

AVOIDING THE ECONOMIC LOSS RULE IN CONSTRUCTION CLAIMS

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The Economic Loss Rule¹ was initially developed in the products liability context.

The essence of the early holdings discussing the [Economic Loss Rule] is to prohibit a party from suing in tort for purely economic losses to a product or object provided to another for consideration, the rationale being that in those cases ‘contract principles [are] more appropriate than tort principles for resolving economic loss without an accompanying physical injury or property damage.’²

However, over the years, courts have used the product liability concepts created in the early cases interpreting the Rule to expand the Rule’s application to include construction claims, which has created problems in applying the Rule in non-product liability claims. “[T]he troublesome cases discussing the dreaded economic loss rule have usually arisen in the field of construction.”³

The phrase “economic loss” generally includes the cost of repairs or replacement of a defective property which is the subject of the parties’ relationship, as well as commercial loss for inadequate value.⁴

Whether the Economic Loss Rule applies in any particular situation may have a significant impact on the recoverable damages associated with a particular claim because parties may limit the types of damages that are recoverable (i.e. consequential damages), and may also cap a party’s liability.

Contract Law, and the law of warranty in particular, is well suited to commercial controversies of the sort involved in [a product liability] case because the parties may set the terms of their own agreements. The manufacturer can restrict its liability, within limits, by disclaiming warranties or limiting remedies.⁵

As each jurisdiction applies the rule differently, it is important to understand how the jurisdiction where the loss occurs is likely to apply the Economic Loss Rule to the facts of your case.

I. Damage to “Other Property”

As indicated above, the Economic Loss Rule was initially developed to prevent a party from recovering under a tort theory of liability, when the damages are limited to the product that is the subject of the parties’ relationship. However, if the damages sustained are related to property other than the product itself, the Economic Loss Rule will not limit a party’s ability to recover for those damages.

¹ Also referred to as the “Economic Loss Doctrine” or “Economic Loss Rule Doctrine”

² Moransais v. Heathman, 744 So. 2d 973, 980 (Fla. 1999), *citing* Florida Power & Light Co. v. Westinghouse Elec. Corp., 510 So. 2d 899, 902 (Fla. 1987)

³ Monroe v. Sarasota County School Bd, 746 So.2d 530, 538 (Fla. 2nd DCA 1999).

⁴ Salmon Rivers Sportsman Camps, Inc. v. Cessna Air. Co., 97 Idaho 348, 351, 544 P.2d 306, 309 (1975)

⁵ East River Steamship Cor. v. Transamerica Delaval, Inc., 476 U.S. 858, 872-873 (1986)

[T]he economic loss rule allows a plaintiff to recover in strict products liability in tort when a product defect causes damage to ‘other property,’ that is, property other than the product itself. The law of contractual warranty governs damage to the product itself.⁶

While the term “other property” seems to be relatively clear, in the construction setting, what constitutes other property may not be so clear. Unfortunately, courts have generally considered the entire construction project as the “product” that is the subject of the parties’ relationship. In Casa Clara, the Florida Supreme Court held that the Economic Loss Rule barred a tort claim against the concrete provider for a building where there was no damage to anything other than the building itself.⁷ In finding the Economic Loss Rule applicable, the Court stated that “the character of a loss determines the appropriate remedies, and, to determine the character of a loss, one must look to the product purchased by the plaintiff, not the product sold by the defendant.”⁸

In East River, supra, the U.S. Supreme Court explained that the general rationale for not separating a product into different component parts was due to the fact that “all but the very simplest machines have component parts, [a contrary] holding would require a finding of ‘property damage’ in virtually every case where a product damages itself.”⁹ While the court in East River, supra was considering a products liability claim against a manufacturer, it is clear from the decision in Casa Clara, supra that some jurisdictions are unwilling to separate a construction project into distinct components for purposes of the Economic Loss Rule.¹⁰

While many jurisdictions appear reluctant to separate a construction project into separate components for purposes of the Economic Loss Rule, there are jurisdictions that recognize that damage to other parts of the structure would constitute “other property,” and refuse to apply the Economic Loss Rule under such circumstances.¹¹

II. Contract for Services

⁶ Jimenez v. Superior Court, 58 P.3d 450 (Ca. 2003)

⁷ Casa Clara Condo. Ass'n v. Charley Toppino & Sons, Inc., 620 So.2d 1244 (Fla.1993)

⁸ Id at 1247, citing King v. Hilton-Davis, 855 F.2d 1047 (3d Cir.1988)

⁹ East River Steamship Corp., 476 U.S. at 867, 106 S.Ct. 2295, citing, No. Power & Eng'g Corp. v. Caterpillar Tractor Co., 623 P.2d 324, 330 (Alaska 1981).

¹⁰ Wilson v. Dryvit Systems, Inc., 206 F.Supp.2d 749, 754 (E.D.N.C.2002) (concluding damage caused by EIFS system constituted damage to house itself and no “other property damage,” and holding homeowners' claims barred by economic loss doctrine); Herman v. McCarthy Enterps., Inc., 61 Va. Cir. 697, 2002 WL 31974659 (Va. Cir. Ct.2002) (stating that, because there were no allegations that applicator's negligence in applying EIFS system resulted in personal injury or damage to “property other than the home itself” and that there were only claims for economic loss, homeowners did not have viable negligence claims against applicator); see also, Bay Breeze Condo. Assoc. v. Norco Windows, Inc., 257 Wis.2d 511, 651 N.W.2d 738, 746 (Wis.Ct.App.2002) (applying economic loss doctrine in building construction defect case “when defective product is a component part of an integrated structure or finished product,” and holding homeowners' negligence and products liability claims against windows manufacturer for damages to interior and exterior of condo units caused by failed windows were barred by economic loss doctrine).

¹¹ Stearman v. Centex Homes, 78 Cal.App.4th 611, 622-623, 92 Cal.Rptr.2d 761, 769 (2000),

While the Economic Loss Rule originally arose in a products liability setting, over the years, some jurisdictions have expanded the application of the Economic Loss Rule to the provision of services.¹²

A provider of services and his client have an important interest in being able to establish the terms of their relationship prior to entering into a final agreement. The policy interest supporting the ability to comprehensively define a relationship in a service contract parallels the policy interest supporting the ability to comprehensively define a relationship in a contract for the sale of goods.¹³

If the Economic Loss Rule applies to both services and products, the determination of whether the rule applies is relatively straight forward. However, in those jurisdictions in which the Economic Loss Rule does not extend to the provision of services, the analysis that must be performed to determine the application of the rule can be complicated.

The Florida Supreme Court recently decided to withdraw from its prior decisions applying the Economic Loss Rule to claims involving the provision of services.¹⁴ While limiting the application of the Economic Loss Rule to only products liability claim, appears to be a “bright line” rule, in the construction industry, it can be difficult to determine whether a contract is solely for services or solely for products, or is a hybrid contract for the provision of both goods and services. In these situations, the courts consider the “predominant purpose” of the contract.

Whether a ‘hybrid [contract]’ under which the seller supplies both goods and services...is governed by the UCC’s provisions regarding the sale of goods -- and thus subject to the economic loss doctrine -- becomes a question of ‘whether the dominant factor or ‘essence’ is the sale of the materials or the services.’¹⁵

The “predominant purpose” test first arose in the context of the Uniform Commercial Code (“UCC”). As the UCC is limited to the sale of goods, when a contract involves both the sale of goods and the provision of services, it was necessary to determine whether the UCC provisions would apply to the parties’ dispute. In those jurisdictions, like Florida, that do not apply the Economic Loss Rule to the provision of services, this same “predominant purpose” type analysis is necessary. Unfortunately, in the construction industry, the contracts are more likely to be a hybrid contract for both goods and services. Therefore, a predominant purpose test will be necessary in those jurisdictions.

The test for inclusion or exclusion is not whether they are mixed, but, granting that they are mixed, whether their predominant factor, their thrust, their purpose, reasonably stated, is the rendition of service, with goods incidentally involved...or is a transaction of sale, with labor incidentally involved.

¹² See *Generally, Indemnity Insurance Co. v. North America Aviation, Inc.*, 891 So. 2d 532 (Fla. 2004) and *Tusch Enterprises v. Coffin*, 740 P.2d 1022 (Id. 1987).

¹³ *Fireman's Fund Insurance Co. v. SEC Donohue, Inc.*, 679 N.E. 2d 1197, 1200 (Ill. 1997).

¹⁴ *Tiara Condominium Association, Inc. v. Marsh McClennan Companies, Inc.*

¹⁵ *Aliki Foods, LLC v. Otter Valley Foods, Inc.*, 726 F. Supp. 2d 159, 166 (D. Conn. 2010), citing *Nora Beverages, Inc. v. Perrier Group of Am.*, 164 F.3d 736, 747 (2d Cir.1998) (quoting *Incomm. Inc. v. Thermo-Spa, Inc.*, 41 Conn. Supp. 566, 570, 595 A.2d 954 (Conn.Super.Ct.1991)).

The determination of whether the Economic Loss Rule applies, or does not apply, to a particular claim, could significantly impact the recoverable damages. Therefore, it is important to review the jurisdiction in which the claim arises to determine how the Economic Loss Rule is applied to hybrid contracts.

III. Duty Arises Independent of Contract

While the Economic Loss Rule may limit a party's ability to assert a claim when the parties have a contractual relationship, the rule is not intended to eliminate tort claims that arise outside of the contractual relationship.

[T]he question of whether the plaintiff may maintain an action in tort for purely economic loss turns on the determination of the source of the duty plaintiff claims the defendant owed. A breach of a duty which arises under the provisions of a contract between the parties must be redressed under contract, and a tort action will not lie. A breach of duty arising independently of any contract duties between the parties, however, may support a tort action.¹⁶

What constitutes a "duty arising independently of any contract duties," will vary from jurisdiction to jurisdiction. Therefore, it is important evaluate the tortfeasor's conduct to determine if the damages were the result of a breach of a duty that arose independent of the contract. For purposes of avoiding the Economic Loss Rule, the independent duty may be based upon common law, statute, or public policy.

When considering whether there is a duty independent of the contract in a construction setting, you should initially determine if there was a violation of the applicable building code. In Florida, a breach of the Florida Building Code is available "notwithstanding any other civil remedies available."¹⁷ Given this statutory language, the Florida Supreme Court has stated:

The Legislature has made it abundantly clear in unambiguous language that the statutory remedy for violation of the building code is available 'notwithstanding any other civil remedies available.' The judicially created economic loss rule cannot abrogate this statutory cause of action.¹⁸

While Florida provides that compliance with the building code is a duty outside of the parties' contractual relationship, some jurisdictions limit this exception to the Economic Loss Rule in only limited circumstances, such as when the claim involves a residential property.¹⁹

"Another situation involves cases such as those alleging neglect in providing professional services, in which this Court has determined that public policy dictates that liability not be limited to the

¹⁶ Tommy L. Griffin Plumbing & Heating Co. v. Jordan, Jones & Goulding, Inc., 463 S.E.2d 85, 88 (S.C. 1995); See, Moransais, *supra*, at 975-976.; Also See, Donnelly Construction Co. v. Oberg/Hunt/Gilleland, 139 Ariz. 184, 677 P.2d 1292 (Ariz.1984).

¹⁷ §553.84 Fla. Stat. (2012)

¹⁸ Comptech International, Inc. v. Milam Commerce Park, LTD, 753 So. 2d 1219,1227 (Fla. 2000); See also, Kennedy v. Columbia Lumber and Mfg. Co., Inc., 384 S.E.2d 730 (S.C. 1989).

¹⁹ Sapp v. Ford Motor Co., 687 S.E.2d 47 (S.C. 2009).

terms of the contract.”²⁰ Therefore, when evaluating recovery potential in construction claims, you should consider whether a claim against the engineer, architect, and/or other professional is available. If the jurisdiction in which the construction claim arises recognizes a professional malpractice exception to the Economic Loss Doctrine, it is important to determine how the jurisdiction defines a “professional” for purposes of the Economic Loss Doctrine, although an engineer or architect would likely qualify as a professional in any jurisdiction.

Some jurisdictions also provide that public policy considerations may be sufficient to avoid the application of the Economic Loss Rule.

To discourage misconduct and provide an incentive for avoiding preventable harm, we conclude that subcontractors owe homeowners a duty of care, independent of any contract provision, in connection with the construction of homes.²¹

The residential construction setting is normally where these types of public policy considerations arise. The rationale is based upon the fact that a home purchase is typically a person’s largest investment, and the homebuyer does not have the necessary skills to oversee the construction project, and therefore must rely on the contractor to construct the property.

IV. Conclusion

While the Economic Loss Rule was initially developed by courts to apply in a product liability setting, its expansion has created numerous issues that need to be considered when evaluating the potential for a recovery in a construction claim. While it is possible to navigate through the maze of court decisions applying the Economic Loss Rule, it is an unenviable task given the significant differences that apply from jurisdiction to jurisdiction. However, with an understanding of the underpinnings of the exceptions to the rule, you may be able to avoid the application of the Economic Loss Rule, and effectuate a recovery.

²⁰ Indem. Ins. Co., *supra* at 537; Moransais, *supra* at 984 (We also hold that Florida recognizes a common law cause of action against professionals based on their acts of negligence despite the lack of a direct contract between the professional and the aggrieved party); Jackowski v. Borchelt, 209 P.3d 514, 521 (Ct. of App. Washington, Div. 2, (2009) (Neither do we believe that the economic loss rule, ...abrogates all professional malpractice claims, particularly where a client hires a professional and, therefore, establishes a privity of contract with that professional); but see, Floor Craft Floor Covering, Inc. v. Parma Community General Hosp. Ass'n, 560 N.E.2d 206 (OH, 1990). (Tort law is not designed, however, to compensate parties for losses suffered as a result of a breach of duties assumed only by agreement.).

²¹ Yacht Club II Homeowners Association, Inc. v. A.C. Excavating, 94 P.3d 1177, 1182 (Col. App. III, 2003).