THE ECONOMIC LOSS RULE IN CONSTRUCTION

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I. INTRODUCTION

Owners, design professionals, general and trade contractors, and construction managers can all be held responsible in damages to other construction project participants. Damages may be assessed as an extra to the amount of the initial contract, because of breach of express or implied warranties, and, in tort, separate from contractual remedies. While no one enjoys paying extra or receiving less, the most difficult construction damages to tolerate are those that are unexpected and for which no funds have been budgeted. Surprising project costs, incurred by the payor or unrecoverable by one required to incur the cost, will sour anyone’s attitude about an otherwise acceptable project.

The complexity of today’s construction projects strains the law of contracts. When something goes wrong on a construction site, or when the completed edifice doesn’t deliver, there are usually a number of entities – perhaps within the contract chain, perhaps not – with a hand in the cause. For many of today’s construction issues, common law contract causes of action can be cumbersome in the extreme. If a problem takes several years to manifest itself, if contractual responsibilities for the work are not the same up and down the chain of specialization, or if there are gaps in the scope of and responsibilities for the work, damages may occur for which

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there is no common law contract remedy. As it is human nature not to gladly accept responsibility for the perceived folly of others, construction project participants have increasingly turned to tort law.

But there are certain limitations on tort damages, especially claims for purely economic damages, chiefly manifested, in the construction industry, in the judge-made “economic loss rule,” which prohibits non-intentional tort recovery of economic damages, direct or consequential, when there is no concurrent physical injury or property damage, or breach of a separate tort duty. After all, construction projects are founded in contract, not tort, and the contractual legal rules, including bargained-for certainty, should be honored. For some, the economic loss rule is a proper judicial response to what some commentators have characterized as an unfair assault on privity.

1 The Latin phrases employed over the centuries to describe these situations are *injuria absque damno, damnum absque injuria,* and *damnum sine injuria.*
2 This adage generates a resounding “Amen” when considered in the construction industry, where budget-busting problems regularly have many parents, but often only a few bear the cost of financial resolution. It is often difficult, especially for owners, to understand why, if they are not at fault, they must pay extra. After all, many owners reason, that was the point of hiring construction “professionals”—contractors and designers—to control costs so that the project would be built without breaking the budget.
3 Economic damages, in this instance, as distinct from bodily injuries or damages to separate tangible property. But, as will be seen within this chapter, the elasticity of the definition of “economic” has been situationally tested by various courts in various situations.
4 See, *e.g.,* Affiliated FM Ins. Co. v. LTK Consulting Servs., Inc., 243 P.3d 521 (Wash. 2010) (en banc) (concessionaire’s nonprivity claim against engineer for negligent design of monorail repairs that led to a fire causing property damage that was the subject of engineer’s contract with city was not barred by the economic loss rule [hereinafter “ELR”] because engineer owed an independent duty of safe repair design to the concessionaire).
5 No-damage-for-delay, consequential damages waivers, are just two regularly-employed contractual clauses to limit otherwise available contract damages.
and a cancer-like invasion by torts of the contractual setting. But the economic loss rule has hardly been applied uniformly. Each year, new opinions put a new spin on the rule, making its application and exceptions a matter of locality.

II. THE ECONOMIC LOSS RULE – HISTORY AND DEVELOPMENT

The economic loss rule, as originally stated, provides that in an action alleging negligence or strict liability arising from a transaction involving a product, a plaintiff may not recover purely economic damages caused by a

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7 Because situations involving negligence tend to occur in the construction industry more often than other torts – a simple negligence claim may exist against a trade contractor or builder when a strict liability (or negligence per se) claim does not – this chapter will focus primarily upon the application of the economic loss rule in negligence-based actions. See authorities cited at West’s 115 DAMAGES, k136; West’s 313A PRODUCTS LIABILITY, k17.1.

8 The economic loss rule is generally also applied in actions alleging strict liability. See Seely v. White Motor Co., 403 P.2d 145 (Cal. 1965) (en banc); Stearman v. Centex Homes, 92 Cal. Rptr. 2d 761 (Cal. Ct. App. 2000) (citing cases); Fieldstone Co. v. Briggs Plumbing Prods., Inc., 62 Cal. Rptr. 2d 701 (Cal. Ct. App. 1997) (prematurely rusted sinks damaged only themselves, strict liability claim dismissed). Strict liability actions under §402 of the RESTATEMENT (SECOND) OF TORTS (1979) generally involve manufactured products. Those who supply services are generally not strictly liable. See Murphy v. E.R. Squibb & Sons, Inc., 710 P.2d 247 (Cal. 1985) (strict products liability law does not apply to services); RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY §19(b) (1998) (“services, even when provided commercially, are not products” and are governed by the law of negligence).

9 Courts generally agree that the economic loss rule does not apply to intentional torts. See United Int’l Holdings, Inc. v. Wharf (Holdings) Ltd., 210 F.3d 1207 (10th Cir. 2000) (the breaching party is also a tortfeasor); Pulte, supra note 6, at 739 (builder’s negligence claim for defective fire retardant chemical as applied to


defective product that injures only itself. Economic damages represent “inadequate value, costs of repair and replacement of the defective product or consequent loss of profits without any claim of personal injury or damage to other property.” Economic losses also include the “diminution in value of the product because it is inferior in quality and [because it] does not work for the general purpose for which it was manufactured and sold.”

The principle of the economic loss rule is easiest to apply in product liability cases, where the rule originated. Over the years, the economic loss...
rule has been extended, depending upon the jurisdiction, to claims against most construction service as well as product providers – including manufacturers, suppliers, design professionals, contractors, and subcontractors – regardless of privity and regardless of whether the claims allege pure negligence, professional negligence, or negligent misrepresentation. A number of courts have held that consumer homeowners are barred from asserting negligence actions against manufacturers to recover economic damages – either the cost to repair defective construction or the diminution in value of their home – unless there is property damage to some other part of the home. A number of courts have held that once building materials are incorporated into a structure, the entire structure itself becomes the "product." As this result economic loss is not arbitrary and does not rest on the ‘luck’ of one plaintiff in having an accident causing physical injury. The distinction rests, rather, on an understanding of the nature of the responsibility a manufacturer must undertake in distributing his products.” Seeley, supra note 8, at 151; see also E. River, supra note 10, at 858. In each of these cases, the product (a truck and a ship’s turbines) damaged itself, causing repair costs and lost profits, but no bodily injury or physical damage to other property or product. While this has long been the position taken by general liability insurers on the coverage issue of damage to the insured’s work – that if there is no property damage to other property, there is no coverage – recent opinions from the Supreme Courts of California, Nevada, and Alabama prohibit any economic loss claim against construction component suppliers other than a direct contract or warranty claim. These opinions foretell the upcoming battle as to the meaning of property “other than the product itself.” See Keck v. Dryvit Sys., Inc., 830 So. 2d 1 (Ala. 2002); Aas v. Superior Court, 12 P.3d 1125 (Cal. 2000); Calloway v. City of Reno, 993 P. 2d 1259 (Nev. 2000). Aas has been superseded by statute. See Rosen v. State Farm Gen. Ins. Co., 30 Cal. 4th 1070 (2003). Calloway has been effectively overruled by statute as well. See Olson v. Richard, 89 P. 3d 31, 33 (Nev. 2004). See discussion infra at notes 55-61; Wilson v. Dryvit Sys., Inc., 206 F. Supp. 2d 749 (E.D.N.C. 2002). But see Jimenez v. Superior Court, 58 P.3d 450 (Cal. 2002).
would effectively bar all negligence claims for most economic damages from construction defects, at least one commentator has speculated that homeowners may assert personal injury claims to avoid the rule.  

The traditional test of the economic loss rule concerns the type of damage caused by a defective product: Was there injury to a person or other property, or was the damage only to the product? In *Seely v. White Motor Co.*,[17] a commercial customer’s action against a truck manufacturer, the only losses were the cost of repairing the truck and loss of income due to the truck’s unserviceable state. These damages were not allowed under negligence or strict liability counts, and, because they represented the plaintiff’s only damages, the negligence and strict liability causes of action were dismissed.[18] Viewed thusly, the economic loss rule forms a damages restriction rule only – barring recovery for certain losses under an otherwise viable negligence or strict liability cause of action.[19]

A proper application of the rule occurs when there are only economic damages. If a plaintiff has sustained bodily injury or physical harm to “other

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17 *Seely, supra* note 8, at 145.
18 The *Seely* plaintiff’s claims sounding in contract were upheld. The Supreme Court of California (Traynor, C.J.) affirmed the plaintiff’s recovery, under claims for breach of express warranty, of the purchase price of the truck and plaintiff’s lost profits.
19 See *Casey v. Overhead Door Corp.*, 87 Cal. Rptr. 2d 603, 610–11 (Cal. Ct. App. 1999) (plaintiffs were not prejudiced by the trial court’s ruling *in limine* excluding economic damages, since they could have introduced other evidence to support their negligence count, if they had any).
property,” then in both cases he or she may recover economic losses attendant to the physical damages, assuming, of course, the damages are foreseeable and proximately caused by the defendant’s conduct.

The legal and policy considerations that underpin the rule in the products liability context rest upon a manufacturer’s responsibility for its goods. Defects that cause physical harm are deemed to be properly chargeable to the manufacturer. Those that affect the product’s “level of performance” are not, unless the manufacturer agrees to be so charged (e.g., by giving a warranty). These considerations are said to be based in the different common law concepts dividing tort and contract law. To recover in tort, there must be some showing of harm above and beyond disappointed expectations.

In the twentieth century, tort remedies began to insinuate themselves into commercial transactions, including construction-related commercial activities. Not every appellate court saw this trend as wise. In the decades

\[20\] See Held v. Mitsubishi Aircraft Int’l, Inc., 672 F. Supp. 369, 376–77 (D. Minn. 1987) (applying Texas law); see also Daanen & Janssen, Inc. v. Cedarapids, Inc., 573 N.W.2d 842, 845 (Wis. 1998) (“The economic loss doctrine, however, does not bar ... economic loss claims that are alleged in combination with noneconomic losses”) (citing cases); authorities cited at West’s 313A PRODUCTS LIABILITY, k17.1. But see World Trade Co. v. Westinghouse Elec. Corp., 682 N.Y.S.2d 385, 387 (App. Div. 1998) (fact that two injured workers had negligence claims against product manufacturer does not inure to the project owner’s benefit when owner’s only losses are replacement of defective product and consequential damages therefrom).

\[21\] Seely, supra note 8, at 195.

\[22\] Id. See E. River, supra note 10, at 871; Nat’l Union Fire Ins. Co. v. Pratt & Whitney Canada, Inc., 815 P.2d 601, 604 (Nev. 1991); see also 1 A.R. FRUMER & M. I. FRIEDMAN, PRODUCTS LIABILITY §3.01(2)(f) (1991); authorities cited at West’s 379 Torts, k5, 11; West’s 313A PRODUCTS LIABILITY, k8, 17.1.
following Seely, many courts became enamored of the economic loss rule’s predictability – so enamored that they began applying the rule in negligence actions outside the manufactured products arena. The eagerness of such courts to expand the rule may have been due to the discomfort those same jurists felt about the encroachment of tort duties and remedies into commercial transactions. A close reading of many of these decisions tends to show that to these judges, the economic loss rule does more than exclude specific damages. Indeed, the rule articulates an “anti-tort-in-commercial-transactions” principle, and a method to revive more predictable privity-of-contract remedies to commercial disputes.

Most jurisdictions have adopted the economic loss rule in actions involving manufacturers of defective products. In this context, the principle

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23See, e.g., Calloway, supra note 14, at 1266,1274. See also the discussion within Parts IV, V, and VI of this Chapter, infra.

24See, e.g., Calloway, supra note 14, at 1274 (“As stated previously, the economic loss doctrine arose, in large part, from the development of products liability, but its application is broader and serves to maintain a distinction between contract and tort principles.” “...the fundamental policy behind [the economic loss] rule is to restrict parties to commercial transactions to contractual remedies based simply upon the foreseeability of loss of financial expectancies”) (emphasis added). A number of courts have observed, however, when applying the economic loss rule in the manufactured products context, that privity has no role to play. See, e.g., Sullivan Indus., Inc. v. Double Seal Glass Co., 480 N.W. 2d 623, 629 (Mich. Ct. App. 1991) (“The reliance on privity notions to ascertain whether tort or commercial law applies serves only to blur the distinction between, and the applicability of, commercial law and tort law to economic losses”); see also Bowling Green Mun. Utils. v. Thomasson Lumber Co., 902 F. Supp. 134, 136 (W.D. Ky. 1996) (“The underlying rationale is that the rights and duties of the parties should be bargained for at arms’ length with the parties negotiating the contract as to the allocation of risk.”).

25See authorities cited at West’s 313A PRODUCTS LIABILITY, k17.1; see generally Christopher S. D’Angelo, supra note 6, at 609, for a survey of jurisdictions that have adopted the economic loss rule in various applications.
applies regardless of whether the parties are or are not in privity. As the scope of the rule has expanded, many negligence claims must now run the rule’s gauntlet. But the more broadly the principle is applied, the more opportunity is created for distinctions, subtle and obvious, in its application and effect.

The nuances of the economic loss rule make it a doctrine that is in some jurisdictions riddled with exceptions, and in others often more honored in the breach than in the observance. A generation ago, one court lamented that the concept is “stated with ease, but applied with great difficulty.” The same may be said today. Legal commentators and jurists cannot agree upon the reasons courts distinguish between proper and

26 See, e.g., Seely, supra note 8, at 147 (rule applied without privity); Town of Alma v. Azco Constr., Inc., 10 P.3d 1256, 1262–63 (Colo. 2000) (en banc) (discussing workable economic loss rule as an “independent duty rule,” which applies to all contractual settings regardless of privity); Sullivan, supra note 24, at 628-629 (court applied rule to parties not in privity—previous state court opinions applied rule only to parties in privity); Nat’l Union Fire Ins., supra note 22, at 601 (rule applied without privity); Daanen & Janssen, supra note 20, at 846 (economic loss rule applies in the manufactured products context, regardless of privity). See also authorities cited at West’s 313A PRODUCTS LIABILITY, k17.1.

27 See Ramerth v. Hart, 983 P.2d 848, 851 (Idaho 1999) (economic loss doctrine “applies to negligence cases in general; its application is not restricted to products liability cases”). See also Local Joint Executive Bd. v. Stern, 651 P.2d 637 (Nev. 1982) (where former employees of the MGM Grand Hotel sought to recover lost salaries and employment benefits while the resort was closed following a fire allegedly caused by defendant, ELR applied to prevent recovery); 532 Madison Ave. Gourmet Foods, Inc. v. Finlandia Ctr., Inc., 750 N.E.2d 1097 (N.Y. 2001) (construction-related disasters in midtown Manhattan caused business closures and loss of income, but no recovery allowed without bodily injury or other property damage); authorities cited at West’s 272 NEGLIGENCE, k463.


improper applications of the rule. At the end of the twentieth century, an astute Florida jurist observed that in his jurisdiction there were three distinct, but often overlapping, economic loss rules:

First, there is the products liability economic loss rule: If the defendant’s product physically damages only itself, causing additional economic loss, no recovery is permitted in “tort.”

Second, there is the contract economic loss rule: If the parties have entered into a contract, the obligations of the contract cannot be relied upon to establish a cause of

30 Compare the opposite analyses of the rule’s policy considerations by Beth Andrus & Bill Joyce in The Economic Loss Doctrine in Constraction Cases: Are the Odds for Design Professionals Better in Vegas? 2:1 JOURNAL OF THE AMERICAN COLLEGE OF CONSTRUCTION LAWYERS 53 (Winter 2008). See also the three points of view within the following articles from The Construction Lawyer: (1) Luther P. House, Jr., & Hubert J. Bell, Jr., The Economic Loss Rule: A Fair Balancing of Interests, 11:2 THE Constr. Law. 1 (April 1991) (rule is correctly applied in the construction industry based upon the presence or lack of a duty owed by those sought to be held liable); (2) G. Anthony Smith, The Continuing Decline of the “Economic Loss Rule” in Construction Litigation, 10:4 THE Constr. Law. 1 (November 1990) (rule should not be applied in construction setting because of the foreseeability of damage to a limited class of users); (3) Steven B. Lesser, Economic Loss Doctrine and Its Impact Upon Construction Claims, 14:3 THE Constr. Law. 21–26 (August 1994) (injured parties too often have no way to affect the hiring or contractual responsibility of, and have no contractual remedy against, project participants, so to deny relief to those so harmed violates the protection and the tenets of Marbury v. Madison). Compare also the analyses of the rule by the court in Casa Clara Condo. Ass’n v. Charley Toppino & Sons, Inc., 620 So. 2d 1244 (Fla. 1993) (high salt concrete caused rebar to rust and balconies to crumble; mere economic damage to “product”) with that by the court in Borough of Lansdowne, Pa., v. Sevenson Envtl. Servs., Inc., No. 99–3781, 2000 WL 1886578 (E.D. Pa. December 12, 2000) (economic loss rule blocks negligence action against construction professional only when parties are in privity).
action in tort for the recovery of purely economic damages.... There must be a separate, “independent tort.”

Finally, there is the negligence economic loss rule. Common law negligence generally has not been expanded to protect economic interests in the absence of personal injury or property damage.\(^{31}\)

How a jurisdiction will apply or refuse to apply these differently stated rules may depend upon how the appellate judiciary of that jurisdiction regards the “collision” at the intersection of tort and contract law. In the absence of binding precedent applicable to a particular set of facts, the timbre of the language used by an appellate court in similar fact patterns can be instructive. Courts that seek to “maintain a distinction between contract and tort principles” are likely to agree with the court that held: “Economic losses from a defective building are just as offensive to tort law as damages sought for economic losses stemming from a defective product.”\(^{32}\)

In contrast, if the judiciary acknowledges that a “unique relationship” exists among contractors, subcontractors, and design professionals that creates “an interdependence of responsibility” among project participants,

\(^{31}\) Woodson, supra note 9, at 1331 (Altenbernd, J. dissenting).

\(^{32}\) Calloway, supra note 14, at 1265-66 (emphasis added); see also E. River, supra note 10, at 866, setting forth the often-quoted reason for the rule – to protect contract law from “drown[ing] in a sea of tort.” The rhetoric in many of these opinions is reminiscent of the arguments presented to state legislatures and Congress in support of personal injury damage caps for pain and suffering in response to damage awards caused by “trial lawyers run amok” – arguments made, and often financed, cynical commentators note, by insurance companies and other typically defense-oriented interests.
then the court may be more inclined to hold noncontracting parties accountable for economic losses that foreseeably arise from the failure of a project participant to discharge his or her contractual duties in a nonnegligent manner. If the appellate opinion goes on to emphasize that the economic loss rule “may have some genuine, but limited, value in our damages law,” and that “if the doctrine were generally applied to bar all tort claims for economic losses without accompanying personal injury or property damage, the rule would wreak havoc on the common law of torts,” one can deduce at least where the court will begin its analysis.

The impact of the economic loss limitation is immense. In the construction arena, it eliminates many claims for what would otherwise be categorized as property damage. Because of the rule’s draconian effect, many courts have struggled with its application to realty improved by the

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34 Moransais, supra note 29, at 983 (emphasis added) (professional engineer’s negligent inspection failed to disclose defects that caused economic loss, but had not caused property damage or personal injury).

35 As the Washington Supreme Court observed, “definitions of economic injuries are broad and malleable.” Affiliated FM Ins., supra note 4, at 521.

construction process. Jurisdictions honor the economic loss rule in various ways depending upon whether the context involves defective construction products or services that create improvements to the built environment, but courts have been less than uniform in their approach.

Suffice it to say that there are strong feelings in the bar and the judiciary on the subject of the economic loss rule. Meanwhile, its application continues to be dynamic; courts have changed and may continue to change their minds about its proper scope and breadth.

III. THE ECONOMIC LOSS RULE RELATING TO DEFECTIVE CONSTRUCTION PRODUCTS

As a child of manufactured products liability law, the economic loss rule was first employed in the construction context by courts considering allegations of defective or deficient construction products or equipment. Of the many ways a construction project or its participants could be

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37 See, e.g., dialogue between majority and dissenting opinions in Aas, supra note 14, at 1132-35, 1143-50.
38 See the discussion in Parts IV and V below regarding construction services, professional services, and residential property exceptions.
39 Compare the analyses by the Florida Supreme Court in Moransais, supra note 34, by the same court in Casa Clara, supra note 30, and by an intermediate Florida appellate court in Sandarac, supra note 29, at 1349, overruled by Moransais. Compare also the analysis by the South Carolina Supreme Court in Colleton, infra note 75, overruled a year later by the same court in Sapp, infra note 75.
40 See Sacramento Reg'l Transit Dist. v. Grumman Flexible, 204 Cal. Rptr. 736 (Cal. Ct. App. 1984) (repair of defective bus parts was not actionable where defect had not caused further damage); Sunnyslope Grading, Inc. v. Bradford, Miller, & Risberg, Inc., 437 N.W.2d 213 (Wis. 1989) (backhoe’s defective parts were covered by manufacturer’s warranty, but plaintiff’s claims for economic damages in the form of additional repair cost, downtime, and lost profits were denied in a tort action where the defective backhoe caused no injury to another person or other property).
economically harmed, unlooked-for repair costs, lost profits, and other economic damage due to defective equipment or a negligently manufactured product stand the closest factually to the Seely model and create the scenario where the economic loss rule ought to be most uniformly applied. Such has proved to be the case, especially when the product has injured “only itself.”

Beyond the simplest of facts, however, the analytical landscape for damage caused by defective construction products becomes cluttered. During the construction process, products and equipment are incorporated into systems, and many hands are laid upon them. Not all products remain in their original form once incorporated into a structure. Incorporated products may be identifiable, but to remove or repair them often injures or destroys still other products. Economic losses to the project owner and project participants can also occur when a product is improperly installed. Structures may diminish in value under the stigma of nascent but unrealized injury due to defective components. And economic damage can be visited

41 See William K. Jones, Product Defects Causing Commercial Loss, The Ascendancy of Contract Over Tort, 44 U. MIAMI L. REV. 731 (1990); Jay M. Zitter, Annotation, Strict Products Liability: Recovery for Damage to Product Alone, 72 A.L.R.4TH 12 (1985 and Supp. 1995); see also Mid Continent Aircraft Corp. v. Curry County Spraying Serv., Inc., 572 S.W.2d 308, 312 (Tex. 1978) (quoting Dean Keeton on the difference between a dangerous condition that harms only the product and a condition that is dangerous to other persons or property).

42 Those providing construction services may be liable in negligence or implied warranty, but are generally not strictly liable, for their work or for the components they install. See discussion at note 88, infra; RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY, §19, subd. (b) (1998) (“services, even when provided commercially, are not products” and are governed by the law of negligence).
upon the owner or upon various project participants due to improper component-related professional services, including defective design, selection, or coordination of construction components.

In many construction situations, those economically damaged by a defectively designed or manufactured product, or by negligent professional conduct or defective construction work relating to the product, are not in privity of contract with (or do not have a contractual remedy against) the provider of the defective product, work, or service. Often, project owners and providers of construction services have limited influence in the selection of construction materials, and few are the owners who can competently judge the quality and suitability of a professional’s design selection or evaluate the work of a trade contractor who installs the product. Warranties from product manufacturers may be available, but are hard to bargain for – a manufacturer’s warranty “is what it is,” and a warranty from a design professional is not covered by professional liability insurance.\(^{43}\)

Economic losses sustained by owners and participants due to the negligent conduct of those specifying, manufacturing, supplying, or installing materials are foreseeable. Nevertheless, under a strict application of the economic loss rule, these injuries are not recoverable in a negligence action. A party that lacks contractual remedies against the entity causing the loss,\(^{44}\)


\(^{44}\) Sophisticated parties to the construction process can be very creative in crafting
or at least the ability either to close or leap gaps in the contractual chain, will more often than not be denied recovery.45

To the extent that the economic loss rule is premised upon the type of damages suffered, it is properly applied in the manufactured products context whether the parties are in privity of contract or not.46 But privity matters, as courts routinely dismiss claims sounding in tort for “negligent performance” or “negligent breach” of a contract, especially involving the sale and installation of a product.47 In Myrtle Beach Pipeline Corp. v.
Emerson Electric Co.,\(^48\) specially-made pipe leaked, causing a large fuel spill and subsequent clean-up costs. Despite damage to land adjacent to the pipeline project, tort recovery for the clean-up cost was denied on privity grounds.\(^49\) Other courts may be less direct in referring to privity (or a perceived equivalent) as a reason to deny tort relief, but use the fact that the affected parties have a direct contract (even though not with the defendant tortfeasor) to restrict the type of “other property” whose unanticipated damage would otherwise not be compensable under the economic loss rule.\(^50\)

Courts also deny recovery in non-privity negligence situations where a product warranty is available to the plaintiff.\(^51\) In these situations, the warranty supplies the “bargained-for” aspect of a contract, triggering the economic loss rule, often despite damages to components other than the

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\(^{49}\) Id. at 1048–55. The court discussed the economic loss rule, but was more impressed that these were “sophisticated parties” to a “negotiated” contract and added that, even if “other property” were damaged, such damage was contemplated by the parties’ contract. Id. at 1057. But see Tourist Vill. Motel, Inc. v. Mass. Eng’g Co., 801 F. Supp. 903 (D.N.H. 1992) (where a fuel drum leak damaged plaintiff’s property, the economic loss rule was not applied).

\(^{50}\) See Palmetto Linen Serv., Inc. v. U.N.X., Inc., 205 F.3d 126, 129 (4th Cir. 2000) (“sophisticated parties” in privity should have contemplated the type of injury sustained, thereby “rendering other property damage inseparable from the defect in the product itself”); Wausau Tile, Inc. v. County Concrete Corp., 593 N.W.2d 445 (Wis. 1999) (where defective cement from supplier in privity caused manufacturer to fabricate and sell defective pavers that cracked, split, and expanded, no recovery in tort was allowed for the purely economic damages to the “product”).

\(^{51}\) Kelly v. Georgia-Pacific LLC, 671 F. Supp. 2d 785 (E.D.N.C. 2009) (homeowner’s negligence claim against house trim manufacturer not in privity for purely economic damages was barred by the economic loss rule where homeowner had a warranty remedy available against the manufacturer).
warranted product.\textsuperscript{52}

Courts also are sometimes confronted by the question of whether the contractual arrangement between the parties is for a product or for services.\textsuperscript{53} In these situations, many courts examine whether the Uniform Commercial Code governs the transaction. If so, most courts are inclined to consider contract and U.C.C. remedies and dismiss the negligence claims.\textsuperscript{54}

One of the more frequently-litigated issues in construction defect cases involves what exactly constitutes the “product” once a component has been incorporated into a structure. Although defective products which cause bodily injuries are rather easily identified,\textsuperscript{55} courts struggle with whether an incorporated, but defective, product has physically damaged “property other

\textsuperscript{52} \textit{Id.} Again, this result is an example of the “contract economic loss rule,” barring negligence claims and nonbargained-for damages when contract remedies govern the transaction.

\textsuperscript{53} See Louisville Gas & Elec. Co. v. Cont’l Field Sys., Inc., 420 F. Supp. 2d 764 (W.D. Ky. 2005) (court refused to extend application of the ELR to bar a negligence claim by electrical generator owner against maintenance contractor and welding subcontractor where they provided services and not a product). This analysis is regularly undertaken in jurisdictions that distinguish between products and services in the applicability of the rule.

\textsuperscript{54} Quicksilver Res. v. Eagle Drilling, L.L.C., No. H-08-868, 2009 WL 1312598 (S.D. Tex. May 8, 2009) (if the U.C.C. governs the dispute, there is no negligence claim, so no need to consider ELR, but also no recovery beyond contract damages).

\textsuperscript{55} Most courts are able to consistently discern the presence or absence of a causal link between a defective construction product and bodily injury. More difficult for courts are determinations of whether a defective construction product has caused damage to “other property.” In nontraumatic situations, significant bodily injuries proximately caused by a benignly defective construction product (such as a leaking window) are rare. And the proximate causation element of emotional distress claims can be attenuated, to say the least. \textit{See, e.g.}, Erlich v. Menezes, 981 P.2d 978 (Cal. 1999) (reversing an award of damages for emotional distress in negligent construction case).
than the product itself.”56

The “other property” analysis is rather simple to articulate. Its application is less so. In the construction arena in particular, often the defective nature of a product57 can cause “physical damage.” Examples include water intrusion from an improperly applied roofing membrane and cracked marble flooring due to a badly deflecting floor truss. Whether these damages are recoverable in negligence depends upon how a particular jurisdiction defines “product” and “other property” damaged by the defective product, and how the jurisdiction frames its desired exceptions to the rule.

If the completed, integrated structure is the “product,” the economic loss rule bars recovery for any damaged part of it.58 A significant number of

56The traditional ELR bars recovery of economic losses where the product “damages only itself.” E. River, supra note 10, at 858. See also County of Chenango Indus. Dev. Agency v. Lockwood Greene Eng’rs, 494 N.Y.S.2d 832 (App. Div. 1985) (building owners could not recover in tort against roofing manufacturer for cracks, splits, and leaks in roof, held to constitute only economic damage). The majority of courts do not differentiate, when the question is the viability of an action in negligence against a manufacturer, between types of owner or uses of the structure. Courts are, however, quick to spot, and deny recovery for, de minimis damage to “other property.” See Travelers Cas. & Sur. Co. v. Dormitory Auth. – State of N.Y., No. 07 Civ 6915 (DLC), 2008 WL 1882714 (S.D. N.Y. April 25, 2008) (surety’s negligence claim against terrazzo manufacturer barred by ELR; current and future damage to floor slabs due to defective terrazzo was not damage to “other property”); Steffy v. The Home Depot, Inc., No. 1:06-CV-02227, 2009 WL 904966 (M.D. Pa. March 31, 2009) (commercial building buyer’s negligence claims against supplier of plywood containing excessive formaldehyde were barred by ELR; court declined to find that indoor air quality was “other property”); Veeder v. N.C. Mach. Co., 720 F. Supp. 847 (W.D. Wash. 1989) (damage to rug from oil spray de minimis); Wis. Pub. Serv. Corp. v. Ecodyne Corp., 702 F. Supp. 217 (E.D. Wis. 1998) (de minimis damage to other property insufficient to overcome economic loss rule).

57Defective design and construction services can also cause physical damage. See discussion in the next sections of this article.

58See, e.g., Dakota Gasification Co. v. Pascoe Bldg. Sys., 91 F.3d 1094, 1099 (8th
courts, and the Restatement of Torts,\textsuperscript{59} follow the broad “integrated product” analysis. If the defendant manufacturer of the allegedly defective construction product convinces the court that the product is so integrated into the structure (or a construction system such as a roof within the structure) that it loses its identity,\textsuperscript{60} then the integrated whole becomes the “product.” If the structure is the “product,” it cannot be “other property” whose physical damage would suffice to avoid the economic loss rule.

\textsuperscript{59} The Restatement (Third) of Torts: Products Liability (1998) describes the characterization process (separate or integrated) when products are incorporated into a system as “difficult.” Nonetheless, the Restatement authors opine: “When the product or system is deemed to be an integrated whole, courts treat such damage as harm to the product itself.” Id. §21, cmt. e, at 295–96. But as observed by at least one commentator and several courts, this analysis fails to recognize the duties “that arise independently of the pyramid structure of privity created by the tiers of contracts and subcontracts.” Cheezem, supra note 36, at 22. See also Gilbane Bldg. Co. v. Nemours Found., 606 F. Supp. 995, 1005 (D. Del. 1985) (recognizing the interdependence of construction participants).

\textsuperscript{60} See, e.g., Trump Int’l Hotel & Tower v. Carrier Corp., 524 F. Supp. 2d 302 (S.D. N.Y 2007) (hotel owner’s negligence claim against HVAC manufacturer in privity involving service of safety controls was barred by ELR where absorption chiller and its safety controls were considered an “integrated unit” under product liability law and no independent tort duty existed); Nat’l Union Fire Ins., supra note 22, at 601 (a defective part in the engine of a factory-assembled airplane damaged the engine and the airplane; the airplane was held to be the integrated whole, and therefore the “product”).
protecting the manufacturer. On the other hand, a number of courts have not followed the “integrated structure as a product” analysis. These judges allow recovery against a remote manufacturer for property damage to “other property” when the defective product damages another identifiable construction component.61

Some defective products cases (most outside the construction arena) allow recovery of economic damages when the cause of physical property

61 See, e.g., Lamb v. Georgia-Pacific Corp., 392 S.E.2d 307, 308 (Ga. Ct. App. 1990) (where allegedly defective particle board installed underneath tile floor caused tile to crack, costs to repair the damaged portion of the tile floor were recoverable as damage to “property other than the product itself,” but other economic damages would be denied); see also Saratoga Fishing Co. v. J.M. Martinac & Co., 520 U.S. 875, 879 (1997) (ship’s defective component damaged equipment added to the ship after the ship’s initial purchase, held, added equipment was “other property”); Pulte, supra note 6, at 741 (“to satisfy the other property exception [to the economic loss rule], Pulte must establish damage to property aside from the FRT plywood treated with Osmose chemicals.” Other components may have been replaced but not because they were damaged by the FRT, but rather as a consequence of replacing the FRT plywood); Jimenez, supra note 15, at 450) (strict liability case against a manufacturer; defective windows caused water damage to walls, floors, etc., which were held to be “other property,” as windows could be removed from the structure); Stearman, supra note 8 (in strict liability case, defective foundation construction and inadequate soil compaction caused slab movement, deformation, and cracked walls, which were held to be physical damage to “other property”); Comptech Int’l Inc. v. Milam Commerce Park, Ltd., 753 So. 2d 1219 (Fla. 1999) (in negligence claim by tenant against landlord for selection of contractor who damaged tenant’s electrical systems, warehouse space, and computers during renovation, existing electrical systems and computers were held to be “other property”); United Air Lines, Inc. v. CEI Indus. of Illinois, 499 N.E.2d 558 (Ill. App. Ct. 1986) (water leaks in defective roof caused collapse of ceiling); Northridge Co. v. W.R. Grace & Co., 471 N.W.2d 179 (Wis. 1991) (asbestos causes physical harm to structure, structure is “other property” and outside the economic loss rule); City of La Crosse v. Schubert, Schroeder & Assocs., 240 N.W.2d 124 (Wis. 1976) (in remote purchaser’s negligence action against manufacturer of a roof that leaked and required replacement, damages to other parts of the structure were recoverable); authorities cited at West’s 115 DAMAGES, k36, 39; West’s 313A PRODUCTS LIABILITY, k17.1, 42.
damage to a product is an outside source, such as fire.\textsuperscript{62} Courts also have made distinctions when damaged property is contained within, but not integrated into, the structure.\textsuperscript{63} In \textit{Scott & Fetzer Co. v. Montgomery Ward & Co.},\textsuperscript{64} fire warning systems malfunctioned in a large warehouse occupied by several tenants. The fire spread throughout the warehouse, causing damage to the premises leased by various tenants and to their personal property. The court went so far as to deem the loss of the value of the tenants’ leasehold and their personal items to be “not economic,” because the damage was for “loss of property other than the defective product.”\textsuperscript{65}

Courts also struggle with the situation where the product is defective, and potentially dangerous, but has not yet injured anyone.\textsuperscript{66} In \textit{Council of

\textsuperscript{62} See, e.g., Rocky Mountain Fire & Cas. Co. v. Biddulph Oldsmobile, 640 P.2d 851 (Ariz. 1982) (where a Winnebago was destroyed by fire, court held economic loss rule does not apply to property damage, but would apply to claim for lost profits or other commercial losses); Gherna v. Ford Motor Co., 55 Cal. Rptr. 94 (Cal. Ct. App. 1966) (where fire in the engine compartment destroyed an entire automobile, some economic losses allowed). \textit{But see} Lloyd Wood Coal Co. v. Clark Equip. Co., 543 So. 2d 671 ( Ala. 1989) (front end loader’s hydraulic hose ruptured, causing a fire, but damage was only to the product itself, and recovery for economic losses was barred).

\textsuperscript{63} See 2-J Corp. v. Tice, 126 F.3d 539, 544 (3d Cir. 1997) (applying Pennsylvania law) (a collapsed metal building caused damage to stored inventory, which was held “other property,” and manufacturer was liable for economic losses).

\textsuperscript{64} 493 N.E.2d 1022 (Ill. 1986).

\textsuperscript{65} \textit{Id.} at 1026. The court also noted that the damage was caused by a “sudden and dangerous conflagration.” Again, it is this sort of language which shows the confusion that some courts have in distinguishing between the economic loss rule and liability insurance coverage exclusions.

\textsuperscript{66} See Menards, Inc. v. Countryside Indus., Inc., No. 01 C 7142, 2004 WL 1336380 (N.D. Ill. June 14, 2004) (owner’s negligence claim for purely economic losses against designers and contractors for negligent design/construction of retaining wall was not barred by ELR where the defective retaining wall could qualify under the “sudden, dangerous, or calamitous” exception); Valley Forge Ins. Co. v. Sam's Plumbing, LLC, 207 P.3d 765 (Ariz. Ct. App. 2009) (owner’s negligence claim

\hfill 22
Co-Owners Atlantis Condo., Inc. v. Whiting-Turner Contracting Co., 67 the Court of Judicial Appeals of Maryland carved out an exception to the otherwise accepted economic loss rule (barring recovery if the defective product has not caused physical injury) for a defect that can lead to a “serious risk of creating a dangerous condition.” 68 There, the defect was both in the product and in the construction installation services of the contractors.

The Maryland court, drilling down into the facts, exposed one of the economic loss rule’s major weaknesses when applied in the construction context – that a defective product or condition may be potentially dangerous without causing physical (and therefore recoverable) damage. 69 Even when a defect creates an inherently dangerous situation, the economic loss rule, strictly applied, bars any recovery (and therefore without bodily injury would prevent an action) for the repair or replacement of the defective product. 70

against plumber involving gas line explosion was not barred by ELR where damage to other property occurred and the plumber’s work presented an extreme risk of danger to person and property, qualifying for the sudden calamity or extraordinary event exception).


68 Id. Although the project was multifamily residential, the Maryland court did not limit the exception strictly to claims for damage to residential properties.

69 In Whiting-Turner, supra note 67, the court observed: “Why should a buyer have to wait for a personal tragedy to occur in order to recover damages to remedy or repair defects?” 517 A.2d at 345.

70 One court has opined that only a few jurisdictions allow direct negligence actions for purely economic losses, or have recognized tort-based warranties, against product manufacturers of defective construction components not in privity of contract with the plaintiff, absent a showing of physical harm or the serious risk of
The Maryland court determined that focusing upon the “fortuitous circumstance of the nature of the resultant damage” was the wrong approach.71

Other cases have reached just the opposite result.72 In an economic loss products case involving potentially dangerous corroding steel wall panels,73 the U.S. Court of Appeals for the Seventh Circuit strictly applied the economic loss rule to the owner’s negligence count. Writing for the court, Judge Posner acknowledged that allowing recovery for bodily injuries caused by a defective product (including economic damages arising from the injuries), but barring recovery for economic damages in the absence of bodily injury caused by the same defective product, was a matter of fortuity. Still, Judge Posner observed, the court “could not recast this case as if one of the corroded wall panels had fallen and broken [the plaintiff’s] foot.”74

harm. See Wilson, supra note 15, at 749 (where the structure as a whole suffered only economic damages even though water intrusion allowed by defective cladding caused structural damage, the court held that the economic loss rule applied to a claim against a remote manufacturer) (citing cases). Compare the application of the rule to construction service providers, at Part IV, infra.

71 Whiting-Turner, supra note 67. See also Kennedy v. Columbia Lumber & Mfg. Co., 384 S.E.2d 730, 737 (S.C. 1989), where the court opined: “We find that this legal framework [focusing only upon the type of damage incurred] generates difficulties. This is so because the framework’s focus is on consequences, not action. ... The framework we adopt focuses on activity, not consequence.”

72 Indianapolis-Marion County Pub. Library v. Charlier Clark & Linard, P.C., 929 N.E.2d 722 (Ind. 2010) (owner’s claim against subcontractors and engineer was brought before construction was finished, library claimed imminent risk or danger exception to ELR should apply, court declined in absence of personal injury).

73 Miller v. United States Steel Corp., 902 F.2d 573 (7th Cir. 1990).

74 Id. at 574. Interestingly, less than two years later, in a somewhat analogous case involving commercial general liability coverage for “property damage,” Judge Posner wrote, “The incorporation of a defective product into another product inflicts physical injury in the relevant sense [insurance coverage] on the latter [the
The South Carolina Supreme Court recently expanded the “risk of serious harm” exception to the economic loss rule to include claims against commercial construction product manufacturers, only to overrule itself not one year later – confining the risk of serious harm exception to the formerly-recognized, limited category of residential homeowner claims.\(^\text{75}\)

Many courts have created another product exception – for buildings, especially schools or governmental offices, that contain asbestos.\(^\text{76}\) The cost of removing asbestos, though clearly only an economic damage, has been awarded even in jurisdictions that otherwise strongly endorse the economic loss rule.\(^\text{77}\) The courts in Illinois, for instance, seem to be firm supporters of the economic loss rule. Illinois has consistently denied recovery when a nondefective product] at the moment of incorporation—here, the moment when the defective Qest systems were installed in homes” (emphasis added); see Eljer Mfg., Inc. v. Liberty Mut. Ins. Co., 972 F.2d 805, 814 (7th Cir. 1992) (declaratory judgment action brought to determine if physical injury occurred for the purposes of property damage triggering commercial general liability coverage); see also Roger H. Proulx & Co. v. Crest Liners, Inc., 119 Cal. Rptr. 2d 442 (Cal. Ct. App. 2002) (insurance broker was sued in negligence for failure to procure coverage, and defended on basis that the underlying claims were barred by economic loss rule; court held that claimed damages raised triable issue).

\(^\text{75}\) Colleton Preparatory Acad., Inc. v. Hoover Universal, Inc., 666 S.E.2d 247 (S.C. 2008) (school’s negligence claim for purely economic losses against roof truss manufacturer qualified for exception to economic loss rule where violation of industry standards in the manufacture of the roof truss led to a serious risk of personal injury); Sapp v. Ford Motor Co., 687 S.E.2d 47 (2009) (overruled Colleton, holding the “risk of serious harm” exception to the economic loss rule is limited to the residential homeowner arena).

\(^\text{76}\) See authorities cited at West’s 313A PRODUCT LIABILITY, k42.

\(^\text{77}\) See, e.g., Bd. of Educ. v. A, C & S, Inc., 546 N.E.2d 580 (Ill. 1989) (citing cases); United States Fid. & Guar. Co. v. Wilkin Insulation Co., 550 N.E.2d 1032 (Ill. App. Ct. 1989) (the installation of insulation containing asbestos in schools and other public buildings was property damage for general liability insurance purposes); but see Steffy, supra note 56 (in building buyer’s negligence claim against supplier, court declined to extend the asbestos public policy exception to plywood containing formaldehyde, noting this wasn’t a public building).
defective condition exists but no physical harm has been caused by a defective product other than to itself.\textsuperscript{78} When schools and asbestos were involved, however, Illinois found that asbestos fibers in the asbestos-containing materials “may, in certain circumstances, be harmful.”\textsuperscript{79} In the “circumstance” of the thirty-four school districts in the Chicago area that had removed asbestos-containing materials and were seeking to recover their removal costs, the court found the requisite harm.\textsuperscript{80} The court admonished, however, that the presence of asbestos “should not be construed as an invitation to bring economic loss contract actions within the sphere of tort law through the use of some \textit{fictional} property damage.”\textsuperscript{81}

As many courts around the United States have observed, asbestos

\textsuperscript{78} The leading case in Illinois is \textit{Moorman Mfg.}, \textit{supra} note 9, at 443 (a grain storage tank cracked, resulting in a sudden and violent ripping, which fortunately did not extend to the full height of the tank, but the court found economic losses only and refused recovery).

\textsuperscript{79} \textit{Bd. of Educ.}, \textit{supra} note 77, at 588.

\textsuperscript{80} \textit{Id.} The thirty-four school districts in the Chicago area constituted a formidable set of plaintiffs.

\textsuperscript{81} \textit{Id.} (emphasis supplied). At least one jurist has opined that because tort law reduces even bodily injury to monetary damages, the distinction between physical injury and economic loss is in itself a fiction. See F. Malcolm Cunningham, Jr. \& Amy L. Fischer, \textit{The Economic Loss Rule: Deconstructing the Mixed Metaphor in Construction Cases}, 33 \textit{TORT INS. L.J.} 147, 148 (1997), quoting from the dissent in \textit{Floor Craft Floor Covering, Inc. v. Parma Cmty. Gen. Hosp. Ass’n}, 560 N.E.2d 206, 213–16 (Ohio 1990) (Brown, J. dissenting). \textit{Compare} the opinion in \textit{A, C & S}, \textit{supra} note 77, at 585–86, \textit{with} that of the same court in \textit{Redarowicz v. Ohlendorf}, 441 N.E.2d 324, 331 (Ill. 1982) (when defective soil compaction caused the chimney and adjoining wall at plaintiff’s residence to pull away from the house, the court held, this a mere disappointed expectation: “the only danger to the plaintiff is that he would be forced to incur additional expenses for living conditions that were less than what was bargained for”); \textit{see also Foxcroft}, \textit{supra} note 58 (economic loss rule bars damages resulting from defective siding without personal injury or damage to “other property”).
cases are “unique in the law.” A number of the earlier asbestos-in-building decisions conflict with other appellate decisions from the same jurisdictions, as owners were allowed to recover the economic cost of removing asbestos-containing materials without a showing of bodily injury or physical damage other than the “contamination” of the structure itself. Within a decade, however, jurisdictions comfortable with a broader application of the economic loss rule dealt with asbestos-in-building cases by not allowing tort actions until asbestos was airborne within the structure, and dismissing negligence-based claims until the asbestos-containing material was friable. Friable asbestos, which allowed asbestos fibers to be released into the environment of the structure, “contaminated” the

83 Compare City of Greenville v. W.R. Grace & Co., 827 F.2d 975 (4th Cir. 1987) (applying South Carolina law) (asbestos fireproofing created risk of asbestos-related diseases, and city could maintain negligence action for solely economic losses), with 2000 Watermark Ass’n v. Celotex Corp., 784 F.2d 1183,1185 (4th Cir. 1986) (applying South Carolina law) (blistering roof at plaintiff’s condominium project constituted mere economic loss, and recovery in negligence was unavailable) citing E. River, supra note 10, at 858; and Myrtle Beach, supra note 48.
85 See discussion and survey of cases in San Francisco United Sch. Dist., supra note 82, 37 Cal. App. 4th at 1334; see also Adams-Arapahoe Sch. Dist. No. 28-J v. GAF Corp., 959 F.2d 868, 871–73 (10th Cir. 1992) (applying Colorado law); authorities cited at West’s 241 LIMITATIONOFACTIONS, k55 (1)(2).
structure; the mere presence of asbestos (e.g., in a relatively inert tile product) did not.\textsuperscript{86}

\textbf{IV. THE ECONOMIC LOSS RULE AS APPLIED TO THE WORK OF CONTRACTORS}

For builders, general contractors, and trade contractors, the economic loss rule can be a boon and a bust. The rule protects contractors from unanticipated tort claims, but also may prevent them from recovering repair and replacement costs caused by defective work, services, or products of others.\textsuperscript{87}

Construction involves the delegation and allocation of responsibility by contract. Within the pyramid of this process, however, many of the participants are not in privity of contract. The defective work and products\textsuperscript{88} of a participant can cause economic damage to other providers, and cause upstream contractors or contractors responsible for adjacent work to be targets of claims involving damages for various deficiencies.\textsuperscript{89}

\begin{footnotesize}
\begin{enumerate}
\item Adams-Arapahoe, supra note 85, at 872; see also Comment, Asbestos in Schools and the Economic Loss Doctrine, 54 U. CHI. L. REV. 277, 298–300 (1987).
\item See, e.g., Pulte Home Corp. v. Parex, Inc., 579 S.E.2d 188 (Va. 2003) (builder repaired cladding defects, but was denied right to pursue indemnity claim against manufacturer in contract due to lack of privity and in tort due to the economic loss rule).
\item Construction providers do not manufacture or supply “products,” at least for strict liability purposes. See Restatement (Third) of Torts: Products Liability §19, subd. (b) (1998) (“services, even when provided commercially, are not products” and are governed by the law of negligence.) For purposes of discussion within this section, construction providers furnish services, rather than products.
\item It is important for contractors of all stripes to be able to quantify financial exposure for construction defects and deficiencies, especially to the extent insurance carriers will deny coverage. The economic loss rule contributes to this
\end{enumerate}
\end{footnotesize}
applied, the economic loss rule often prohibits direct actions by construction participants against those within the pyramid who are principally responsible for construction defects, but against whom the injured parties have no contract remedies. The overarching policy question is: Where do contract rights stop and tort rights begin? It is at that point that the economic loss rule is no longer applied. Courts take different routes and weigh factors differently in finding this crossroads, and therefore often arrive at different locations.

A threshold question is whether the the deficient work (and its contractual setting) concerns providing services or a product. If the contract is determined to be for (or primarily for) a product, the manufactured product rules apply as to economic damages. Beyond the product-service inquiry, the analysis where construction services are involved to determine the limits of the rule differs slightly from that grappled goal, although in rough and irregular fashion.

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90 Linden v. Cascade Stone Co., 699 N.W.2d 189 (Wis. 2005) (in Wisconsin, the ELR does not apply to pure services contracts; residential house contract between owner and builder analyzed under totality-of-the-circumstances test determined predominate purpose of contract was for a product even though substantial services involved, thus ELR barred owner negligence claims against subcontractors); but see Ins. Co. of N. Am. v. Cease Elec. Inc., 688 N.W.2d 462 (Wis. 2004) (ELR not applicable to services; barn owner’s claim for negligence against electrician for purely economic losses was not subject to ELR where electrician provided services, not a product; court noted service contracts don’t have the same body of law (and protections) as UCC actions, so no need to limit the remedy to the contract).

91 See 1325 North Van Buren, LLC v. T-3 Group, Ltd., 716 N.W.2d 822 (Wis. 2006) (owner-builder contract for commercial condo building with attached garages was predominantly for a product, not services, so the ELR applied). See also discussion in Part III of this Chapter, supra.
by courts concerning manufactured products. 92 The inquiry begins with whether privity, or its equivalent, exists. 93 As part of the privity inquiry, most courts compare the damages claimed to the scope of work and duties the service provider has undertaken contractually, regardless of whether privity with the plaintiff exists. 94 Next, courts look to see if the facts take the dispute out of the realm of contract: first, whether damage to “other property” outside of the scope of the work undertaken by the putative defendant has occurred, and second, if the defective work and damages from such work can be related to an independent duty recognized in tort.

While a few courts deem lack of privity an absolute bar, 95 most states perceive privity as a starting point to discuss whether the damages claimed arise only from the contractual scope of services and whether the damages arise from the presence or absence of an independent duty.

If the plaintiff and the construction service provider are parties to a contract, and the economic damage claimed is to, or arises from, the

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92 The agreements of construction service providers are, for instance, generally not governed by the U.C.C.
93 If the parties are in privity of contract, most courts apply the “contract economic loss rule,” barring negligence claims and claims for the nonbargained-for economic damages allowed in tort actions when contract remedies govern the transaction. See Ports, supra note 47; see also authorities cited at West’s NEGLIGENCE, k321, 463.
94 If the damages arise solely from deficiencies in the contractual performance, many courts find, in effect, a “substitute for privity” or privity equivalent, and bar a negligence claim. See citations referenced in notes 97-98, infra.
95 See Sensenbrenner v. Rust, Orling & Neal Architects, Inc., 374 S.E.2d 55 (Va. 1988) (homeowners’ action against pool subcontractor and architect dismissed for lack of privity). This holding is consistent with the law in the Old Dominion. See discussion relating to claims against design professionals and indemnification claims, at note 127, infra.
contractual (or subcontractual) subject matter of the work, the economic loss rule generally bars recovery in negligence for economic damages. If the plaintiff is not in privity with the provider of defective work, but the deficient work and damages arising from the deficient work are the subject matter of the provider’s contract, the rule will also generally bar economic damages arising from a negligence claim alleging damages arising from the same deficient work. Some courts arrive at this result by fashioning a

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97 J. Kinson Cook of Georgia, Inc. v. Heery/Mitchell, 644 S.E.2d 440 (Ga. Ct. App. 2007) (contractor’s negligence claim against non-privity construction manager – essentially for negligent project supervision – barred by ELR where CM’s only duty was contractual to the school district, no independent tort duty); Ass’n of Apartment Owners ex rel. its Bd. of Dirs. v. Venture 15, Inc., 167 P.3d 225 (Haw. 2007) (HOA negligence claims involving only economic losses against subcontractor for defective floor slabs barred by ELR where contract was between developer/contractor – no privity); cf. Real Estate Mktg., Inc. v. Franz, 885 S.W.2d 921 (Ky. 1994) (claim by remote purchaser was barred; court noted that “tort recovery is contingent upon damage from a destructive occurrence as contrasted with economic loss related solely to diminution in value’’); see also Nastri v. Wood Bros. Homes, 690 P.2d 158, 163–64 (Ariz. Ct. App. 1984) (despite latent structural defects, remote purchasers could not recover from the builder on a negligence theory, but could recover for implied-in-law warranty of habitability); Jardel Enters., Inc. v. Triconsultants, Inc., 770 P.2d 1301 (Colo. Ct. App. 1988) (restaurant owner could not bring negligence claim against subcontractor for lost profits resulting from delayed opening of restaurant due to initial construction of the restaurant at the wrong location); Calloway, supra note 14, at 1261-62 (townhouse owners’ claims against subcontractors for economic losses caused by defective roofing and siding did not state cause of action in negligence); but see Lord v. Customized Consulting Specialty, Inc., 643 S.E.2d 28 (N.C. Ct. App. 2007).
nexus or chain-of-contracts analysis, in order to treat non-privity relationships as a substitute for privity. So, again, privity (or its equivalent) matters when the damages arise purely from deficiencies in the contractual undertaking.

To many courts, economic injuries caused by the defective work but visited upon “other property” may be enough to allow a negligence action to proceed, but the courts are stingy with this exception. Damage to “other property” generally means property unrelated to the service provider’s work.

(homeowner’s negligence claim involving only economic losses against truss subcontractor were not barred by ELR because parties were not in privity).

98 See, e.g., Indianapolis-Marion County, supra note 72 (library’s negligence and negligent misrepresentation claims involving purely economic damages due to structural deficiencies in parking garage against remote engineer and subcontractors were barred by ELR because of “network or chain of contracts”); Stelko Elec., Inc. v. Taylor Cmty. Sch. Bldg. Corp., 826 N.E.2d 152 (Ind. Ct. App. 2005) (contractor’s negligence claim for purely economic losses against construction manager barred by ELR because there was no privity, and contractor did not show that CM had, or should have had, actual knowledge of contractor’s reliance on the schedules prepared by CM).

99 See Town of Alma, supra note 26, at 1264 (citing cases) (town was in privity with contractor, other plaintiffs were not; the court made no distinction based on privity, but adopted and applied a “workable” economic loss rule based on the extent of contractual duty and lack of independent tort duty and relied on it to deny liability for the repair of construction defects and other consequential economic damages. The court acknowledged that the rule would not apply to damages from separate torts).

100 See, e.g., Aas, supra note 14, at 1130 (citing cases) (homeowners’ association and individual homeowners could not bring negligence actions against developer, contractor, or subcontractors for construction defects or diminution in value, unless damage to “other property” could be shown. “Any construction defect can diminish the value of a house. But the difference between price paid and value received, and deviations from standards of quality that have not resulted in property damage or personal injury, are primarily the domain of contract and warranty law or the law of fraud, rather than of negligence”); Am. Stores Props., Inc. v. Spotts, Stevens & McCoy, Inc., No. 05-1461, 2009 WL 2513446 (E.D. Pa. August 13, 2009) (owner’s negligence claims involving purely economic loss against non-privity subcontractors and suppliers for failure of retaining wall were barred by ELR; owner bargained for the entire retaining wall, not a component, so damage to the wall was not damage to other property).
Thus, the “incorporation” and “integration” analysis concerning manufactured products is similarly employed in claims against and among service providers.\(^\text{101}\)

Perhaps the most oft-cited exception to the bar of the economic loss rule is the breach by the defendant of a separate, independent tort duty.\(^\text{102}\)

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\(^{101}\) See discussion in Part III, *supra*, of this article as to the incorporation of products and services to form an “integrated product”—the structure. *See also* Lexington Ins. Co. v. W. Roofing Co., 316 F.Supp.2d 1142 (D. Kan. 2004) (property insurer’s negligence claim against roofing contractor for only economic losses barred by ELR; court took broad “integrated building” approach and found that defective overflow scuppers were part of an integrated roofing drainage system, which was indistinguishable from the entire building, so no damage to “other property”); Ass’n of Apartment Owners, *supra* note 97, at 225 (in HOA’s negligence claim against remote subcontractor, damages to windows, tile, termites, and walls did not constitute damage to “other property”; the court seemed to follow integrated product rule without naming it such); Blahd v. Richard B. Smith, Inc., 108 P.3d 996 (Idaho 2005) (homebuyers’ negligence claims against developer and geotechnical engineer barred by ELR even though house damaged due to foundation settlement because the “integrated product” is the lot and the house that was the subject of the transaction); *Linden, supra* note 90, at 189 (where water intrusion due to deficient stucco and roof shingling caused mold and air-quality damage in house, court held that the cladding and HVAC systems were integrated into a functioning structure and thus property owners were barred from seeking tort remedies from subcontractors). *But see Comptech Int’l, supra* note 61 (tenant sued landlord for negligent selection of contractor, who, in renovating tenant space in warehouse, damaged electrical and computer equipment; the court held that the contract was for a service – the renovation – and suggested that services do not involve “other property,” however to the extent that the warehouse was the object of the contract, the wiring and computers were “other property”); McDonough v. Whalen, 313 N.E.2d 435, 439 (Mass. 1974) (owner could recover against subcontractor for negligent design and installation of septic system and recover economic damages despite lack of privity; sewage “flowing over their land” is damage to “other property” for purposes of avoiding the economic loss rule. The implied warranty of habitability was not discussed).

\(^{102}\) See *Town of Alma, supra* note 26, and cases cited therein; *see also United Int’l Holdings, supra* note 9 (deliberate or negligent conduct inducing reliance constitutes an independent tort); Oates v. JAG, 333 S.E.2d 222, 224–26 (N.C. 1985) (remote homeowner may recover economic damages against original builder in negligence action); Olympic Prods. Co. v. Roof Sys., Inc., 363 S.E.2d 367 (N.C. App. 1988) (manufacturer’s failure to properly inspect installation or thereafter to report improper installation was negligent, and economic damages were allowed);
But here, also, courts are wary.\textsuperscript{103} If the plaintiff is in privity of contract with the defendant, breach of the obligations of the contract ordinarily cannot be relied upon to support an action in negligence; the parties have already selected a contractual remedy. Failure to perform one’s contract, even carelessly, without more will generally not support a negligence action for economic damages.\textsuperscript{104} On the other hand, whether privity exists or not, a plaintiff may successfully avoid the bar of the economic loss rule by demonstrating that the defendant breached a tort duty independent of (although normally related to) the service provider’s contract.\textsuperscript{105}

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Brown v. Fowler, 279 N.W.2d 907 (S.D. 1979) (remote residence purchaser has a negligence claim against builder for economic damages due to breach of separate duty. This was not an action on an implied warranty of habitability, which under South Dakota law extends only to the initial purchaser); authorities cited at West’s \textsuperscript{379} Torts, k5, 1251.

\textsuperscript{103} See Corporex Dev. & Constr. Mgt., Inc. v. Shook, Inc., 835 N.E.2d 701 (Ohio 2005) (owner’s negligence claim against subcontractor for purely economic loss was barred by ELR where subcontractor’s underlying duties arose from its subcontract with the general contractor, and subcontractor’s mere knowledge of existence of owner was not enough to create independent tort duty).

\textsuperscript{104} See, e.g., Palmetto Linen Service, supra note 50, at 129 (applying South Carolina law), quoting from Kennedy, supra note 21 (“the ‘economic loss’ rule will still apply where duties are created solely by contract”) (emphasis in original); Ports, supra note 47; see also authorities cited at West’s \textsuperscript{313A} Products Liability, k17.1.

\textsuperscript{105} See Public Bldg. Auth. of Huntsville v. St. Paul Fire & Marine Ins. Co., 80 So. 3d 171 (Ala. 2010) (subcontractor was not entitled to summary judgment on owner’s negligence claims for purely economic loss because ELR does not apply in the commercial construction context in Alabama, rather the court looks to whether a duty exists (six factors are looked at) between parties not in privity with each other); A.C. Excavating v. Yacht Club II Homeowners Ass’n, Inc. 114 P.3d 862 (Colo. 2005) (en banc) (HOA’s negligence claim against subcontractors for purely economic losses not barred by ELR because subcontractors owed HOA a separate “builder’s duty” independent of the subcontracts as court interpreted a Colorado statute); Consol. Hardwoods, Inc. v. Alexander Concrete Constr., Inc., 811 P.2d 440, 443 (Colo. Ct. App. 1991) (owner’s negligence claim against subcontractor allowed because independent duty was breached); Juliano v. Gaston, 455 A.2d 523.
To meet the “independent tort duty” requirement, many plaintiffs take advantage of a policy distinction between commercial and residential homeowner projects. In construction defect cases, many courts distinguish on public policy grounds between homeowner residences and commercial projects. Some states have enacted statutes to protect residential owners by specifically allowing negligence claims involving only economic losses.\(^\text{106}\)

Most states recognize implied-in-law warranties in the sale of new residences by builder-vendors,\(^\text{107}\) which in legal analysis is a first cousin to a tort claim. A few courts recognize a general exception to the economic loss rule in negligence actions against builders and subcontractors arising out of new residential construction. In *Kennedy v. Columbia Lumber & Manufacturing Co.*,\(^\text{108}\) the Supreme Court of South Carolina held that to apply the economic loss rule to insulate contractors from liability for building code violations would be “repugnant” to South Carolina’s public policy.\(^\text{109}\)

While the principal example within the *Kennedy* opinion was the residential builder whose work

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\(^{106}\) Greystone Homes, Inc. v. Midtec, Inc., 86 Cal. Rptr. 3d 196 (Cal. Ct. App. 2008) (ELR was abrogated by “Right to Repair Act” for homeowner’s negligence claim against plumbing contractor and manufacturer involving purely economic damages); Olson v. Richard, 89 P.3d 31 (Nev. 2004) (homeowner’s negligence claim against stucco subcontractor was not barred by ELR where statute provided a cause of action separate from the common law).

\(^{107}\) Many courts have recognized implied-in-law construction-related warranties to homeowners, including implied warranties of habitability and of workmanlike construction. These are frequently measured by minimum building codes. Although related to negligence actions, these warranties permit a cause of action based on a promise implied-in-law, thereby avoiding the economic loss rule.

\(^{108}\) *Supra* note 71.

\(^{109}\) *Id.* at 734.
did not meet minimum building codes,110 this court later expanded its holding to include developers and those providing defective professional construction services in the new home market.111

For those jurisdictions that recognize negligence actions against builders and trade contractors, regardless of privity, upon a showing of the breach of an “independent tort,” some plaintiffs have found a valuable ally in the state building codes. A violation of a minimum building code is generally regarded as more than “mere discomfort.”112 Such transgressions have proven durable in supporting claims based in negligence113 as well as

110 Id. The precise holding in *Kennedy* did not concern a general contractor. A supplier who acquired title to a new residence by lien foreclosure (against the builder) and who then sold the residence to the Kennedys was held not to be a builder-vendor for purposes of the implied warranty of habitability. Nevertheless, the cause of the lawsuit—the general contractor’s defective foundation—became the launching pad for the court to announce its rejection of the economic loss rule in the new home residential construction context where the work of contractors did not meet minimum building codes. Code compliance was determined to be a separate duty actionable in negligence, and economic damages were recoverable for the breach of that separate duty. *Id.*

111 *Id.* at 735; see also *Beachwalk Villas Condo. Ass’n v. Martin*, 406 S.E.2d 372 (S.C. 1991) (condominium owners could sue architect for negligent design and contract administration). The court’s negligence liability net captures other construction service providers, including subcontractors and suppliers.

112 Compare *Sullivan v. Smith*, 289 S.E.2d 870, 873 (N.C. Ct. App 1982) (general contractor and masonry subcontractor were both liable in negligence action for economic damages, for breach of independent tort duty to build fireplace and chimney to minimum building codes), with *Ohlendorf*, *supra* note 81 (remote homeowner’s claim against builder did not sound in negligence but in implied warranty of habitability although court held it was “mere discomfort” to have chimney pull away from house due to defective construction).

113 See *Cosmopolitan Homes, Inc. v. Weller*, 663 P.2d 1041 (Colo. 1983) (en banc) (fourth purchaser may recover economic damages in negligence from builder based on latent defects in residence); *Kristek v. Catron*, 644 P.2d 480 (Kan. Ct. App. 1982) (builder was liable to remote purchaser in negligence for economic damages caused by defective roof). *Ass’n of Apartment Owners, supra* note 97. (HOA’s negligence claims against remote subcontractor involving only economic losses
implied-in-law warranties (such as habitability).114

The building code standard can prove legally powerful, because repair costs to meet it are certain and diminution in value damages to a non-code compliant home are easily understood. Many of these cases are fought at and settled after dispositive motions, as fact-finders are consumers and tend to sympathize (if not empathize) with project end users, who generally do not select structural materials or draft disclaimers or remedy limitations within the construction contract.

V. THE ECONOMIC LOSS RULE AS APPLIED TO PROFESSIONAL CONSTRUCTION SERVICES

Professional services in the construction context are supplied by architects, engineers, and related consultants.115 Their negligent performance creates a conundrum for the economic loss rule.

Negligent professional services, including design and construction administration services, can economically injure any construction participant

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114 See Keyes v. Guy Bailey Homes, Inc., 439 So.2d 670 (Miss. 1983) (remote purchaser may recover in negligence for economic damages and for breach of implied-in-law warranties against builder despite lack of privity, economic loss rule not discussed); Moxley v. Laramie Builders, Inc., 600 P.2d 733 (Wyo. 1979) (negligence action and implied warranty of habitability claim by remote home purchaser against builder for economic damages caused by latent defects were allowed, even though builder’s work was accepted by first owner before damages were made manifest. Wyoming also extends the implied warranty to second purchaser). See also authorities cited at West’s 272 NEGLIGENCE, k1025.

115 Hydrologists, geotechnical engineers, and geologists are examples of related professional consultants. Licensure or registration with a state governing board normally determines a consultant’s status.
or end user, from the owner’s tenant to a second-tier supplier. The harm can be direct or involve principles of indemnification. The foreseeable class of economically-damaged plaintiffs with legitimate negligence claims against design professionals is large, greater even perhaps than against a negligent trade contractor. The set of individuals adversely affected economically by a contractor’s faulty work normally is limited to the users of such project, whereas a design professional’s negligence can cause economic losses to owners, users, and project participants.

The scope of services undertaken by a design professional directly affects the breadth of the duty required of the professional. The architect or engineer must meet the standard of care for the scope of services undertaken. To recover in negligence against a design professional, there must be proof of a breach of the standard of care. Similarly, most contract-based actions against design professionals also require plaintiffs to demonstrate a breach of the professional standard of care assumed for the activity in question.¹¹⁶ On these points, jurisdictions generally agree. Beyond this legal framework, courts part company. Who may and who may not maintain a negligence action against a design professional for economic loss is a matter as much of local legal inference as legal analysis.¹¹⁷

¹¹⁶ A full discussion of architect responsibility to its client is beyond the scope of this article.
¹¹⁷ The discussion in this paper concerns economic losses sustained by owners, end users, and project participants. Instances of bodily injury and physical property damage can also occur, but are outside the scope of this article. The issue of
It is in the context of construction design professional services that the application of the economic loss rule is most difficult to reconcile. No analytical theme predominates. It is almost as if someone had written the words “privity,” “special relationship,” “foreseeability,” “supervising architect,” “no duty,” and “covered by another contract” on the six sides of a die, and then passed the die to appellate judiciaries of various states to roll. The only constant is that economic damages are the subject of the claim.

Some courts hold that if an owner has reached a bargain with the design professional as to the scope and standard of professional services, the owner must look solely to that agreement for resolution of economic disputes.\textsuperscript{118} Courts that adopt this view require a special relationship or damage to property “other than the product itself,” which pervades the discussion of the economic loss rule in the manufactured product context, is alive in some analyses, but is most often recast in the professional services context as the issue whether the damage was contemplated by “a contract,” and therefore should be resolved by looking only to contractually-available remedies.

\textsuperscript{118} See, e.g., Maine Rubber Int’l v. Envtl. Mgmt. Group, Inc., 298 F. Supp. 2d 133 (D. Me. 2004) (commercial property purchaser’s negligence claim against engineering firm in privity involving negligent environmental site assessment was barred by ELR where only economic losses were claimed; no professional services exception to ELR for an engineering firm where both parties were sophisticated commercial entities); Flagstaff Affordable Housing Ltd. P’ship v. Design Alliance, Inc., 223 P.3d 664 (Ariz. 2010) (en banc) (public housing owner’s negligence claims against architect in privity involving purely economic loss were barred by ELR; court also said that it would not apply ELR to negligence actions against architects not in privity, as architects and engineers should not be treated differently than contractors); City Express, Inc. v. Express Partners, 959 P.2d 836 (Haw. 1998) (economic loss rule barred owner’s negligence action against a design professional where the two were in privity of contract); Martusciello v. JDS Homes, Inc., 838 N.E.2d 9 (Ill. App. Ct. 2005) (homeowner’s negligence claim against its architect for purely economic losses was barred by ELR because there was no independent tort duty owed by architect; architect’s service produced a tangible result (i.e. plans) unlike an accountant or attorney who produces tangible and intangible results, neither of which are protected by the ELR); Terracon Consultants W., Inc. v.
unique circumstance between the claimant and the design professional to support an action alleging professional negligence as well as the breach-of-contract claim. Other jurisdictions allow a party in privity with a design professional, such as an owner, to bring simultaneously an action for breach of contract and one for professional negligence. This can be significant, as

Mandalay Resort Group, 206 P.3d 81 (Nev. 2009) (ELR barred owner’s professional negligence claims against owner’s geotechnical engineer where claim involving negligent design of foundations for a casino alleged only purely economic losses and no personal injury or property damages) (case of first impression); Brushton-Moira Cent. Sch. Dist. v. Alliance Wall Corp., 600 N.Y.S.2d 511 (App. Div. 1993) (where panels selected by architect were inappropriate for school project, the contract action was allowed and the tort action dismissed); Key Int’l Mfg. v. Morse/Diesel, Inc., 536 N.Y.S.2d 792 (App. Div. 1988) (owner cannot sue architect or prime contractor in negligence for economic loss since the damages sought are of the type remediable in contract). See also authorities cited at West’s 272 NEGLIGENCE, k1251; West’s 184 FRAUD, k13(3).

119 See, e.g., Bldg. Erection Servs. Co., L.C. v. Am. Bldgs. Co., No. 09-2104-CM, 2010 WL 2667201 (D. Kan. June 29, 2010) (applying Missouri law) (subcontractor’s negligence claim for purely economic losses against second tier subcontractor for faulty design of sheet metal roof was not barred by ELR where defendant owed a professional duty to first tier subcontractor apart from the contractual duty); Donatelli v. D.R. Strong Consulting Eng’rs, Inc., 261 P.3d 664 (Wash. Ct. App. 2011), cert. pending, (engineer owed owners a duty apart from the contract under the independent duty doctrine; engineer’s motion for summary judgment was properly denied). But see EBWS, LLC v. Britly Corp, 928 A.2d 497 (Vt. 2007) (ELR barred owner’s claim against design-builder, the court declined to apply the special relationship exception to design-builder where the design-builder did not hold itself out as a licensed architect and the separate duty doctrine applies only to professional licensees).

120 See, e.g., Consol. Edison Co. v. Westinghouse Elec. Corp., 567 F.Supp. 358 (S.D.N.Y. 1983) (architect was liable to owner in contract and in negligence); Kellogg v. Pizza Oven, Inc., 402 P.2d 633, 635 (Colo. 1965) (claim sounds in negligence separate from contract); Robinson Redevelopment Co. v. Anderson, 547 N.Y.S.2d 458 (App. Div. 1989) (negligence action allowed); Housing Vermont v. Goldsmith & Morris, 685 A.2d 1086 (Vt. 1996) (malpractice action allowed when site grading plan was insufficient for construction purposes). See also authorities cited at West’s 272 NEGLIGENCE, k321. Design professionals may also be individually liable in negligence even though they practice through a corporation. See Moransais, supra note 29 (owner was allowed to bring a negligence action against the individual professional engineers and a contract action against the engineering services company with which the owner had contracted); Crown Castle.
statutes of limitation and other procedural rules vary between contract and
tort-based causes of action. Also, contractual disclaimers and limitations
of liability may govern the contract action, but not the action for professional
negligence.

For third parties not in privity with the design professional, the
reported cases go both ways, and the legal bases for the decisions are
mixed. A number of courts hold that no action for economic losses may be
maintained by a third party against a design professional in the absence of
privity, regardless of the scope of its services or the foreseeability of
harm. In the majority of these jurisdictions, the analysis for applying the
economic loss rule to bar recovery is generally described as the “no

\begin{footnotesize}
USA Inc. v. Fred A. Nudd Corp., No. 05-CV-6163T, 2008 WL 3841298 (W.D.N.Y.
August 13, 2008) (cell tower owner’s professional negligence claim for purely
economic losses against designer/constructor of tower was not barred by ELR, even
when court found the mixed contract was predominantly one for the sale of goods);
see also discussion in Chapter 7 of this text.

1992) (owner’s contract claim was barred by statute of limitations but its tort action
was allowed to proceed).

1989) (exculpatory terms within the owner/architect contract did not bar a claim for
professional negligence); Bd. of Educ. v. Sargent, Webster, Crenshaw & Folley, 539
not absolve architect from duty to alert owner of defective construction).

Idaho, ELR generally applies to negligence claims involving purely economic loss,
with exceptions for “special relationships” and “unique circumstances”; ELR and
lack of privity barred homeowner’s negligence claims against manufacturer of a wall
panel system and the engineer that reviewed the system’s plans where there was
no special relationship or unique circumstance); Indianapolis-Marion, supra note
98 (in owner’s negligence claim against remote engineer, engineer’s design was
considered part of the “product” ordered by owner, renovation of a library, thus no
damage to “other property” due to engineer’s negligent design, and ELR applied);
See also authorities cited at West’s 272 NEGLIGENCE, k1205(4), 1251.
\end{footnotesize}
independent duty” or “covered by another contract” side of the gambling die rather than the “privity” side.\textsuperscript{124}

These courts do not dismiss third-party actions because they lack privity as such, but instead invoke a “privity-substitute” analysis to deduce that plaintiffs not in privity are nevertheless not owed a duty by the design professional outside of the professional’s bargained-for project contractual responsibilities – thereby cutting off tort damages.\textsuperscript{125} To these judges, it is

\textsuperscript{124} See, e.g., Widett v. U.S. Fid. & Guar. Co., 815 F.2d 885, 886–87 (2d Cir. 1987) (absent privity, architect was not liable for professional negligence to subcontractors that detrimentally relied on erroneous site plans); Fireman’s Fund Ins. Co. v. SEC Donohue, Inc., 679 N.E.2d 1197 (Ill. 1997) (economic loss rule applies to engineers and architects, barring any recovery in tort for economic losses); 2314 Lincoln Park West Condo. Ass’n v. Mann, Gin, Ebel & Frazier Ltd., 555 N.E. 2d 346 (Ill. 1990) (same); Floor Craft Floor Covering, Inc. v. Parma Cnty. Gen. Hosp. Ass’n, 560 N.E.2d 206 (Ohio 1990) (in accord with Widett). See also RLI Ins. Co. v. John H. Hampshire, Inc., 461 F. Supp. 2d 364 (D. Md. 2006) (surety’s negligence claim involving purely economic damages against architect was barred by ELR where surety failed to show an “intimate nexus” between surety and architect that could establish a duty); Plourde Sand & Gravel v. JGI E., Inc., 917 A.2d 1250 (N.H. 2007) (gravel supplier’s negligence claim against engineer for purely economic losses barred by ELR because no special relationship existed between engineer and supplier and imposing a tort duty here would disrupt the contractual relationships among the various parties); Border Brook Terrace Condo. Ass’n v. Gladstone, 622 A.2d 1248 (N.H. 1993) (economic loss doctrine applied); \textit{Am. Towers Owners, supra} note 58, at 1192 (same).

\textsuperscript{125} See, e.g., BRW, Inc. v. Dufficy & Sons, Inc., 99 P.3d 66 (Colo. 2004) (structural steel subcontractor lacking privity was barred by ELR from recovering in negligence against design engineer or inspecting engineer for only economic losses because engineers’ contracts were “interrelated” to the project and thus to the steel subcontract, no tort duty of engineer or inspector existed outside of the interrelated project contracts. The court noted that although the subcontractor could not bargain directly with engineer, subcontractor could bargain for allocation of risks of engineers’ negligence within its subcontract with general contractor); Fleischer v. Hellmuth, Obata & Kassabaum, Inc., 870 S.W.2d 832 (Mo. Ct. App. 1993) (architect had no duty to construction manager); Rissler & McMurray Co. v. Sheridan Area Water Supply Joint Powers Bd., 929 P.2d 1228 (Wyo. 1996) (engineer’s duty under its contract with the water board did not extend to the contractor either under a design negligence theory or a negligent misrepresentation theory); \textit{but see} Miller v. Big River Concrete, LLC, 14 S.W.3d 129, 134 (Mo. Ct. App. 1999).
often at least noteworthy that the “inter-related” project contracts and
subcontracts among contractors, owners, design professionals, and other
participants contain provisions (including limitations) relating to and often
allocating foreseeable economic losses.\textsuperscript{126} At least one jurisdiction, however,
has not employed the economic loss rule (denominated as such) in
professional negligence actions, but instead has relied consistently and
strictly upon privity of contract to reject all third-party causes of action for
professional negligence.\textsuperscript{127}

Other jurisdictions allow parties not in privity to assert professional
negligence actions for economic damages.\textsuperscript{128} The legal basis cited in these

\textsuperscript{126} See Berschauer/Phillips Constr. Co. v. Seattle Sch. Dist. No.1, 881 P.2d 986
(Wash. 1994) (en banc) (limiting contractor’s recovery of purely economic damages
to remedies provided and disclaimed in contract with owner); Excel Constr., Inc. v.
HKM Eng’g, Inc., 228 P.3d 40 (Wyo. 2010) (contractor’s negligence claim against
town engineer not in privity was barred by ELR; parties to construction contracts
have opportunities to allocate economic risks, therefore no need for special
protections of tort law).

\textsuperscript{127} See Bryant Elec. Co. v. City of Fredricksburg, 762 F.2d 1192 (4th Cir. 1985)
(there is no cause of action for a contractor to recover against an engineer for
economic loss in the absence of privity under Virginia law); Blake Constr. Co. v.
Alley, 353 S.E.2d 724, 727 (Va. 1987) (same). Unlike other jurisdictions, Virginia is
uniformly strict in its privity requirement, for all professionals. See, e.g.,
Copenhaver v. Rogers, 384 S.E.2d 593 (Va. 1998) (privity required in claim against
attorney). Virginia also requires privity for most indemnification actions. See Parex,
\textit{supra} note 87; Ward v. Ernst & Young, 435 S.E.2d 628 (Va. 1993) (action against
CPA requires privity).

\textsuperscript{128} See \textit{Bldg. Erection Servs.\textit{, supra} note 119 (applying Missouri law, first tier
subcontractor’s negligence claim for purely economic losses against second tier
subcontractor for faulty design of sheet metal roof was not barred by ELR where
defendant owed a professional duty to plaintiff apart from the contractual duty;
Riggs-Brewer Indus., Inc. v. Shelton Senior Housing, Inc., No. CV044000365, 2006
WL 1738231 (Conn. Super. Ct June 6, 2006) (contractor’s claim against architect
not barred by ELR where contract between architect and owner was for professional

decisions rests in the reasonable foreseeability that harm may result to a particular group from the design professional’s negligent conduct. This foreseeability is implicitly recognized as a “substitute for privity,” which creates a duty to use due professional care.

Some courts distinguish between design services that predate the commencement of construction (preparation of plans and specifications) and professional services performed during the project (contract administration). Several of these opinions refer to a “special relationship” between an architect who has contract administration duties and the project participants. California was one of the first jurisdictions to recognize that a

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services and not governed by the UCC); Affiliated FM Ins., supra note 4 (monorail concessionaire’s claim against engineer for negligent design of monorail repair that led to a fire was not barred by ELR because engineer owed an independent duty to the concessionaire arising out of safety concerns (first time Wash. Supreme Ct. held an engineer owes a independent duty of care). See generally Matthew S. Steffey, Negligence, Contract, and Architect’s Liability for Economic Loss, 82 Ky. L.J. 659, 662 (1993); Annotation, Tort Liability of Project Architect for Economic Damages Suffered by Contractor, 65 A.L.R.3d 249 (1975).

129 See, e.g., Consult Urban Renewal Dev. Corp. v. T.R. Arnold & Assocs., No. 06-1684 (WJM), 2009 WL 1969083 (D.N.J. July 1, 2009) (economic loss rule in NJ does not apply to services contracts, did not bar construction manager’s negligence claims against remote inspector of pre-manufactured housing units where inspector owed plaintiff a duty); Ins. Co. of N. Am. v. Town of Manchester, 17 F. Supp. 2d 81, 84 (D. Conn. 1998) (applying Connecticut law) (“foreseeability is key to the determination of a cause of action in negligence”).

“supervising architect,” who holds the power of the purse against the contractor, has power “tantamount to life or death.” Other jurisdictions decline to require the “special relationship” of power, and enforce provable economic loss actions against construction design professionals for various sorts of professional conduct.

Sch. Dist., No. 09CA8, 2010 WL 2172380 (Ohio Ct. App. May 20, 2010) (adopted rule that design professional who exerts “excessive control” over contractors [serving as a substitute for privity] may be liable to contractor for economic damages); Tommy L. Griffin Plumbing & Heating Co. v. Jordan, Jones & Goulding, Inc., 463 S.E.2d 85 (S.C. 1995) (engineer owed contractor a duty not to negligently design or negligently supervise project and was liable to contractor for economic losses even absent privity). But see Recreational Design & Constr. Inc. v. Wiss, Janney, Elstner Assocs., 820 F. Supp. 2d 1293 (S.D. Fla. 2011) (contractor’s claim against engineer was not barred by economic loss rule, but court found no duty owed by engineer to contractor where no allegations that engineer exercised decision-making authority over contractor, that they had any contact with each other, or that a contractual nexus existed).

Los Angeles Testing, supra note 33, at 136.

See Bagwell Coatings, Inc. v. Middle S. Energy, Inc., 797 F.2d 1298 (5th Cir. 1986) (contractor’s negligence action allowed against architect who was aware contractor would be harmed if architect did not properly perform his contractual duties to owner); Mayor & City Council v. Clark-Dietz & Assocs. Eng’rs, 550 F. Supp. 610, 623 (N.D. Miss. 1982) (architect owes duty to those parties proximately suffering economic losses as a result of architect’s negligent design); Stone’s Throw Condo. Ass’n v. Sand Cove Apartments, Inc., 749 So. 2d 520, 522 (Fla. Dist. Ct. App. 1999) (architect’s liability for failure to design to state minimum building code and for negligent misrepresentation are not barred by economic loss rule despite lack of privity); Moransais v. Heathman, 744 So. 2d 973, 983 (Fla. 1999) (“the mere existence of such a contract should not serve per se to bar an action for professional malpractice”). But see R.H. Macy & Co. v. Williams Tile & Terrazo, Inc. 585 F. Supp. 175, 180 (N.D. Ga. 1984) (applying Georgia law, architect owes no tort duty to subcontractor if their relationship does not “approach” that of privity or reliance).

See, e.g., Shekhter v. Seneca Structural Design, Inc., 18 Cal. Rptr. 3d 83 (Ct. App. 2004) (apartment owner’s claim against engineer for negligent design of post-tensioning system allowed in absence of privity because of independent tort duty; design and engineering of a post-tensioned system to reinforce a structure is not a “product” under California ELR, which requires damage to “other property”); Magnolia Constr. Co. v. Mississippi Gulf S. Eng’rs, Inc., 518 So. 2d 1194, 1202 (Miss. 1988) (third parties are entitled in Mississippi to rely on a design professional’s contractual obligation to the owner and may recover economic losses.
In allowing negligence actions to proceed against design professionals in the absence of privity, courts follow precedent established in other professional liability situations.\textsuperscript{134} The construction process, however, is viewed by some jurisdictions as a different area of commerce, needing different legal rules. Illinois, for instance, allows nonprivity negligence actions against professionals and nonprofessionals outside the construction process, including accountants,\textsuperscript{135} attorneys,\textsuperscript{136} and even stock market indexing services,\textsuperscript{137} but not against architects.

VI. THE ECONOMIC LOSS RULE AS APPLIED TO THE TORT OF NEGLIGENT MISREPRESENTATION

The separate negligence-based tort of negligent misrepresentation may be asserted against any construction project participant who

\textsuperscript{134} See, e.g., \textit{Town of Manchester}, supra note 129, (design professionals, like other professionals such as accounting firms and attorneys, are liable for economic damages regardless of privity where reliance by the plaintiff was reasonably foreseeable); Seigle v. Jasper, 867 S.W.2d 467 (Ky. Ct. App. 1993) (Restatement applied to sustain a claim against title abstractor by claimant not in privity with defendant).

\textsuperscript{135} Congregation of the Passion, Holy Cross Province v. Touche Ross & Co., 636 N.E.2d 503 (Ill. 1994); \textit{see also} Ingram Indus., Inc. v. Nowicki, 527 F. Supp. 683 (E.D. Ky. 1981) (adopting Restatement view as applied to accountants).

\textsuperscript{136} Collins v. Reynard, 607 N.E.2d 1185 (Ill. 1992) (an attorney’s duty of competence exists “without regard to the terms of any contract of employment”).

disseminates project-related information. Owners, construction managers, general and trade contractors, and design professionals may be alleged to have negligently supplied inaccurate information for the guidance of others.\^{138} The Restatement (Third) of Torts, Section 552, specifically allows an action for the tort to be maintained whether or not the injured party has a contract with the information-disseminating party.\^{139} In place of privity, the Restatement emphasizes foreseeability, predicing liability on a requirement that the party providing the information know the class of those intended to receive and use the information.\^{140}

Many judges are less than comfortable with the breadth of the Restatement’s pronouncements. To them, the Restatement’s foreseeability standard is a poor substitute for bargained-for contractual responsibility. As noted by one court, it is “a standard that sweeps too broadly in a professional or commercial context, portending liability that is socially harmful in its potential scope and uncertainty.”\^{141} In the construction setting in particular, courts have been uneasy assessing responsibility for economic damage based on the transmission of inaccurate information related to a contractual undertaking.\^{142}

\footnotesize{\begin{itemize}
\item[139] Id., cmt. g.
\item[140] Id., cmt. h.
\item[141] Stern, supra note 27, at 638.
\item[142] See Travelers Cas., supra note 56 (surety’s negligent misrepresentation claim for purely economic losses against architect was barred by ELR where relationship between the parties did not amount to “functional equivalent of privity” after court applied a tripartite test: 1) awareness by architect that statement would be used.}

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A number of courts maintain that where there is privity of contract and only economic damages arising out of the scope of work of the contract,\(^{143}\) there is no need for an additional tort of negligent misrepresentation.\(^{144}\) Other courts have chosen not to allow negligent misrepresentation claims when there is a contract—any contract—that relates to the subject matter of the claimed damages.\(^{145}\)

In *Berschauer/Phillips Construction Co. v. Seattle School District No. 1*,\(^{146}\) a delayed general contractor settled with the owner, reserving purely economic claims against the design professionals occasioned by professional negligence and negligent misrepresentation that caused or contributed to the project delay.\(^{147}\) Noting that no physical property damage or bodily

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\(^{143}\) If the misrepresentation was outside the scope of the bargained-for contract, however, the claim may be upheld. *See, e.g.*, Mem’l Hosp. v. Healthcare Realty Trust Inc., 509 F.3d 1225 (10th Cir. 2007) (owner’s claim against construction consultant for negligent misrepresentation for purely economic losses not barred by ELR where alleged misrepresentation did not arise out of consultant’s contract scope, but rather information supplied by consultant to owner concerning financial viability of project).

\(^{144}\) *See, e.g.*, Marvin Lumber & Cedar Co. v. PPG Indus., Inc., 223 F.3d 873, 884–85 (8th Cir. 2000); Duquesne Light Co. v. Westinghouse Elec. Corp., 66 F.3d 604 (3rd Cir. 1995); City Express, Inc. v. Express Partners, 959 P.2d 836 (Haw. 1998). *See also* authorities cited at West’s 184 FRAUD, k25, 27.

\(^{145}\) *BRW, Inc.*, supra note 125 (claim for negligent misrepresentation by subcontractor against remote engineer barred by ELR where misrepresentation arose in the project context governed by “inter-related” contracts); *Indianapolis-Marion County*, supra note 72 (library’s negligent misrepresentation claims involving purely economic damages due to structural deficiencies in parking garage against engineer and subcontractors not in privity was barred by ELR because of “network or chain of contracts”).

\(^{146}\) 881 P.2d 986 (Wash. 1994) (en banc).

\(^{147}\) The contractor alleged that the design professionals supplied inaccurate information, which caused the contractor to incur extra costs and delay damages in
injury was alleged, the court dismissed all negligence-based claims against the design professionals, including the claim for negligent misrepresentation. In so doing, the court acknowledged that Section 552 of the Restatement was recognized in the State of Washington, but held that "in the construction industry, contract principles "override" the tort principles in Section 552 and, thus, purely economic damages are not recoverable." The fact that the general contractor had a contractual remedy against the owner was dispositive for the court.

Other courts limit the expanse of the Restatement’s class of potential plaintiffs by making fine distinctions, on behalf of design professionals, concerning what constitutes "information in the course of one’s business or profession." Illinois, for instance, specifically recognizes a general connection with the performance of the construction contract.

148 881 P.2d at 986.
149 Id. at 993.
150 That there may have been contract provisions in the general contract with the owner that severely limited the general contractor’s right to recover foreseeable and substantial delay damages was apparently irrelevant to the court. Contrast the Berschauer analysis with the 2010 analysis by the same court in Affiliated FM, supra note 4 (en banc), where engineering defects which caused a fire and resulting economic losses were held recoverable because the engineer's safety responsibilities were independent of the its bargained-for "contractual expectations." Id. at 527-28.
151 Some precise distinctions could be described as tantamount to "counting the angels dancing on the head of a pin."
exception to the economic loss rule (outside of the construction context) for damages caused by another’s negligent misrepresentation as described in Restatement Section 552. But when presented with the case of a professional engineer whose plans for a tunnel location were inaccurate by seventy-five yards, not only causing the contractor to incur additional costs but also causing damage to other property, the Illinois Supreme Court nevertheless held that the engineer was not “in the business of supplying information.” In a concluding remark, the court noted that the remedy for inaccurate plans could be expressed “in contract terms.”

Economic losses barred where engineer was not “in the business of supplying information,” but rather information was ancillary to the sale of a “product” – design plans); Excavation Technologies, Inc. v. Columbia Gas Co., 936 A.2d 111 (Pa. Super. Ct. 2007) (contractor’s negligent misrepresentation claim against gas company for mis-identifying location of eleven gas lines did not qualify for exception to economic loss rule under Restatement § 552 because gas company was “not a professional information supplier”; court contrasted gas company with design professional on a construction project, which Pennsylvania Supreme Ct. had determined regularly “supplied information covered by §552” and was subject to negligent misrepresentation claims).

See Moorman Mfg. Co., supra note 9, at 449, and its progeny. This exception is one of three to the economic loss rule recognized in Moorman. The other two are fraud and property damage from a sudden or dangerous occurrence. Id. at 450. See also Rozny v. Marnul, 250 N.E.2d 656, 660 (Ill. 1969) (plaintiffs not in privity were allowed to recover economic damages against a surveyor for inaccurate information on survey).

Fireman’s Fund, supra note 124, at 1201-02 (a design professional’s plans and drawings were incidental to the tangible product, the water pipe project); see also 2314 Lincoln Park, supra note 124 (architect’s information is incidental to a tangible product, i.e., a structure and details on plans are normally transformed into the structure) (dicta). But see Tolan & Son, Inc. v. KLLM Architects, Inc., 719 N.E.2d 288, 298 (Ill. App. Ct. 1999) (refining the “incidental” analysis to design professionals; project design architects were not “providers of information,” but a consulting engineer could be).

SEC Donohue, supra note 124, at 1202. Apparently, this parsing of the Restatement requirements is limited to the court’s resentment of tort claims in the construction sector, and not in other commercial transactions. See Rosenstein,
Courts that allow the tort of negligent misrepresentation in the construction setting tend to inquire rather deeply into the facts of a contested case, in order to satisfy themselves that economic damage to a certain class of recipients was foreseeable. As in the analysis of the “supervising architect” exception in cases of design professional negligence discussed above, many courts look for a relationship between the parties that is “so close as to be the functional equivalent of contractual privity.” If it is found, the economic loss rule is often not applied.

The concern of Restatement Section 552 is with foreseeability of the particular class of recipients of information. Foreseeability supplies consistency in the identity of potential plaintiffs similar to the bargained-for protection of a contract. Foreseeability is vital to courts that uphold a plaintiff’s right to sue for negligent misrepresentation, regardless of privity, when harmed only economically. Thus, despite the economic loss rule,

\[\text{supra} \text{ note 137 (negligent misrepresentation claim allowed against stock market indexing service by those not in privity). Illinois also allows negligent misrepresentation claims against attorneys and CPAs. See notes 135-136, }\text{supra}.\text{ This distinction has drawn the criticism of a number of commentators, and three of the state’s Supreme Court Justices. See SEC Donohue, supra, note 124, at 1202 (Heiple, J. in dissent).}\]

\[156\text{ See Bilt-Rite Contractors, Inc. v. Architectural Studio, 581 Pa. 454, 866 A.2d 270 (2005), (contractor’s negligent misrepresentation claim was allowed against an architect despite absence of physical injury or property damage).}\]

\[157\text{ Ossining Union Free Sch. Dist. v. Anderson LaRocca Anderson, 539 N.E.2d 91 (N.Y. 1989).}\]

\[158\text{ Id. at 92. See also authorities cited at West’s }184\text{ FRAUD, k29.}\]

\[159\text{ See, e.g., Borough of Lansdowne, supra note 30, at *2 (“Section 552 has supplanted the need for contractual privity as the device by which liability is limited from the world at large to those whom the actor should reasonably foresee might be harmed by his negligent provision of false information”).}\]
negligent misrepresentation claims have been maintained against builders and developers,\textsuperscript{160} construction managers,\textsuperscript{161} design professionals,\textsuperscript{162} and construction product manufacturers.\textsuperscript{163}

\textsuperscript{160} Council of Co-Owners, supra note 67, at 348.
\textsuperscript{161} Constr. Managers, Inc. v. EH Constr., LLC, 134 S.W.3d 575 (Ky. 2004) (Supreme Court adopts Restatement §552 and allows contractor’s claim against construction manager for negligent misrepresentation involving purely economic losses); John Martin Co. v. Morse/Diesel, Inc., 819 S.W.2d 428 (Tenn. 1991) (subcontractor was allowed to maintain negligent misrepresentation claim against construction manager for improper information in directing the subcontractor’s work).
\textsuperscript{162} Guardian Constr. v. Tetra Tech, Inc., 583 A.2d 1378 (Del. Super. Ct. 1990) (plaintiffs not in privity were allowed to maintain action for negligent misrepresentation against engineer); Nota Constr. Corp. v. Keyes Assocs., 694 N.E.2d 401 (Mass. App. Ct. 1998) (mistakes and misinformation in architect’s plans could give rise to negligent misrepresentation action despite lack of privity); Bilt-Rite Contractors, supra note 156 (contractor’s negligent misrepresentation claim for purely economic damages against architect not in privity for misrepresentations in architect’s plans and specs for a school project was not barred by ELR). But see Am. Mfrs. Mut. Ins. Co. v. Payton Lane Nursing Home, Inc., No. CV-05-9155 (SJF), 2007 WL 674691 (E.D.N.Y February 28, 2007) (surety’s negligent misrepresentation claim against architect for purely economic losses was barred by ELR where relationship between parties did not approach that of privity, even though architect knew its certifications for payment would be relied on by surety, architect was not retained by owner for the specific purpose of providing information to the surety).
\textsuperscript{163} See Vill. of Cross Keys, Inc. v. U.S. Gypsum Co., 556 A.2d 1126, 1133 (Md. 1989) (negligent misrepresentation claim against designer/manufacturer of curtain wall system not barred by economic loss rule, although recovery was denied due to failure to follow manufacturer’s specifications); see also State ex rel. Bronster v. United States Steel Corp., 919 P.2d 294, 302 (Haw. 1996) (economic loss rule properly disregarded, and recovery allowed, in negligent misrepresentation case against steel manufacturer where there was privity).