of their principals, so defense lawyers cannot be the agents of the liability insurer.

Thus, *Guin* does not imply (or no longer implies) that lawyers are the (sub)agents of insurers. At the same time, the Traver majority made it clear that a defending liability insurer may very well be directly liable for its own negligent conduct.

Thus, if an insurer negligently instructs a lawyer, the insurer will have to pay. Further, by implication, if a liability insurer is negligent in selecting defense counsel, the

liability carrier may have to pay damages for that error.

V

Justice Gonzales, joined by Justice Abbot, concurred and dissented. Justice Gonzales was concerned about the organization of the insurance defense practice. This is a large business. It is also a business with conflicting demands at its very heart.

Defense lawyers serve insureds. Unquestionably, the insured who has been sued is a client of the lawyer. At the same time, defense lawyers are dependent upon insur-

ance companies for their livelihood. In addition, although the courts do not mention it, lawyers provide defending insurers with legal advice (for example, as to the price and advisability of settlement), and insurers both solicit and accept this advice. Thus, no matter what the bar would like to think, defense lawyers frequently have two clients: the accused insured and the defending insurer.

Because of their active involvement in litigation and because of their economic clout, it stands to reason that liability insurers may be able to influence defense lawyers improperly but in ways which are subtle and therefore difficult to detect. Thus, the Supreme Court's holding "that an insurance company has no responsibility for the attorneys it selects to represent the insured is overly broad."

According to Justice Gonzales, it is idyllic and naive. According to Justice Gonzales, the majority simply does not appreciate the range and depth of insurer control. The court needs to attend to the wisdom the ancient proverb, "He who pays the piper calls the tune." Proverbs become ancient precisely because they are true.

Justice Gonzales is also concerned about "captive law firms," i.e., law firms which are actually divisions of the insurance company. Lawyers in captive firms are, of course, employees of the insurer and so cannot be independent contractors. If insurance companies exercise control over theoretically independent law firms, imagine the control they exercise over their own lawyer-employees.

Of course, the State Bar of Texas is concerned about captive law firms, as well. Not long ago, the Unauthorized Practice of Law Committee instituted a suit in Dallas against an insurer (Allstate) for utilizing such an arrangement. This is an extraordinarily interesting problem. The public and its elected representatives cry out for reduced insurance rates.

The use of captive counsel (in the aggregate) substantially reduces liability insurance rates. The performance of employed counsel is frequently above reproach. Many of them defend insureds only where coverage is not subject to question, and captive counsel are frequently (at least on paper) better trained than independent lawyers handling insurance defense matters. Further, when an insurer uses captive counsel, it is more easily subject to a Stowers demand, and this speeds litigation.

VI

One wonders about the foundations of the Traver decision. Traditionally, lawyers have been conceptualized as agents of their
continued on page 35



Frontier
General Insurance Agency, Inc.

**Your Passport To Profits
Surplus Lines Specialists**



**Excellent Claim Service - Prompt Friendly Service
Call 1-800-880-0474 Ext. 2007 for complete details.**

**P.O. Box 230 • Fort Worth, Texas 76101
817-732-2111 • 800-880-0474 • FAX 817-732-1011**

Legal Beat

continued from page 32

clients. The very first section of the RESTATEMENT (SECOND) OF AGENCY states that "an agent may be one for whose physical acts the employer is not responsible and who is called as an independent contractor in order to distinguish him from a servant... Thus, the attorney-at-law, the broker...and other similar persons employed either for a single transaction or for a series of transactions, are agents, although as to their physical activities they are independent contractors."

So, attorneys are agents of their clients, even though the clients do not control the details of the work. Now, if the client delegates the responsibility of regulating the lawyer to somebody else, (say, an insurance company) wouldn't the lawyer become the agent of the insurance company, where the scope of the agency is to defend the insured?

VII

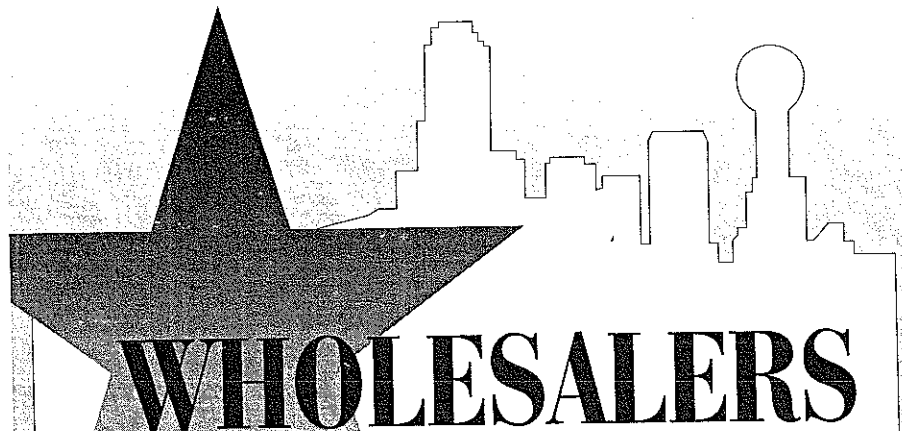
The rule that a principal who hires an independent contractor can be directly liable for its own negligence is not a new rule. However, the applications of that rule in *Read* and *Traver* appear to extend the rule beyond its formerly narrow niche. Insurance intermediaries need to be concerned about this newly expanded rule for two reasons.

First, some insurance is sold in-home. Insurance agencies need to make sure that they do the proper background checks, or they may find themselves liable for very unpleasant torts.

The same thing is true for insurance companies. Moreover, insurance companies which have mandatory specifications for how agencies do business may find themselves liable for setting up agency and operative misconduct.

Second, and perhaps more significantly, insurance intermediaries need to be prepared to advise their customers that they may need coverage which—based on history and B-school teaching—they don't think they need. Probably, insureds won't need new types of coverage. Probably, they will just need a little more coverage than they have had in the past. Arguably, this should be handled through umbrella policies. They don't need to be mega-policies, since punitive damages against the principal are unlikely. However, it must be handled. ■

Quinn is an Austin-based attorney with the law firm of Sheinfeld, Maley & Kay. He was recently selected to receive the 1998 Outstanding Law Journal Article Award by the Texas Bar Foundation.



If you are looking for... **capacity** ★ **competitive rates** ★ **A-rated paper (admitted and non-admitted)** ★ **rapid quote response, and** ★ **high commissions** ...you need to look for First Capital of Texas. This brightest insurance star in the Lone Star State will make you sparkle for your customers.

Writing through Reliance Group Holding Companies, First Capital of Texas offers highly competitive rates and the capacity you demand for both residential and commercial real estate. We also underwrite restaurants, caterers and light manufacturing.

Count on us for same-day quotes and loss-control engineering inspections within thirty days after binding coverage.

You'll be dazzled by service provided by the experienced First Capital of Texas team, led by Paul Warmingham, President, and Jerry Miller, Vice President. Plus they're backed by the entire First Capital Group, with offices in California, Illinois, Pennsylvania and New York.



Help ensure an even brighter future for your agency. Contact First Capital of Texas today!

1-800-924-1687