

Ten Ways to Avoid The Economic Loss Doctrine

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Unfortunately, most defense lawyers have finally discovered the economic loss doctrine. Given the nature of the typical property loss subrogation action, such as damage to a building or piece of equipment, the doctrine is frequently raised as a defense.

But there are ways around the doctrine. And with a little creative thought, the economic loss doctrine can be avoided in many actions.

Introduction—So What’s All This Talk About Drowning In A Sea Of Tort?

What is the economic loss doctrine? The doctrine began as a common law principle (which means it was created by judges rather than by statute) intended to keep plaintiffs from turning what were historically breach of contract cases into tort cases. The intent of the doctrine was to require parties to a contract to abide by the terms of their contract, rather than ignoring the contract and instead filing tort-based claims such as negligence and strict products liability. The rationale behind the doctrine was to prevent parties from recovering in tort for damages resulting from lost expectations or their benefit of the bargain.² Courts held that parties should protect against the risk of economic loss during contract negotiations, such as by obtaining warranty provisions and price adjustments.³ Some courts have even gone so far to say that allocation of the risk of loss through assigning responsibility for obtaining insurance is a consideration. Of course, such comments completely ignore the concept of subrogation (an issue which in and of itself could be the subject of an entire article).

As it has developed, the doctrine has essentially been defined as precluding a plaintiff from recovering in tort for damages that are purely “economic losses”.⁴ The threshold issue, of course, is what are economic losses? Courts have defined economic losses as those for inadequate value of a product, the cost of repair or replacement of a defective product, or the loss of profits resulting from the failure of the product. Basically—damage to the product itself. What are not economic losses, at least in most jurisdictions, are claims for personal injury or damage to property other than the product itself.⁵

So what does this all mean? Stated simply, if a loss occurs and the only damage is to the product itself, the economic loss doctrine precludes the injured party from pursuing tort-based remedies. The party instead is limited to any contractual or warranty claims it may have.

¹ The views expressed herein are solely those of the authors and do not necessarily reflect those of Zelle, Hofmann, Voelbel, Mason & Gette, L.L.P. or any of the firm's other attorneys or its clients. The contents of this paper do not constitute legal advice.

² See *Squish La Fish, Inc. v. Thomco Specialty Prod., Inc.*, 149 F.3d 1288 (11th Cir. 1998)(citations omitted) (applying Georgia law).

³ See *Pulte Home Corp. v. Osmose Wood Preserving, Inc.*, 60 F.3d 734 (11th Cir. 1995) (applying Florida law).

⁴ See *Squish La Fish, Inc.*, 149 F.3d at 1291.

⁵ See *Casa Clara Condo. Ass'n v. Charley Toppino & Sons, Inc.*, 620 So.2d 1244 (Fla. 1993)(citation omitted).

Typical Case Scenario

To assist in considering the application of the doctrine and ways around it, the following scenario should provide some insight.

Suppose your loss involves hail damage to a commercial roofing system. The entirety of the three and a half year old roof is covered with small fractures, clearly caused by ½ inch hail. As a result of the damage to the roofing material, the entire roofing system (roofing membrane and insulation) will have to be replaced. Plus, there is interior water damage that needs to be repaired.

Your expert investigates the loss and concludes that the hail damage occurred because the roofing material was not designed properly by the manufacturer to withstand a hail storm that was reasonably foreseeable in the geographic area.⁶ He tells you that there is a great product defect case—and of course you start thinking about negligence and strict product liability claims against the manufacturer.

At first glance, this loss appears to have significant economic loss doctrine problems. You have a loss involving damage to the “product itself”. But all hope is not lost. There are several issues that one should consider before giving up on pursuing claims on the basis of the economic loss doctrine.

Ten Ways To Get Around The Doctrine

Issue #1: **Was there damage to “other property”?**

The most common exception to the economic loss doctrine exists where there is damage to “other property”.⁷ Some jurisdictions have extended this exception even further to permit recovery in tort where there is a significant/unreasonable risk of injury to persons or property.⁸

In the example, there are several avenues that could give rise to the application of this exception. Most importantly, the roof failure caused interior damage. The doctrine does not apply when there is damage to “other property”. And even without interior damage, the “product” which failed was the roofing membrane. An argument could be made that the insulation and other roof components which also must be replaced constitute other property. Courts vary on their interpretation of what constitutes other property. Some would hold that the entire roof is the product, others will say that only the product supplied by the defendant is the product and everything else is other property.⁹

⁶ Yes, there is subrogation for hail damage to roofing products!

⁷ See *American Eagle Ins. v. United Tech. Corp.*, 48 F.3d 142 (5th Cir. 1995) (applying Texas law).

⁸ See *St. Denis v. Dept. of Housing & Urban Develop.*, 900 F. Supp. 1194 (D. Alaska 1995) (applying Alaska law); *U.S. Gypsum Co. v. Baltimore*, 647 A.2d 405 (Md. 1994)(citation omitted).

⁹ An additional issue that often arises under this exception is what damages are recoverable if there is damage to other property—just the other property or also the product itself. The courts are split on this issue.

Issue #2: Was the loss a sudden and calamitous event?

Recall that the doctrine was originally intended to address situations where a product simply doesn't work as it was intended—such as the piece of equipment that wears out too soon or fails to work right. Therefore, in some jurisdictions, another exception to the doctrine arises when there is a sudden and calamitous event.¹⁰ This type of event is often distinguished from gradual deterioration over time. For example, the \$100,000 piece of equipment that simply fails to work after two years is a contract issue, while the \$100,000 piece of equipment that blows up is a tort issue. While a couple of jurisdictions allow recovery under this exception solely where there is a sudden and calamitous event, this exception is typically applied where it combines with injury to persons or other property damage.¹¹

If all that is necessary in the relevant jurisdiction is a sudden and calamitous event, this exception again may provide a basis for recovery under the facts of our scenario. In order for this exception to apply, the event must be, not surprisingly, both sudden and calamitous. Therefore, the roofing membrane that was performing fine but then completely failed in a hail storm would be both a sudden and calamitous loss.

Issue #3: Is there privity between the injured party and the tortfeasor?

In order for the economic loss doctrine to apply, some jurisdictions require that there be privity between the injured party and the tortfeasor. Privity exists where the injured party contracts directly with the tortfeasor.¹²

This makes sense, given that the entire purpose of the doctrine is to require parties to be bound by the terms of the contractual relationship. If there is no contract between the parties, there are no contract remedies available.

In the roofing scenario, if the injured party contracted for construction of the building only with a general contractor and had no contractual relationship (and no written warranty) with the roofing membrane manufacturer, then privity does not exist and the doctrine may be avoided.

Issue #4: Does the claim involve a consumer (non-commercial) dispute?

A few courts allow consumers to recover for purely economic losses in spite of the economic loss doctrine. In the limited instances where courts have applied this exception there has been little clarification on what constitutes a consumer.¹³ The rationale is that commercial parties are much more able to protect their interests through contract bargaining. The consumer, on the other hand, is often stuck with boilerplate contracts.

¹⁰ See *Anderson v. Chrysler Corp.*, 403 S.E.2d 189 (W. Va. 1991); *Agristor Leasing v. Meuli*, 634 F. Supp. 1208 (D. Kan. 1986).

¹¹ See *Squish La Fish, Inc.*, 149 F.3d at n. 1 (citation omitted).

¹² See generally *Butchkowsky v. Enstrom Helicopter Corp.*, 784 F. Supp. 882 (S.D. Fla. 1992).

¹³ See *Rousseau v. K.N. Constr., Inc.*, 727 A.2d 190 (R.I. 1999) (limiting the economic loss doctrine solely to commercial transactions that do not involve consumers).

Issue #5: Is there a “professional liability” claim?

Courts have created an additional exception to the economic loss doctrine for professionals who are in the business of supplying information for the guidance of others in their business transactions.¹⁴ The justification for this exception lies in the fact that the rendering of knowledge and expertise by a professional is independent of any contractual obligation. This rule has not extended to every profession but the population of professionals is ever increasing.

Undoubtedly, professional malpractice claims often involve purely economic losses without any accompanying personal injury or property damage.¹⁵ Many courts do not apply the economic loss doctrine to certain malpractice claims. The theory behind this is that if courts extended the economic loss doctrine to malpractice claims it would effectively abolish malpractice claims altogether.

The higher standard of care required of professionals gives rise to this exception. The economic loss doctrine finds its roots in the fact that the parties have pre-negotiated liability in the event of a breach.¹⁶ This pre-negotiated liability is more abstract in the case of professional malpractice. The exception for professional malpractice has been extended to engineers,¹⁷ supervising architects,¹⁸ appraisers,¹⁹ and accountants.²⁰ In our example, there might be a claim against the architect who failed to specify a hail resistant roofing material in a hail prone region.

Issue #6: Is there a basis for intentional tort claims?

Due consideration should be given to intentional torts as exceptions to the economic loss doctrine. While some courts recognize any type of fraud as an exception to the economic loss doctrine, the most commonly recognized exception is for fraud in the inducement.

Courts are less reluctant to cut off independent tort claims when misrepresentations, untruths or half-truths induced the contract in the first place.²¹ Allowing a cause of action for fraud in the inducement does not circumvent the fundamental purpose of the economic loss doctrine. In reality, a claim for fraud in the inducement does not even address contract or warranty terms that are subsequently breached by the seller.

¹⁴ Applying the professional services exception to the economic loss doctrine requires a two part inquiry. First, is the claimant in privity with the service provider? If not, does the jurisdiction recognize a professional service provider exception in the absence of privity? The ability to apply this exception depends on the jurisdiction. For instance, West Virginia does not recognize a tort for negligence against an accountant in the absence of contractual privity between the parties. *Ward v. Young*, 435 S.E.2d 628 (Va. 1993). In contrast, Florida recognizes a cause of action by a third party for the accountant’s negligence even in the absence of privity. *First Florida Bank v. Max Mitchell & Co.*, 558 So.2d 9 (Fla. 1990).

¹⁵ See *Steiner Corp. v. Johnson & Higgins of CA.*, 196 F.R.D. 653 (D. Utah 2000).

¹⁶ See *First Florida Bank v. Max Mitchell & Co.*, 558 So.2d 9 (Fla. 1990).

¹⁷ See *Bay Garden Manor Condo. Ass’n, Inc. v. James D. Marks Assoc., Inc.*, 576 So.2d 744 (Fla. Dist. Ct. App. 1991).

¹⁸ See *Beachwalk Villas Condo. Ass’n, Inc. v. Martin*, 406 S.E.2d 372 (S.C. 1991) (allowing a homeowner to assert a claim against an architect).

¹⁹ See *First State Sav .Bank v. Albright & Assoc. of Ocala, Inc.*, 561 So.2d 1326 (Fla. 5th DCA), review denied, 576 So.2d 284 (Fla. 1990).

²⁰ See *First Florida Bank v. Max Mitchell & Co.*, 558 So.2d 9 (Fla. 1990).

²¹ See *Huron and Eng. Co. v. Precision Consulting Servs., Inc.*, 532 N.W.2d 541 (Mich. App. 1995).

The focus is whether the claimant would have entered into the contract had he known the truth about the fraudulent information. On the contrary, if the fraud only concerns the quality of the goods sold or some other characteristic contemplated by the contract then the claimant had the ability and opportunity to negotiate these concerns into the warranty terms. The failure to contemplate these contingencies would not fall within the fraud in the inducement exception. The original contract documents and interviews of the principal players involved in the negotiations are essential to the recovery under this exception.

Issue #7: Was there a negligent misrepresentation?

Like the fraudulent inducement exception, consideration should be given to the idea of recovery for negligent misrepresentation.²² The duty owed in a negligent misrepresentation claim must be separate and distinct from any contractual duty. Accordingly, this independent duty must fall outside the duty abrogated by the economic loss doctrine. Negligent misrepresentation claims seem to create trouble for courts in trying to determine where the contractual duty ends and an independent duty begins.

The most widely recognized negligent misrepresentation exception finds its roots in the fraudulent inducement exception. If the negligent misrepresentation centers upon an inducement to enter into the contract as opposed to performance of the contract the economic loss doctrine will not apply. Illinois has fashioned its own exception by allowing a recovery in tort for economic losses "where the plaintiff's damages are a proximate result of a negligent misrepresentation by a defendant in the business of supplying information for the guidance of others in their business transactions."²³ The main focus of this inquiry is whether the intended end result of the plaintiff-defendant relationship is for the defendant to create a product. If so, then the defendant will not fit into the "business of supplying information" negligent misrepresentation exception.

A negligent misrepresentation claim as an outright exception to the economic loss doctrine should also be given some consideration. Some jurisdictions allow a negligent misrepresentation claim to survive the economic loss doctrine altogether.²⁴ In short, determine the applicable jurisdiction for negligent misrepresentation claims and determine whether the facts properly fit into one of the recognized exceptions.

Issue #8: Are there any common law warranty claims?

Common law warranties play an important role in protecting consumers. The common law warranties of habitability and good and workmanlike conduct provide extended protection to

²² The elements of a negligent misrepresentation claim may vary by jurisdiction, however, the same basic principles apply. Generally, the claimant must show (1) a duty of care owed to the claimant in which there was a false statement of material fact; (2) an intention that the statement will be relied upon; (3) knowledge that the claimant will rely on the statement, which, if erroneous, will cause a loss or injury; (4) the claimant justifiably relied upon the misrepresentation; and (5) the claimant suffered damage by the defendant's negligence. See *Fox Assocs., Inc. v. Robert Half Int'l., Inc.*, 777 N.E. 2d 603 (Ill. App. Ct. 2002).

²³ This exception coincides with the professional malpractice exception discussed *infra*.

²⁴ See *Bower v. Stein Eriksen Lodge Owners Ass'n, Inc.*, 201 F. Supp.2d 1134 (D. Utah 2002).

consumers. Common law warranties may provide an avenue to avoid the application of the economic loss doctrine. Because they are often not considered tort-based claims, the economic loss doctrine should not bar implied warranty claims.

If in the typical case scenario, instead of hail damage, the roof had failed in a windstorm because it was not adhered correctly by the roofing contractor, a claim for breach of the implied warranty of good and workmanlike conduct should not be barred by the economic loss doctrine.

Issue #9: Are there any statutory causes of action?

Courts have also permitted recovery where the injured party has statutory causes of action.²⁵ As a common law theory, the economic loss doctrine cannot “trump” statutory causes of action. An obvious statutory basis for recovery is the breach of the implied warranties in the Uniform Commercial Code. Additionally, many states have adopted consumer protection acts that may provide a basis for recovery.

The failed roofing material would likely provide a basis for breach of the implied warranties of fitness for a particular purpose and merchantability. The failure may also provide a basis for pursuing claims for violation of a state’s consumer protection act if, for instance, the manufacturer falsely represented that the roofing material met certain criteria or standards.

Issue #10: If all else fails, are there any express warranty or contract claims?

Remember, the doctrine precludes recovery in tort. The doctrine does not preclude recovery for any express warranty or contract claims.

To determine whether such claims exist in our example, it would be necessary to obtain documentation for the purchase, design, and installation of the roof.²⁶ The most obvious documents to look for are warranties. Design specifications as well as general terms and conditions for the installation of the roof are also important. These materials may provide a basis for recovery, such as requirements that the construction meet certain local or national standards (i.e., building codes) or that the general contractor is responsible for all of the work, including that performed by subcontractors.

Conclusion

The economic loss doctrine is usually just an obstacle but not a bar to recovery. In most cases, at least one of the foregoing exceptions to the doctrine will be applicable. A little digging and creative thought is all that is needed.

In closing, it is important to note that application of the economic loss doctrine varies significantly from state to state. The discussion above is very general and some of the

²⁵ See *Comptech Int'l, Inc. v. Milam Commerce Park, Ltd.*, 753 So.2d 1219 (Fla. 1999) (economic loss rule could not bar claim based on statute providing cause of action for injury resulting from violations of the building code during construction).

²⁶ Obtaining these documents is also important for other reasons. These documents may contain limitations of liability, limitations of damages, and notice requirements in the event of a loss.

exceptions discussed will not apply in certain jurisdictions. It is therefore important to promptly determine how the appropriate jurisdiction applies the doctrine and its exceptions.²⁷

²⁷ For purposes of brevity, citations to case law were kept to a minimum. For additional citations for any of the issues discussed herein, please contact the authors at tparsons@zelle.com and bwalling@zelle.com.