

# SUBROGATION AND THE ECONOMIC LOSS DOCTRINE

## A 50 STATE SURVEY

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*The generator in a \$300,000 luxury motor home produces arcing which ignites engine oil and the resulting fire soon destroys the entire vehicle. Your insured's printing press is destroyed when the entire unit becomes engulfed in flames after a catastrophic failure due to a defect in its design. Soot covers the entire inside of a new vacation home after its furnace puffs back due to a malfunction in the HVAC system. A defect in the steering system on a new GMAC truck results in overturn and destruction of the vehicle, but no personal injuries to the driver. An insured experiences complete destruction of a \$10,000,000 power generation system when defective blades on a turbine fail and fly through the attached generator. Despite a recall, a faulty ignition switch results in a fire and total loss of a used Ford Bronco owned by your insured. A property owner purchases a new home or building and the structure begins to leak because of alleged defects in the roofing, siding, and/or windows. As a result, mold begins to grow. The mold damages interior walls and ceilings and requires the owner to repair and replace these building components. Although no one is sick, a \$400,000 home must be razed, and you are left holding the resulting insurance claim.*

All of the above real claim scenarios, or ones similar to them, should be familiar to insurance claims adjusters and subrogation professionals. All of them appear to have good subrogation potential. But look again! Each of the above scenarios involves a situation in which the defendant manufacturer was able to avoid liability due to the application of an often-misunderstood doctrine known as the Economic Loss Doctrine. Being familiar with this doctrine, understanding its parameters and limitations, and knowing when it applies and doesn't apply, are all critical for subrogation professionals looking to maximize their property damage and lost profits claim payment recoveries. Not knowing is no longer an option.

### WHAT IS THE ECONOMIC LOSS DOCTRINE?

The Economic Loss Doctrine (ELD) is a court-developed doctrine that has been adopted by a majority of U.S. states and jurisdictions. In its traditional form, the rule prohibits a tort recovery (negligence, strict liability, etc.) when a product defect or failure causes damage to itself, resulting in only economic loss, but does not cause personal injury or damage to any other property other than itself.

***The economic loss doctrine prohibits recovery in tort when a product defect or failure causes damage only to the product itself. It preserves the distinction between contract and tort law and prevents parties to a contract from avoiding agreed-upon contract remedies and seeking broader remedies under tort theory than the contract would have permitted.***

The Wisconsin Court of Appeals defined the doctrine as one which precludes a purchaser of a product from recovering from a manufacturer "on a tort theory for damages that are solely economic". Rather, the purchaser is expected to protect itself under contract law and warranty

principles. However, the economic loss doctrine does not apply "if the damage is to property other than the defective product itself; in that case, a complainant may pursue an action in tort."

### **WHAT IS ECONOMIC LOSS?**

Property damage is usually readily distinguishable from economic loss. For example, operation of a defective heater that causes property damage when it results in a fire that destroys the plaintiff's store and inventory constitutes economic harm when it results in conditions so uncomfortable that it causes the loss of customer patronage resulting in loss profits. At times, however, the distinction may be more difficult to draw. If A manufactures paste which it sells to B who uses it to cement shoes which he sells to C, a failure of the paste to properly adhere causes economic loss if it does not physically damage the shoes but merely renders them unsaleable. On the other hand, a defect in the paste which physically damages the shoes causes property loss. If the damage is to the defective product itself, similar distinctions must be drawn. When the defect causes an accident "involving some violence or collision with external objects," the resulting loss is treated as property damage. However, if the damage to the product results from deterioration, internal breakage, or other non-accidental causes, it is treated as economic loss. The definition of "economic loss" usually includes the cost of repair or replacement of the defective product.

Purely economic losses may be classified into two basic categories: direct economic losses and indirect or consequential economic losses. Direct economic loss may be said to encompass damage based on insufficient product value; thus, direct economic loss may be "out of pocket", the difference in value between what is given and received, or "loss of bargain", the difference between the value of what is received and its value as represented. Direct economic loss may also be measured by costs of replacement and repair. Consequential economic loss includes all indirect loss, such as loss of profits resulting from inability to make use of the defective product. Economic loss is generally defined as damages resulting from inadequate value because the product "is inferior and does not work for the general purposes for which it was manufactured and sold." *Northridge Co. v. W.R. Grace & Co.*, 471 N.W.2d 179 (1991). It includes both direct economic loss and consequential economic loss. The former is the loss in value of the product itself; the latter is all the other economic losses attributable to the product defect. In short, pure economic loss is damage to a product itself or monetary loss caused by the defective product, which does not cause personal injury or damage to other property. However, the important thing to remember is that the definition of "economic loss" usually includes the cost of repair or replacement of the defective product.

### **PURPOSE OF THE ECONOMIC LOSS DOCTRINE**

The ELD represents the line between the law of contracts, which secures the expectations of the parties, and the law of torts, which is governed by the duty owed to the injured party. Courts have held that a consumer should not have to face alone the risk of personal injury or damage to property when he purchases a product. *East River S.S. Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858 (1986). Therefore, a manufacturer has a duty to manufacture products that will not injury persons or property. On the other hand, consumers may be burdened with the risk that a product will not meet their economic expectations, unless the

manufacturer warrants that it will. Therefore, because tort law does not impose any duty to the manufacturer, only such products that will meet the economic expectations of purchasers, the ELD serves to:

- (1) maintain the distinct functions of tort law and contract law;
- (2) protect the freedom of commercial parties to allocate economic risk between them by contract; and
- (3) encourage the commercial purchaser – best suited to assess the risk of economic loss – to assume, allocate, or insure against that risk.

If tort law replaced negotiation and sales agreements between parties, manufacturers would likely cover the resulting risk by raising prices on every contract. Put another way, the public policy issue is whether the consuming public as a whole should bear the cost of economic losses sustained by those who failed to bargain for adequate contract remedies? A majority of states refuse to do this and employ some version of the economic loss doctrine.

### **HISTORY OF ECONOMIC LOSS DOCTRINE**

The origin of the American economic loss doctrine goes back to New Jersey in 1965. In *Santor v. A. & M. Karaghensian*, 207 A.2d 305 (N.J. 1965), an ordinary consumer of carpeting sued the manufacturer in tort for a defect in the carpeting because the carpeting developed lines running down the middle of it. After getting the runaround from the seller, the consumer went to the store where it was sold and found they had gone out of business. He tracked them down and sued them for a defective product under strict liability. The court decided that the Uniform Commercial Code (U.C.C.) did not provide the exclusive remedy for cases arising out of commercial transactions. If the product is defective, the consumer can bring either a strict product liability action (breach of implied warranty of reasonable fitness) or a warranty claim under the U.C.C. A consumer has a choice of remedies between contract and tort. The court reasoned that the law of strict liability exists to insure that the cost of injuries or damage, either to the goods sold or to other property, resulting from a defective product, is borne by the manufacturer, rather than the party who suffered the loss, who generally is at a disadvantage in negotiating with the manufacturer. Although *Santor* became the genesis of the minority rule in the U.S, New Jersey later abrogated the *Santor* case with *Alloway v. Gen. Marine Industries*, 695 A.2d 264 (N.J. 1997).

### **MINORITY RULE**

From the decision in *Santor*, a minority rule with regard to the application of the ELD developed in the United States. The minority rule essentially rejects the application of the economic loss doctrine. It allows a plaintiff to recover in tort for economic loss without limitation. The minority view is followed loosely by only a handful of states, some of which have begun to chip away at its foundation. The rest of the country follows either the majority rule or the intermediate rule.

In the same year the *Santor* decision was handed down in New Jersey, the courts in California were breaking ground on the same issue, but with completely opposite results. In *Seely v. White Motor Co.*, 403 P.2d 145 (Cal. 1965), a consumer purchased a truck which was defective, resulting in its overturn and property damage to the truck. After the brakes failed, the

plaintiff stopped making payments and the truck was repossessed. The plaintiff sued the manufacturer and the dealer for the property damage to the truck, the money he paid on the truck, and lost profits. The court rejected the *Santor* position allowing a tort action for only economic damage, and noted that strict liability was not supposed to undermine the U.C.C., but rather to compensate for its inadequacies. A consumer should only be able to pursue his warranty remedies when the injury is to the product alone. The consumer shouldn't bear the risk that a product will cause physical injury, but should bear the risk that a product "will not match his economic expectations." The court also felt that contract law is best at dealing with economic expectations and tort law is best left for dealing with physical injury to people or things other than the product. They held that the relative bargaining power of the parties should play no role, because manufacturers cannot disclaim tort liability for non-economic losses, because it would be irrational to require consumers to pay more so that manufacturers could insure the performance of their products. Courts applying the majority rule have found it necessary to create exceptions for asbestos cases where damages involve the removal of asbestos from the building and are purely economic in nature.

### MAJORITY RULE

Many states eschew the minority rule and hold that a plaintiff cannot recover purely economic damages in tort, period. The majority rule flows from the *Seely* decision, which unlike *Santor*, is still good law today. However, the majority rule has been eroded somewhat with exceptions in various situations, such as the exception for asbestos. These exceptions have left several states following what has become known as the intermediate rule, discussed below.

The majority rule was significantly influenced by a U.S. Supreme Court decision in 1986. In *East River S.S. Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858 (1986), the plaintiffs, charters of four oil supertankers, brought a strict liability products suit against the turbine manufacturer, seeking solely economic damages resulting from alleged design and manufacturing defects that caused the supertankers to malfunction while on the high seas. The court held that the economic loss doctrine barred tort claims when "a defective product purchased in a commercial transaction malfunctions, injuring only the product itself". The *East River* approach was similar to that taken in *Seely*. The only difference was *East River* dealt with commercial parties, and did not address a consumer situation. *East River* rejected both the minority rule (recognizing that *Santor* raised legitimate questions about the theories behind restricting product liability) and the intermediate rule (which turned on the degree of risk and/or the manner in which the product is damaged). *East River* is binding in admiralty cases and federal courts are split with review of diversity and other non-admiralty applications.

The stringent application of the majority rule has its drawbacks. It fails to protect victims from unforeseeable dangers, dilutes the underlying tort policy of protection against personal injury, significantly limits the discretion of the courts, and leads to arbitrary results in certain circumstances. Using the example of a boat with an outboard motor, one can easily see the shortcomings of the majority rule. If the owner of a boat purchases an outboard motor and puts it on the boat, and the engine starts a fire which destroys the boat, the purchaser of the engine can recover from the manufacturer of the engine. However, if the boat and motor are purchased together, they become the "product" and the ELD will prohibit the owner from recovering in tort for the fire. If the owner has no warranty options available to him, he is simply

out of luck. In order to address these shortcomings, many states have crafted and adhered to an intermediate rule with regard to the ELD.

## **INTERMEDIATE RULE**

As a result of exceptions to the majority rule which have grown over time, the majority rule in some states has eroded into what has become known as the intermediate rule. The intermediate rule is similar to the majority rule, except that it allows for tort recoveries under certain limited circumstances, attempting to differentiate between the disappointed consumer and the endangered consumer. One example is the sudden and calamitous failure of a product or product failures which prove dangerous to the consumer. The intermediate rule excepts the application of the ELD from such situations, while the majority rule does not. The majority rule focuses on the damages, while the intermediate rule focuses on the nature of the defect itself or the way in which the failure occurred, and allows for only recovery of economic damages to a product, depending on the nature of the failure.

The intermediate rule has advantages over the majority rule, and addresses some of its shortcomings. It offers equitable justice by looking at the nature of the defect. The “sudden and calamitous” and “unreasonable risk of injury” exceptions help insure that victims of accidents are compensated where the policy’s reasons for making manufacturers liable are exactly the same as they are under tort law. The intermediate rule discourages dangerous defects and still provides a limitation on liability necessary to preserve the integrity of the consumer transaction and the agreement of sale entered into between the buyer and the seller.

### **“OTHER PROPERTY” EXCEPTIONS TO THE ECONOMIC LOSS DOCTRINE**

Courts have distinguished between property damage to the defective product itself and damage to “other property”. In commercial cases, most courts have refused to allow tort recovery for damage to the product itself, considering such damage solely economic loss. Some courts have allowed plaintiffs to recover for damage to a dangerously defective product, along with other damages, under a strict liability theory, when the injury results from a sudden and calamitous event or accident. Some courts have allowed tort recovery for damage to the defective product itself where there was no danger or accident, but “other property” was also damaged. Be careful to determine whether the state you are subrogating in allows for recovery of damage to the product which is the subject of the insurance payment if there is concomitant damage to “other property” or whether it simply disallows recovery for damage to the product itself under all circumstances, but does allow for recovery of damages to the “other property”. States which adhere to the majority rule regarding the ELD may still differ on this point. As one Texas scholar put it:

*“A distinction should be made between the type of ‘dangerous condition’ that causes damage only to the product itself and the type that is dangerous to other property or persons. A hazardous product that has harmed something or someone can be labeled as part of the accident problem; tort law seeks to protect against this type of harm through allocation of risk. In contrast, a damaging event that harms only the product should be treated as irrelevant to policy considerations directing liability placement in tort.”* Dean Keeton, *Annual Survey of Texas Law on Torts*, Southwestern Law Journal, Volume 32 (1978).

## IMPLIED WARRANTY

Three standard product liability causes of action are (1) strict liability (tort), (2) negligence (tort), and (3) breach of express or implied warranty (contract). Express warranties involve manufacturer advertising, labeling or warranting of their product in writing. It is essentially a breach of contract action. Implied warranties, as you might expect, are not written – they are implied by law. States differ on the implied warranty causes of action they allow. Some states, such as Wisconsin, do not recognize a product liability cause of action for breach of warranty – only a breach of contract action, assuming the warranty is still in effect. Others, such as New York, allow a cause of action for breach of warranty if the product is not safe for the ordinary purpose for which it is sold. Still others, such as California and Texas, define specific implied warranties under which a party can pursue the manufacturer of a product for a defect, such as the implied warranty of merchantability or the implied warranty of fitness for a particular purpose. However, it is clear that a majority of jurisdictions do not allow recovery for economic loss in tort, but do allow for recovery of economic loss in contract. What is less clear is whether courts will allow recovery for economic loss on an implied warranty theory. The implied warranty theories under which a plaintiff may pursue the manufacturer of a product for a product defect are varied.

Some states allow for recovery based on an implied warranty, even without privity, in situations where owners or second owners of homes sue the home builder for breach of the implied warranty of workmanlike quality, or similar implied warranties and some states do not. Some states implicitly allow recovery for economic loss under such circumstances. *Moxley v. Laramie Builders*, 600 P.2d 733 (Wyo. 1979) (electrical wire defect); *Terlinde v. Neely*, 271 S.E.2d 768 (S.C. 1980) (ill-fitting doors); *Richards v. Powercraft Homes*, 678 P.2d 427 (Ariz. 1984) (separation of walls); *Elden v. Simmons*, 631 P.2d 739 (Okla. 1981) (faulty bricks); *Barnes v. Mac Brown & Co.*, 342 N.E.2d 619 (Ind. 1976). The courts which have allowed economic loss recovery in such situations have done so basically because the line between property damage and economic loss is not always easy to draw.

## ECONOMIC LOSS DOCTRINE IN WISCONSIN

The ELD is a confusing array of various situations, tests, and conditions which underlie a very simple premise – one cannot recover purely economic damages in tort for the failure of a product. It is not applied exactly the same in any two states. For that reason, it is important to look at its genesis and evolution over time in a single state – Wisconsin. Wisconsin has been a hotbed of economic loss doctrine litigation and development, resulting in perhaps more ELD decisions in the past 20 years than any other state. The development of the ELD in Wisconsin is tracked below, and its general application and nuances in any given state is summarized in the list which follows.

Generally. Since the initial recognition of the economic loss rule, Wisconsin courts have significantly expanded the doctrine's scope and breadth. Wisconsin has eliminated any requirement of contractual privity, disregarded arguments that the doctrine leaves parties with no alternative remedy, applied the to services incidental to the purchase, rejected "bootstrapping" non-economic losses of third parties, rejected creating an exception for "sudden and calamitous" occurrences, applied the doctrine to commercial real estate purchases, and applied the doctrine to encompass consumer transactions.

First Recognized. Wisconsin first recognized the economic loss doctrine in 1989. *Sunnyslope Grading, Inc. v. Miller, Bradford & Risberg, Inc.*, 437 N.W.2d 213 (Wis. 1989). Sunnyslope purchased defective backhoes, and later sued to recover economic damages for replacement parts, labor, and lost profits. The written warranty covering the backhoes excluded these items of damage, so *Sunnyslope* circumvented the contract and the suit was brought in strict liability. The Supreme Court looked at the Uniform Commercial Code (U.C.C.) to determine the rules that govern a transaction between two commercial parties of relatively equal bargaining power. The economic loss doctrine was applied, but its application was limited to cases involving warranties. The court didn't answer the following questions:

- (1) Does the ELD apply to parties not in privity?
- (2) Does the ELD apply to consumer transactions?
- (3) Does the ELD apply to unreasonably dangerous products?
- (4) Does the existence of a warranty preclude recovery in tort for damage to other property?
- (5) What constitutes damage to the product as opposed to damage to "other property"?

Other Property. However, the economic loss doctrine does not apply "if the damage is to property other than the defective product itself". If other property is damaged as a result of a defective product, a plaintiff may pursue an action in tort for both the "other property" damage and the damage to the product. *Bay Breeze Condominium Ass'n, Inc. v. Norco Windows, Inc.*, 651 N.W.2d 738 (Wis. App. 2002). It is important, therefore, to look for any damage, however slight, that accompanies the destruction or failure of the product, such as a scorched garage floor which needs cleaning, soot, etc.

Component Parts. The year after *Sunnyslope* was decided, the Wisconsin Court of Appeals decided a case which dealt with the parameters of what was considered "other property". In *Midwhey Powder Co. v. Clayton Industries, Inc.*, 460 N.W.2d 426 (Wis. App. 1990), the ultimate purchaser of steam generators brought an action against the manufacturer and seller, asserting negligence, strict liability, and other claims, after they produced poor quality steam that damaged the generators and turbines attached to them. The court held that the turbines were sufficiently a component part of the overall energy production system bought by the plaintiffs, so the ELD prohibited a tort claim for purely economic damages. The determination of what is separate and what is a component is determined by what the plaintiff buys – recognizing the integrated system rule which was later adopted by the Supreme Court in *Wausau Tile, Inc. v. County Concrete Corp.*, 593 N.W.2d 445 (Wis. 1999) and was summarized as follows:

*"Damage by a defective component of an integrated system to either the system as a whole or other system components is not damage to "other property" which precludes the application of the economic loss doctrine."*

What happens, however, if a product is bought by one party, who adds components onto the product and then sells that product on to future purchasers? What parts of the product are considered "other property"? The U.S. Supreme Court had previously shed some light on that subject in *Saratoga Fishing Co. v. J.M. Martinac & Co.*, 520 U.S. 875 (1977). In that case the court held that while a ship was the product itself when it left the initial seller's hands, equipment added by that buyer and passed on with the ship to future buyers did not become

part of the “product”, but were considered “other property”. In a dissent, Justice Scalia queried whether courts should look to the product purchased by the plaintiff/subsequent purchaser, or whether they should look to the product sold by the defendant. The court’s decision appears to lean in favor of a more expansive definition of “other property” and more freedom to allow tort claims. Unfortunately, Wisconsin has gone in the other direction. In a subrogation suit brought by the insurance company of an insured who suffered damage to its printing press when a defective replacement part manufactured by the defendant failed, the Wisconsin Court of Appeals held that the ELD applies where a commercial purchaser buys used equipment containing a defective replacement part that causes damage to the equipment and results in repair costs and loss of business income. *Cincinnati Ins. Co. v. AM Int’l, Inc.*, 591 N.W.2d 869 (Wis. App. 1999). Wisconsin takes the “integrated systems” approach to the ELD, which means that damage by a defective component of an integrated system to either the system as a whole or other system components is not damage to “other property” that would preclude the application of the economic loss doctrine. *Linden v. Cascade Stone*, 699 N.W.2d 189 (Wis. 2005).

Asbestos Exception. In 1991, Wisconsin adopted a public policy exception to the ELD – asbestos. *Northridge Co. v. W.R. Grace Co.*, 471 N.W.2d 179 (Wis. 1991). The asbestos defect (carcinogenic quality) caused physical damage to property other than the asbestos itself – the building it was in. Even though the asbestos functioned fine as a fire retardant, the product caused an unreasonable risk to health and safety – damages similar to economic losses. Because the asbestos implicated safety, its defect was best handled through tort, rather than contract law. However, this public policy exception to the majority rule didn’t quite rise to the level of an unreasonably dangerous product exception to the ELD and its limits would be tested in 1999 in *Wausau Tile, Inc. v. County Concrete Corp.*, 593 N.W.2d 445 (Wis. 1999).

Privity. The Wisconsin Supreme Court answered one of the questions left unanswered by *Sunnyslope* in 1998. *Daanen & Janssen v. Cedarapids, Inc.*, 573 N.W.2d 842 (Wis. 1998). In *Daanen*, a remote commercial purchaser of a rock crusher sued the manufacturer for repair costs, lost revenue, and prejudgment interest resulting from the defective machine. The court held that even in the absence of privity, the economic loss doctrine bars a remote commercial purchaser from recovering economic losses from a manufacturer under tort theories of strict liability and negligence. The court confirmed that the ELD does not bar a commercial purchaser’s claims based on personal injury or damage to property other than the product, or economic loss claims that are alleged in combination with non-economic losses. The question of whether the existence of a warranty precludes recovery in tort for damage to other property.

Consumer Transactions. The second question left open by *Sunnyslope* was answered in 1999 by *State Farm Mutual Ins. Co. v. Ford Motor Co.*, 592 N.W.2d 201 (Wis. 1999). A consumer purchased a Ford Bronco “as is”, and it subsequently burned due to a faulty ignition switch common to those vehicles and which was the subject of a recall. Nothing else was damaged. The consumer’s insurance company brought a subrogation action. The court cited the *East River* goals of the ELD and extended the ELD to consumer transactions, stating that relative bargaining power between the parties is not required. Even where a product is sold “as is”, the consumer is in the best position to insure against or allocate risk. It held that the ELD barred tort damages for purely economic losses in a consumer transaction. The court also addressed the third issue left open by *Sunnyslope*, by indicating that where the threat of injury to a person

is not realized as a result of a product failure, there is no reason to allow strict liability to come into play. Contract law, the law of warranty and the Uniform Commercial Code are designed to allow the parties to allocate the risk of product failure.

Public Policy Exceptions. That same year, the Supreme Court looked at the limits of the public policy exception to the ELD. In *Wausau Tile, Inc. v. County Concrete Corp.*, 593 N.W.2d 445 (Wis. 1999), the manufacturer of concrete paving blocks brought an action against a cement supplier and its commercial liability insurer under theories of breach of warranty, breach of contract, negligence, indemnification, contribution and strict liability, seeking recovery for defects in paving blocks allegedly caused by defective cement. The Supreme Court refused to extend the *Northridge* public policy exception, even though plaintiffs alleged that buckling, curling and cracking allegedly caused by defective cement constituted a public safety hazard. The court stated that there was no “broad public safety exception” to the ELD; but it didn’t describe how narrow that exception was.

Fraud and Misrepresentation. Wisconsin, like many states, provides for an exception to the ELD when there is misrepresentation or fraud in the inducement. In *Douglas-Hanson Co. v. B.F. Goodrich Co.*, 598 N.W.2d 262 (Wis. App. 1999), the Court of Appeals held that there was a general fraud in the inducement exception to the ELD. It concluded that “the economic loss doctrine does not preclude a plaintiff’s claim for intentional misrepresentation when the misrepresentation fraudulently induces a plaintiff to enter into the contract. See also *Kailin v. Armstrong*, 643 N.W.2d 132 (Wis. App. 2002). In *Douglas-Hanson*, the plaintiff alleged that the manufacturer had intentionally misrepresented that it had a commercially viable product it could deliver for processing. When the product failed, Douglas-Hanson sued. The court held that the ELD does not apply where the seller intentionally misrepresents something to the buyer which induces the buyer into the transaction. The Wisconsin Supreme Court, in a per curiam opinion, stated that the Supreme Court was equally divided on the question of whether the *Douglas-Hanson* exception to the ELD should be affirmed, thereby affirming it without the binding authority of Supreme Court precedent. 607 N.W.2d 621.

Court Confusion over Fraud-In-Inducement Exception. In 2003, the Wisconsin Supreme Court decided *Digicorp, Inc. v. Ameritech Corp.*, 662 N.W.2d 652 (Wis. 2003), a case in which the distributor of telephone calling services sued a telecommunications provider, alleging breach of contract, negligence, intentional, strict liability, and negligent misrepresentation. The decision recognized a narrow exception to the ELD for fraud in the inducement, but the extent of that exception was very unclear, due to a divided court. Subsequently, the Supreme Court decided *Tietsworth v. Harley-Davidson Motor Co.*, 677 N.W.2d 233 (Wis. 2004), in which purchasers of motorcycles sued the manufacturer in strict liability when motorcycles they said were of “premium quality” showed a propensity for engine failure. The court stated that *Digicorp* “did not produce the necessary agreement for an element-specific fraud-in-the-inducement tort cause of action as an exception to the economic loss doctrine”. However, they did not declare a new rule. The fraud-in-the-inducement exception is still somewhat up in the air in Wisconsin. In 2005, the 7<sup>th</sup> Circuit Court of Appeals, applying Wisconsin law, decided *Cerabio, L.L.C. v. Wright Medical Technology, Inc.*, 410 F.3d 981 (7<sup>th</sup> Cir. 2005). A corporation which sold assets and technological know-how to a medical company brought a breach of contract action against the medical company and the medical company counterclaimed alleging breach of contract, fraudulent inducement of contract, pre-contract negligent misrepresentation, and negligent misrepresentation. The court held that under Wisconsin law, the fraud in the inducement

exception to the economic loss doctrine did not apply to the agreement between the parties in which one agreed to sell its assets and technological know-how to the other. The court noted that the parties were sophisticated and well-represented business entities, the crux of agreement centered around the sale and purchase of assets so that company could produce the corporation's product, the company's concern was whether it could replicate the process, and alleged that fraud was the character and quality of product that was the subject matter of agreement. Furthermore, there was a disclaimer of warranty and non-reliance clause in the contract.

Service Contracts. In 2004, the Wisconsin Supreme Court decided *Insurance Co. of North America v. Cease Electric, Inc.*, 688 N.W.2d 462 (Wis. 2004). It declared that because the U.C.C. does not apply to services, neither should the ELD. In its holding, it stated that by applying the ELD to service contracts, lawsuits against professionals could be affected, and they generally lie in both tort and contract.

Service v. Products: Mixed Contracts. On July 8, 2005, the Supreme Court decided the case of *Linden v. Cascade Stone*, 699 N.W.2d 189 (Wis. 2005). This case involved homeowners who brought contract and tort claims against the subcontractors, who worked on building their home, for damages arising from water intrusion into the home. The court held that the general contract between property owners and general contractor, not subcontracts between general contractor and subcontractors, controlled with respect to whether the contract was predominantly for sale of the product or for services for purposes of the economic loss doctrine – the “predominant purpose test”. It further stated that the “totality-of-the-circumstances test”, which includes both quantitatively objective and subjective factors, not the quantitatively objective test, which determines whether the service component or sale of goods component of the contract costs more, is the appropriate test when determining predominant purpose of a mixed contract for purposes of the economic loss doctrine, which precludes buyer's recovery from the manufacturer on the tort theory for damages that are solely economic. A contract must be analyzed first to determine if it is a mixed contract for services and goods. If it is, then the determination has to be made with regard to its predominant purpose. *1325 North Van Buren, L.L.C. v. T-3 Group, Ltd.*, 716 N.W.2d 822 (Wis.2006).

Wisconsin Summary. Since the initial recognition of the economic loss rule, Wisconsin courts have significantly expanded the doctrine's scope and breadth. Wisconsin has eliminated any requirement of contractual privity, disregarded arguments that the doctrine leaves parties with no alternative remedy, applied to the services incidental to the purchase, rejected “bootstrapping” non-economic losses of third parties, rejected creating an exception for “sudden and calamitous” occurrences, applied the doctrine to commercial real estate purchases, and applied the doctrine to encompass consumer transactions.

## **SUMMARY OF ECONOMIC LOSS DOCTRINE IN ALL 50 STATES**

**ALABAMA: Majority Rule.** A cause of action does not arise in tort under theories of negligence, wantonness, strict liability, or extended manufacturer's liability doctrine when a commercial product malfunctions or is defective and the malfunction or defect results in damage only to the product itself, and not personal injury or damage to “other property”. *Lloyd Word Coal Co. v. Clark Equip. Co.*, 543 So.2d 671 (Ala. 1989). A product is considered “other

property” when a replacement part on that product fails and causes damage to the product. *Everett v. Brad Ragan, Inc.*, 2000 WL 360240 (S.D. Ala. 2000) (defective fuel filter replacement on truck). There is also no cause of action under the Alabama Extended Manufacturer's Liability Doctrine (AEMLD) for damage suffered to the product only. *Wellcraft Marine v. Zarzour*, 577 So.2d 414 (Ala. 1990).

**ALASKA: Intermediate Rule.** When a defective product creates a situation potentially dangerous to persons or other properties, and loss occurs as a result of that danger, strict liability in tort is an appropriate theory of recovery, even though the damage is confined to the product itself. In order to recover on such a theory, the plaintiff must show (1) that the loss was a proximate result of the dangerous defect; and (2) that the loss occurred under the kind of circumstances that made the product the basis for strict liability. *Northern Power & Engineering Corp. v. Caterpillar Tractor Co.*, 623 P.2d 324 (Alaska 1981).

**ARIZONA: Intermediate Rule.** The ELD bars recovery in tort for damage only to a defective product, provided there is no damage to person or other property. Three factors must be looked at to determine whether contract or tort law provides the remedy for a product defect that causes damage to the product only: the nature of the product defect that caused the loss to the plaintiff, the manner in which the loss occurred, and the type of loss for which the plaintiff seeks redress. *Salt River Project Agric. Improvement & Power Dist. v. Westinghouse Elec. Corp.*, 694 P.2d 198, 207-211 (Ariz. 1984) (unreasonable risk of harm), abrogated on other grounds by *Phelps v. Firebird Raceway, Inc.*, 111 P.3d 1003 (Ariz. 2005). The gist of a products liability tort case is not that the plaintiff failed to receive the quality of product he expected, but that the plaintiff has been exposed, *through a hazardous product*, to an unreasonable risk of injury to his person or property. *Cloud v. Kit Mfg.*, 563 P.2d 248 (Ariz. 1977) (losses resulting from a sudden accident and those occurring from a slow process of deterioration).

**ARKANSAS: Intermediate Rule.** Strict liability is not applicable where the product, in spite of any defective condition, does not constitute an unreasonable danger to persons or property; or, in the absence of injury to persons, such defect causes purely economic loss. *Berkeley Pump Co. v. Reed-Joseph Land Co.*, 653 S.W.2d 128, 131-132 (Ark. 1983) (unreasonable dangerousness).

**COLORADO: Minority Rule.** A tort claim may not be brought for economic damages flowing from breach of an express or implied contract. *Town of Alma v. Shanks*, 10 P.3d 1256 (Colo. 2000) (e.g., insurance brokers, attorneys, accountants and architects). The ELD does not apply if there is injury or damage to persons or property other than the product or thing itself. *Jardel Enterprises, Inc. v. Triconsultants, Inc.*, 770 P.2d 1301 (Colo. App. 1988). Negligent misrepresentation is an exception to the ELD. *Colo. Nat'l Bank of Denver v. Adventura Associates, Inc.*, 757 F.Supp. 1157 (D. Colo. 1991). Under Colorado's “economic loss rule,” a party suffering purely economic loss from the breach of an express or implied contractual duty is barred from asserting a tort claim for such a breach, absent an independent duty of care under tort law. In order to determine whether the rule applies, a court must focus on the source of the duty alleged to have been violated. *Loughridge v. Goodyear Tire & Rubber Co.*, 192 F.Supp.2d 1175 (D. Colo. 2002). However, because strict product liability imposes a duty on the manufacturer of a product to act reasonably in the design and manufacture of a product, in addition to any duty imposed by contract, the ELD will not prevent a plaintiff from pursuing a

tort claim for only damages to the product or other economic damages flowing from the product's failure. *Loughridge, supra*.

**CONNECTICUT: Minority Rule** (via statute for consumer claims only). Connecticut's Product Liability Law displaces the common law of products liability. *Conn. Gen. Stat.* §§ 52-572m(b), 52-572n(a). Under the statutory scheme, the victims of defective products may recover for "harm," *Conn. Gen. Stat.* § 52-572n(a), which is defined to include "damage to property, including the product itself, and personal injuries including wrongful death." *Conn. Gen. Stat.* § 52-572m(d). The definition of harm itself states that "[a]s between commercial parties, 'harm' does not include commercial loss." As between commercial parties, commercial loss caused by a product is not harm and may not be recovered by a commercial claimant in a product liability claim. An action for commercial loss caused by a product may be brought only under, and shall be governed by, Title 42a of the Uniform Commercial Code. Therefore, economic loss recovery is allowed in non-commercial product liability claims. *Chiang v. Pyro Chemical, Inc.*, 1997 WL 330622 (Conn. Super. 1997). The ELD is not a bar to tort actions where the relationship between the parties is contractual and the damages are economic in nature.

**DELAWARE: Majority Rule** (exception for residential construction). The ELD prevents recovery in tort where only the product itself has been damaged. *Danforth v. Acorn Structures, Inc.*, 608 A.2d 1194 (Del. Super. 1999). In 1996, the Delaware General Assembly passed the Home Owner's Protection Act. 6 *Del. C.* §§ 3651-52. This Act expressly does away with the economic loss doctrine in certain residential construction cases. Otherwise, where solely economic losses were sought and no damage to persons or other property has occurred, the plaintiff is limited to remedies under the Uniform Commercial Code, and may not proceed in tort. When two separate parts are integrated into one functioning whole, damage to either integrated piece by the other component does not constitute damage to "other property" for which tort recovery is allowed. *Delmarva Power & Light v. Meter-Treater, Inc.*, 218 F.Supp.2d 564 (D. Del. 2002).

**DISTRICT OF COLUMBIA: No Rule Adopted**, but leaning toward Minority Rule. The District of Columbia has not expressly adopted the ELD. Maryland law provides that the ELD applies unless there is a serious risk of injury or death. *Morris v. Osmose Wood Preserving*, 667 A.2d 624 (Md. 1995).

**FLORIDA: Majority Rule**. Florida relied on *East River* when it adopted the economic loss rule. *Florida Power & Light Co. v. Westinghouse Electric Corp.*, 510 So.2d 899 (Fla. 1987). The ELD does apply to service contracts. *AFM Corp. v. Southern Bell*, 515 So.2d 180 (Fla. 1987). It also applies to homeowners. *Casa Clara Condominium Ass'n v. Charley Toppino & Sons, Inc.*, 620 So.2d 1244 (Fla. 1993). Florida does recognize a "no alternative theory of recovery" exception to the ELD. *Airport Rent-a-Car, Inc. v. Prevost Car, Inc.*, 660 So.2d 628 (Fla. 1995). It also allows tort claims for fraud in the inducement situations. *PK Ventures, Inc. v. Raymond James & Associations, Inc.*, 690 So.2d 1296 (Fla. 1997). However, the ELD does apply in negligent failure to warn cases. *Airport Rent-a-Car, Inc.*, *supra*. Although seemingly in conflict with the *AFM Corp.* and *Casa Clara* decisions, the Florida Supreme Court has declared that the ELD will not apply to professional negligence claims against professionals such as engineers and lawyers. *Moransais v. Heathman*, 744 So.2d 973 (Fla. 1997).

**GEORGIA: Intermediate Rule** (via statute). Georgia has enacted its own statutory product liability law, rather than relying on common law or Section 402A of the Restatement. O.C.G.A § 51-1-11. No recovery in tort allowed when damage is to product only, unless there is personal injury or damage to “other property”. *Busbee v. Chrysler Corp.*, 524 S.E.2d 539 (Ga. App. 1999). Exception exists when there is sudden and calamitous event that causes risk of injury to persons or other property. *Vulcan Materials Co. v. Drilltech, Inc.*, 306 S.E.2d 253 (Ga. 1983). Another exception exists for misrepresentation relied on by the purchaser. *Robert & Co. Assoc. v. Rhodes-Haverty Partnership*, 300 S.E.2d 503 (Ga. 1983).

**HAWAII: Majority Rule.** The ELD bars claims for relief based on products liability or negligent design and/or manufacture theory for economic loss stemming from to the product alone. *Bronster v. United States Steel*, 919 P.2d 294 (Haw. 1996). Exceptions exist for negligent misrepresentation and fraud. In a construction context, purely economic losses cannot be recovered in tort from design professionals by those in privity of contract with those professionals. *City Express, Inc. v. Express Partners*, 959 P.2d 836 (Haw. 1998).

**IDAHO: Majority Rule.** Absent accompanying personal injury or property damage to property other than the product, purely economic losses alone are not recoverable in tort. *Duffin v. Idaho Crop Improvement Ass’n*, 895 P.2d 1195 (Idaho 1995). An exception exists when there is a special relationship involved, such as professional or quasi-professional relationships. *Duffin v. Idaho Crop Improvement Ass’n*, supra.

**ILLINOIS: Intermediate Rule.** A plaintiff may not recover for solely economic damages such as damage to the product alone in tort, unless accompanied by injury or damage to “other property”. *Moorman Mfg. Co. v. National Tank Co.*, 435 N.E.2d 443 (Ill. 1982). Recovery depends upon the nature of defect and the manner in which damage occurred. When the defect causes an accident “involving some violence or collision with external objects,” the resulting loss is treated as property damage. On the other hand, when the damage to the product results from deterioration, internal breakage, or other non-accidental causes, it is treated as economic loss. Exceptions exist when fraud or negligent misrepresentation are involved. *In re Chicago Flood Litigation*, 680 N.E.2d 265 (Ill. 1997).

**INDIANA: Majority Rule** (but also doesn’t allow recovery for damage to the product even if there is injury or damage to other property). Economic losses are not recoverable for product’s failure to perform, unless personal injury or damage to other property is present. *Bamberger & Feibleman v. Indianapolis Power & Light Co.*, 665 N.E.2d 933 (Ind. App. 1996). However, Indiana defines “economic loss” as “the loss of profits because the product is inferior in quality and does not work for the general purposes for which it was manufactured and sold, and includes such incidental and consequential losses as lost profits, rental expense and lost time.” This is also true under Indiana’s Strict Products Liability Act. *Ind. Code § 34-20-2-1*. Therefore, Indiana does not allow for recovery of damage to product itself, even when accompanied by personal injury or damage to other property. *Fleetwood Enterprises, Inc. v. Progressive Northern Ins. Co.*, 749 N.E.2d 492 (Ind. 2001). However, the Indiana Product Liability Act defines “physical harm” as:

(a) "Physical harm", for purposes of I.C. § 34-20, means bodily injury, death, loss of services, and rights arising from any such injuries, as well as sudden, major damage to property.

*(b) The term does not include gradually evolving damage to property or economic losses from such damage.*

Despite this language, Indiana courts have held that even if damage to the product is “sudden” and “major”, the legislature did not provide for recovery of damages to the product alone. *Progressive Ins. Co. v. General Motors*, 749 N.E.2d 484 (Ind. 2001). The economic loss rule does not bar recovery in tort for damage that a separately acquired defective product or service causes to other portions of a larger product into which the former has been incorporated. *Gunkel v. Renovations, Inc.*, 822 N.E.2d 150 (Ind. 2005).

**IOWA: Intermediate Rule.** Generally, tort recovery for purely economic losses is prohibited, and such claims are consigned to contract law. Factors to be considered in determining whether products liability claims sound in tort or contract are the nature of the defect, the type of risk, and the manner in which the injury arose. *American Fire & Casualty Co. v. Ford Motor Co.*, 588 N.W.2d 437 (Iowa 1999). Tort recovery for damage to the product alone is recoverable when accompanied by a sudden or dangerous occurrence, frequently involving some violence or collision with external objects, resulting from a genuine hazard in the nature of the product defect. As an example, if a fire alarm fails to work and a building burns down, it is considered an “economic loss” even though the building was physically harmed. It was a foreseeable consequence from the failure of the product to work properly. But if the fire was caused by a short circuit in the fire alarm itself, it is not economic loss. Defects of suitability and quality are redressed through contract actions and safety hazards through tort actions.

**KANSAS: Intermediate Rule.** *Daitom, Inc. v. Pennwalt Corp.*, 741 F.2d 1569, 1581 (10<sup>th</sup> Cir. 1984) (unreasonable dangerousness); *AgriStor Leasing v. Meuli*, 634 F. Supp. 1208, 1216-18 (D. Kan. 1986), *aff’d*, 865 F.2d 1150 (10<sup>th</sup> Cir. 1988) (one must examine the nature of the defect, the type of risk, and the manner in which the injury arose to decide whether the safety-insurance policy of tort law or the expectation-bargain protection policy of warranty is applicable).

**KENTUCKY: Majority Rule.** Although the Kentucky Supreme Court has never officially addressed the issue, in Kentucky, the economic loss rule permits recovery for damages to property other than the product purchased but denies recovery for damage to the product itself. *Mt. Lebanon Personal Care Home v. Hoover*, 276 F.2d 875 (6<sup>th</sup> Cir. 2002). The rule applies when parties engage in complex commercial endeavors, in order to preserve parties' abilities to distribute risks via contract, warranty, and insurance. In an unpublished opinion, it seems as though Kentucky is leaning toward the Intermediate Rule, by indicating that the ELD applies only where there is not the kind of harm which public policy requires manufacturers to protect independent of contractual obligation. *Williams v. Volvo-White*, 2003 WL 22681457 (Ky. App. 2003) (*unreported decision*). If an insured can pursue a warranty claim, so can a subrogated insurer – even without privity. *Ohio Cas. Ins. Co. v. Vermeer Mfg. Co.*, 298 F.Supp.2d 575 (W.D. Ky. 2004). The ELD applies whenever the purchasing party has the opportunity to allocate the risk of loss via contract or warranty. *Hoover*, *supra*. A Kentucky federal judge has held that the economic loss rule barred a distributor's claim based on fraudulent inducement, provided the fraudulent misrepresentation is inseparable from the essence of the parties' agreement. *General Electric Co. v. Latin American Imports*, 214 F.Supp.2d 758 (W.D. Ky. 2002).

**LOUISIANA: Minority Rule** (via statute). Louisiana has enacted the Louisiana Products Liability Act (LPLA). *La. Rev. Stat. Ann. § 9:2800.51, et seq.* The LPLA defines the “damages” recoverable for a product defect as to include “damage to the product itself”. *La. Rev. Stat. Ann. § 9:2800.53(5)*. Economic loss alone is recoverable in Louisiana. *DeAtley v. Victoria’s Secret Catalogue*, 876 So.2d 112 (La. App. 2004).

**MAINE: Majority Rule.** Maine strictly adheres to the ELD. *Oceanside at Pine Point Condominiums v. Peachtree Doors, Inc.*, 659 A.2d 267 (Me. 1995). With regard to component parts, Maine follows the “integrated products rule”, which is premised on the view that one must look to the product purchased or bargained for by the plaintiff rather than to the particular product sold by the defendant. *Fireman’s Fund v. Childs*, 52 F.Supp.2d 139 (D. Me. 1999). The relevant product is the product as it is viewed from the purchaser’s prospective. Maine includes service contracts (not including fiduciary relationships) within the purview of the ELD. *Maine Rubber, Int’l. v. Environmental Mgmt. Group*, 298 F.Supp.2d 133 (D. Me. 2004).

**MARYLAND: Intermediate Rule.** There is no recovery under the negligence theory for purely economic losses resulting from defective product, unless the defect causes a dangerous condition creating risk of death or personal injury; “economic losses” include loss of value or use of product itself, cost to repair or replace the product, or lost profits resulting from loss of use of product. *A.J. Decoster v. Westinghouse Electric Corp.*, 634 A.2d 1330 (Md. 1994); *Council of Co-Owners Atlantis Condo., Inc. v. Whiting-Turner Contracting Corp.*, 517 A.2d 336, 345-348 (Md. 1986) (clear danger of death or personal injury).

**MASSACHUSETTS: Intermediate Rule** (no strict liability in Massachusetts). There is no independent claim of strict liability in tort under Massachusetts law, and the most common causes of action in product liability cases are negligence, breach of the implied warranty of merchantability (virtually the same as strict liability), and unfair or deceptive acts or practices in violation of Massachusetts’ laws. Under Massachusetts law, the “economic loss doctrine” provides that purely economic losses are not recoverable in negligence and strict liability actions in the absence of personal injury or damage to property other than the product itself. *Bay State-Spray & Provincetown S.S., Inc. v. Caterpillar Tractor Co.*, 751 N.E.2d 862 (Mass. 1989). Under Massachusetts law, “economic loss” is defined as damages for inadequate value, costs of repair and replacement of a defective product, or the resulting loss of profits, without any claim of personal injury or damage to other property. *Cruickshank v. Clean Seas Co.*, 346 B.R. 571 (D. Mass. 2006). Where a commercial product injures itself and nothing or no one else, there is no need to create a product liability cause of action independent of contract obligation. The ELD draws a distinction between the situation where the injury suffered is merely the failure of the product to function properly, and the situation, traditionally within the purview of tort law, where the plaintiff has been exposed, through a hazardous product, to an unreasonable risk of injury to his person or property. *Sebago, Inc. v. Beazer East, Inc.* 18 F.Supp.2d 70 (D. Mass. 1998). In order for “other property” damage to negate application of the ELD, the “other property” must belong to the plaintiff – it can’t be property belonging to others. *Sebago*, supra.

**MICHIGAN: Intermediate Rule** (commercial parties only). Michigan employs the ELD, but only when the transaction involves two commercial parties. *Nieberger v. Universal Cooperatives*, 486 N.W.2d 612 (Mich. 1992). The rule does not operate to bar tort claims in lawsuits concerning “the sale of defective products to individual consumers who are injured in

a manner which has been traditionally been remedied by resort to the law of torts". *Frankenmuth Mutual Ins. Co. v. Ace Hardware*, 899 F.Supp.2d 348 (W.D. Mich. 1995).

**MINNESOTA: Majority Rule** (via statute). Minnesota has adhered to the ELD for many years, although the doctrine has been through a metamorphosis. *Superwood Corp. v. Siempelkamp Corp.*, 311 N.W.2d 159; *Hapka v. Paquin Farms*, 458 N.W.2d 683 (Minn. 1990). In 1991, Minnesota codified the ELD in their statutes. *Minn. Stat. § 604.10*. The statute, entitled *Economic Loss Arising From The Sale of Goods*, prohibits recovery in tort for damage to the product only, but provides exceptions where there is damage to "other property" or fraud or fraudulent or intentional misrepresentation. The ELD codification was amended in 2000 and applies to sales or leases that occur on or after August 1, 2000. *Minn. Stat. § 604.101*. Under the new statute the ELD applies to products both sold and leased and both consumer and commercial transactions. Misrepresentation claims are now limited to cases involving intentional or reckless misrepresentation.

**MISSISSIPPI: Majority Rule**. As of 1999, Mississippi adheres to the ELD. *State Farm Mutual Auto. Ins. Co. v. Ford Motor Co.*, 736 So.2d 384 (Miss. App. 1999). Mississippi has a statute which governs product liability suits. *Miss. Code Ann. § 11-1-63*. The statute exempts "commercial damage to the product itself" from recoverable damages. Any such damages must be recovered under warranty or breach of contract.

**MISSOURI: Majority Rule**. In a Missouri product liability case, the product must be "defective and unreasonably dangerous", and the damages recoverable are limited to personal injury or to property other than the property sold, unless the product was rendered useless by some "violent occurrence". *Clevenger and Wright, Co. v. A.O. Smith Harvestore Products, Inc.*, 625 S.W.2d 906 (Mo. App. 1981) (action by owner of grain silo owner for damages caused by tornado). If a warranty remedy is not available, the buyer is limited to recovery under a contract theory, which may be subject to defenses based on disclaimer of warranties. *Crowder v. Vandendeale*, 564 S.W.2d 879 (Mo. 1978) (homeowner sued contractor for failure to build home in workmanlike manner). A subsequent Court of Appeals decision, however, held that a secondary purchaser of good may recover damages for injury to the goods sold on a negligence theory, even absent a violent occurrence. *Groppe Co. v. United States Gypsum*, 616 S.W.2d 49 (Mo. App. 1981). The *Groppe* opinion derived the duty of care for this type of negligence cause of action directly from the implied warranty of merchantability provision in Missouri's version of §§ 2-314 through 318 of the Uniform Commercial Code. The 8<sup>th</sup> Circuit later resolved the conflict by holding that *Clevenger* correctly stated the law in Missouri denying recovery for damage to the product only even under a negligence theory. *R.W. Murray, Co. v. Shatterproof Glass Corp.*, 697 F.2d 818 (8<sup>th</sup> Cir. 1983). A fraud claim to recover economic losses is precluded by the economic loss doctrine where plaintiffs' claims for damages are not above and beyond any mere disappointed commercial expectations or desire to enjoy the benefit of the dealer agreements. *Self v. Equilon Enterprises, Inc.*, 2005 WL 3763533 (E.D. Mo. 2005). The ELD applies to sales of good, not services.

**MONTANA: Intermediate Rule**. The use of a product for the purpose for which it was intended has the foreseeable potential of damaging the users property, the doctrine of strict liability applies, even if the damage are to the product only. *Streich v. Hilton-Davis*, 692 P.2d 440 (Mont. 1992). Economic damages only are recoverable under both negligence and

misrepresentation causes of action. *Jim's Excavating Service, Inc. v. HKM Associates*, 878 P.2d 248 (Mont. 1994); *Ellinger v. Northwestern Agency, Inc.*, 938 P.2d 1347 (Mont. 1997).

**NEBRASKA: Majority Rule.** No recovery in tort/product liability allowed for economic damages to product alone unless there is accompanying personal injury or property damage to other property. *National Crane Corp. v. Ohio Steel Tube*, 332 N.W.2d 39 (Neb. 1983). There is an exception for intentional interference with a business relationship. *Koster v. P & P Enterprises, Inc.*, 539 N.W.2d 274 (Neb. 1995).

**NEVADA: Majority Rule** (exception for owners of new homes). No recovery allowed for economic damages to product alone without privity of contract or accompanying personal injuries or damage to other property. *Charlie Brown Construction Co., Inc. v. City of Boulder City*, 797 P.2d 946 (Nev. 1990), overruled on other grounds, 993 P.2d 1259; *Central Bit Supply, Inc. v. Waldrop Drilling & Pump, Inc.*, 717 P.2d 35 (Nev. 1986). However, the ELD does not apply to negligence claims by owners of newly constructed homes against subcontractors, because their damages are best addressed by tort law. *Calloway v. City of Reno*, 993 P.2d 1259 (Nev. 2000).

**NEW HAMPSHIRE: Intermediate Rule** (implied warranty claims only). When a defective product accidentally causes harm to persons or property, the resulting harm is treated as personal injury or property damage; when damage occurs only to an inferior product itself, through deterioration or non-accidental causes, harm is characterized as "economic loss." *Ellis v. Robert C. Morris, Inc.*, 513 A.2d 951 (N.H. 1986). Despite absence of privity of contract, subsequent purchasers of real property are entitled to sue a builder or contractor on the theory of implied warranty of workmanlike quality for latent defects that cause economic loss, so long as latent defects become manifest after the purchase of the property and would not have been discoverable had reasonable inspection of structure been made prior to purchase. *Lemke v. Dagenais*, 547 A.2d 290 (N.H. 1988). New Hampshire allows recovery of economic losses in implied warranty claims, even without privity, for defective products.

**NEW JERSEY: Majority Rule.** A consumer may not bring an action in negligence and strict liability for economic loss arising from purchase of a defective product, but must rely on breach of warranty remedies in the Uniform Commercial Code. *Alloway v. General Marine Industries, L.P.*, 695 A.2d 264 (N.J. 1997). New Jersey has not decided whether the ELD applies when the parties are of unequal bargaining power, the product is a necessity, no alternative source for the product is readily available, and the purchaser cannot reasonably insure against consequential damages.

**NEW MEXICO: Majority Rule.** As between commercial parties where there is no great disparity of bargaining power, the ELD prevents a plaintiff from recovering purely economic damages in tort actions. *Utah Int'l, Inc. v. Caterpillar Tractor Co.*, 775 P.2d 741 (Utah App. 1989). New Mexico feels such losses are better allocated to warranties and/or insurance. New Mexico has not yet decided whether the ELD applies to non-commercial consumers.

**NEW YORK: Majority Rule.** Tort recovery in strict products liability and negligence against a manufacturer should not be available to a downstream purchaser where the claimed losses flow from damage to the property that is the subject of the contract. *Bocre Leasing Corp. v. General Motors Corp.*, 645 N.E.2d 1195 (N.Y. 1995). An end-purchaser of a product is limited

to contract remedies and may not seek damages in tort for economic loss against a manufacturer for damages to the product alone. *Schiavone Construction Co. v. Elgood Mayo Corp.*, 436 N.E.2d 1322 (N.Y. 1982). An exception for service contracts exists. *MCI Telecommunications Corp. v. John Mezzalingua Associates, Inc.*, 921 F.Supp. 936 (N.D.N.Y.).

**NORTH CAROLINA: Majority Rule.** Damages to the product itself may not be recovered in tort based on a defect of the product. *Moore v. Coachmen Industries, Inc.*, 499 S.E.2d 722 (N.C. 1998). However, where “other property” is damaged, the damage to the product can be recovered.

**NORTH DAKOTA: Majority Rule.** North Dakota adopted the ELD in 1984. *Hagart Farms v. Hatton Industries, Inc.*, 350 N.W.2d 591 (N.D. 1984). You can't sue the manufacturer of a product for damage to the product alone where there is no accompanying personal injury or damage to “other property”. The ELD applies equally to commercial and consumer transactions. *Clarys v. Ford Motor Co.*, 592 N.W.2d 573 (N.D. 1999).

**OHIO: Majority Rule** (exception for noncommercial plaintiff). A commercial plaintiff is not permitted to recover in tort for purely economic damages – including damages to product alone. *Foster Wheeler Enviresponse, Inc. v. Franklin County Convention*, 678 N.E.2d 519 (Ohio 1997). Tort theories may be used if other, non-economic damages are sustained. *Lawyers Co-Op. Publishing Co. v. Muething*, 603 N.E.2d 969 (Ohio 1992). An Ohio statute makes it clear that although a cause of action may concern a product, it is not a product liability claim within the purview of Ohio's product liability statutes unless it alleges damages other than economic ones, and that a failure to allege other than economic damages does not destroy the claim, but rather removes it from the purview of those statutes. *R.C. § 2307.72*.

A commercial buyer seeking recovery from a seller for economic losses resulting from damage to defective product itself could maintain a contract action for breach of warranty under Uniform Commercial Code, but absent injury to persons or damage to other property, could not recover for economic losses premised on tort theories of strict liability or negligence. *Chemtrol Adhesives, Inc. v. American Manufacturers' Mutual Ins. Co.*, 537 N.E.2d 634 (Ohio 1989). A non-commercial plaintiff may recover for purely economic damages under the common law theory of implied warranty in tort. *Iacono v. Anderson Concrete Corp.*, 326 N.E.2d 267 (Ohio 1975).

**OKLAHOMA: Majority Rule.** Oklahoma recognizes the ELD, which provides that a product liability claim is not available for injury only to the product itself resulting in purely economic loss. *Waggoner v. Town and Country Mobile Homes, Inc.*, 808 P.2d 649 (Okla. 1990). The Oklahoma Supreme Court has amended the economic loss rule in two important ways. The economic loss rule does not apply in any case where the plaintiff is alleging a personal injury from using an allegedly defective and unreasonably dangerous product. *Dutsch v. Sea Ray Boats, Inc.*, 845 P.2d 187, 193-94 (Okla.1992) (plaintiff could collect damages for personal injury and damage to the product in a products liability action without bringing a separate breach of warranty claim to recover damages for economic loss). The ELD does not preclude recovery for damage to a defective product in cases where the plaintiff was personally injured or suffered damage to “other property”. *United Golf, L.L.C. v. Westlake Chemical Corp.*, 2006 WL 2807342 (N.D. Okla. 2006). Oklahoma has gone about as far as any state in destroying tort remedies for defective products and relying on warranty remedies. The illogical holding in

*United Golf* closes the door opened by *Dutsch*, holding that “consequential damages” to be governed by the ELD include:

- (a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and
- (b) injury to person or property proximately resulting from any breach of warranty. Okla. Stat. Tit. 12A, § 2-715.

The Oklahoma Supreme Court has focused on the foreseeability of damages to determine if the alleged harm qualifies as consequential damages under the UCC. *United Golf*, supra.

**OREGON: Intermediate Rule.** *Russell v. Ford Motor Co.*, 575 P.2d 1383 (Or. 1978) (The loss must be a consequence of the kind of danger and occur under the kind of circumstances, “accidental” or not, that made the condition of the product a basis for strict liability. This distinguishes such a loss from economic losses due only to the poor performance or the reduced resale value of a defective, even a dangerously defective, product. It is a difference between the endangered consumer and the disappointed consumer).

**PENNSYLVANIA: Majority Rule.** Recovery permitted only when there is injury or damage to other property. *R.E.M. Coal Co., Inc. v. Clark Equipment Co.*, 563 A.2d 128 (Pa. Super. 1989). However, there is a negligent misrepresentation exception to economic loss rule. A reasonable reading of this exception is that now any deviation from the standard of care in the design documents prepared by an architect is sufficient to meet the requirements of the negligent misrepresentation criteria adopted by this Pennsylvania court. *Bilt-Rite Contractors, Inc. v. The Architectural Studio*, 866 A.2d 270 (Pa. 2005). Where a plaintiff sues a component manufacturer, rather than the manufacturer of a final assembled product, a court must *not* look to the component part to define the product; rather, the relevant “product” remains “what the plaintiff bargained for,” (i.e., the fully assembled product that the plaintiff ultimately purchased). *Commercial Union Ins. Co. v. Kirby*, 149 F.3d 1163 (3<sup>rd</sup> Cir. 1998). The ELD also applies to service contracts. *Valley Forge Convention and Visitors’ Bureau v. Visitors’ Services, Inc.*, 28 F.Supp.2d 947 (E.D. Pa. 1998).

**RHODE ISLAND: Intermediate Rule** (not well defined). Rhode Island holds that if a defendant owes a duty of care to a third party that arises out of an existing contract, and the party to whom the duty is owed is injured, the injured party may bring a negligence action against the defendant even though the damages are purely economic. *Rousseau v. K.N. Construction, Inc.*, 727 N.E.2d 190 (R.I. 1999). The economic loss doctrine bars plaintiffs from “recovering purely economic losses in a negligence cause of action.” *Boston Investment Property #1 State v. E.W. Burman, Inc.*, 658 A.2d 515 (R.I.1995). Economic loss is defined as “costs associated with repair and-or replacement of a defective product, or loss of profits consequent thereto.” *Hart Engineering Co. v. FMC Corp.*, 593 F.Supp. 1471 (D.R.I. 1984).

**SOUTH CAROLINA: Majority Rule** (waffling). There is no tort liability for a product defect if the damage suffered by a plaintiff is only to the product itself. *Kennedy v. Columbia Leather and Mfg. Co., Inc.* 384 S.E.2d 730 (S.C. 1989). A plaintiff cannot seek economic damages, including damages to the product only, in tort. *Palmetto Linen Service, Inc. v. U.N.X., Inc.*, 105 F.3d 126 (4<sup>th</sup> Cir. 2000). South Carolina meekly recognizes the “other property” exception to

the ELD when non-commercial parties are involved, but in the context of a commercial transaction between sophisticated parties, injury to other property is not actionable in tort if the injury was or should have been reasonably contemplated by the parties to the contract. In a case where it applied the asbestos exception to the majority rule, the South Carolina Supreme Court noted their “difficulty with the economic loss rule generally” and has partially rejected the rule in the residential home building context. *Kershaw County Board of Education v. U.S. Gypsum, Co.*, 396 S.E.2d 369 (S.C. 1990) (citing *Kennedy*).

**SOUTH DAKOTA: Majority Rule.** When there is no accident and no physical harm so that the only loss is pecuniary” – such as damage to the product itself – there can be no recovery in tort. *Diamond Surface, Inc. v. State Cement Plant Comm’n*, 583 N.W.2d 155 (S.D. 1998). The general rule is that economic losses are not recoverable under tort theories; rather, they are limited to the commercial theories found in the UCC. One exception to the general rule is when personal injury is involved. *City of Lennox v. Mitek Industries, Inc.*, 519 N.W.2d 330 (S.D. 1994). The second exception may apply when the damage is to “other property” as opposed to the specific goods that were part of the transaction. Other property has been defined as damage to property collateral to the product itself.

**TENNESSEE: Majority Rule** (leaning toward Intermediate Rule). In a contract for the sale of goods where the only damages alleged are damages to the product itself, the rights and obligations of the buyer and seller are governed exclusively by the contract. *Trinity Industries, Inc. v. McKinnon Bridge Co., Inc.*, 77 S.W.3d 159 (Tenn. Ct. App. 2001). Tennessee accepts the economic loss doctrine as a “crude proxy” for the dividing line between what is tort and what is not. The Tennessee Supreme Court decided a case involving a farmer who had used a product on tomato plants in an attempt to protect plants from frost damage, resulting in economic loss in the form of lost profits due to damage to the tomatoes. Because the plaintiffs sued for “lost profits” instead of damage to the tomatoes, the court held they could not proceed on tort theories – only warranty and contract. *Ritter v. Custom Chemicides, Inc.*, 912 S.W.2d 128 (Tenn. 1995). In *Ritter*, the door appears to have been left open to pursue a tort action for damages to the product only when “the plaintiff has been exposed to an unreasonable risk of injury to his person or his property” as opposed to mere failure of the product to perform as expected.

**TEXAS: Majority Rule.** Texas adheres to the classic ELD, and prohibits recovery in tort for damages to the product alone. *Nobility Homes of Texas, Inc. v. Shivers*, 557 S.W.2d 77 (Tex. 1977); *Purina Mills, Inc. v. Odell*, 948 S.W.2d 927 (Tex. App. 1997). Where a defective product causes damages to the product itself and to surrounding property, the damages to the product itself can be recovered in tort along with the damage to the surrounding property. *Signal Oil and Gas Co. v. Universal Oil Products*, 572 S.W.2d 320 (Tex. 1978).

**UTAH: Intermediate Rule** (waffling and has independent duty exception). Only recently has Utah adopted the ELD, prohibiting the recovery in tort of solely economic damages, including damages to or diminution in value of the product itself. *Hermansen v. Tasulis*, 48 P.3d 234 (Utah 2002). However, Utah has carved an exception which says that the economic loss rule does not bar tort claims when those tort claims *are based on a duty independent of those found in the contract*. *Grynberg v. Questar Pipeline Co.*, 70 P.3d 1 (Utah 2003). In Utah, tort law governs the duties and liabilities imposed by legislatures and courts upon non-consenting members of society, and contract law governs independent duties that exist apart from the

contract. All contract duties and all breaches of those duties, no matter how intentional, must be enforced pursuant to contract law. Until the *Hermansen* decision in 2002, Utah had adhered to the rule that where the alleged defective manufacture of a product results in the deterioration of or damage to that product, the consumer's damages are not "purely economic," or economic loss alone, and actions to recover all damages resulting from the product's deterioration should be allowed under a negligence theory. *W.R.H., Inc. v. Economy Builders' Supply*, 633 P.2d 42 (Utah 1981). Utah had never recognized the economic loss rule as applicable except as against claims of negligent design and construction of improvements to real property. *Steiner Corp. v. Johnson & Higgins of California*, 196 F.R.D. 653 (D. Utah 2000). The Utah Supreme Court has also strictly limited the reach of *W.R.H.* to its facts, and declined to extend its rule to govern transactions between sophisticated commercial entities. *Salt Lake City Corp. v. Kasler Corp.*, 842 F.Supp. 1380 (D. Utah 1994).

**VERMONT: Majority Rule.** In 1998, Vermont adopted the ELD to prohibit owners of a motor home from recovering, in strict product liability action, purely economic losses consisting of reduced value of the motor home resulting from its defective wiring system and related problems. *Paquette v. Deere and Co.*, 719 A.2d 410 (Vt. 1998). Absent some accompanying physical harm, there is no duty to exercise reasonable care to protect another's economic interests, including damages to the product alone.

**VIRGINIA: Majority Rule.** Damages for purely economic loss, as opposed to damages for injury to property or persons, cannot be recovered in a tort claim, based on negligence. The ELD does apply to real property and home sales/construction. *Sensenbrenner v. Rust, Orling & Neale, Architects, Inc.*, 374 S.E.2d 55 (Va. 1988). It also applies to negligent performance of a contract. *Gerald M. Moore & Son, Inc. v. Drewry*, 467 S.E.2d 811 (Va. 1996). Damage to a product itself constitutes "economic loss" because, although damages to a product itself have certain attributes of a product liability claim, the injury suffered (failure of the product to perform properly) is the essence of a warranty action through which a contracting party can seek to recoup the benefit of its bargain. *Burner v. Ford Motor Co.*, 2000 WL 33259938 (Va. Cir. Ct. 2000).

**WASHINGTON: Intermediate Rule.** In 1976, Washington adopted a minority view and permitted a plaintiff to recover damages in tort for purely economic damages (lost profits) after a defectively manufactured engine malfunctioned during a commercial fishing trip. *Berg v. General Motors Corp.*, 555 P.2d 818 (Wash. 1976). The *Berg* decision was short-lived, however, as the Legislature effectively overruled *Berg* in 1981 with the enactment of the Washington Products Liability Act (WPLA), R.C.W.A. § 7.72. Under the WPLA, the Legislature specifically excluded a recovery in tort for economic losses, deferring such claims instead to the Uniform Commercial Code. Architectural services, engineering services, and inspection services are not "products" under the WPLA. Washington analyzes interrelated factors such as the nature of the defect, the type of risk, and the manner in which the injury arose. These factors bear directly on whether the safety-insurance policy of tort law or the expectation-bargain protection policy of warranty law is most applicable to the claim in question. *Washington Water Power Co. v. Graybar Electric Co.*, 774 P.2d 1199 (Wash. 1989).

**WEST VIRGINIA: Intermediate Rule.** Property damage to a defective product alone which results from a sudden calamitous event attributable to the dangerous defect or design of the

product itself, is recoverable under a strict liability cause of action. *Anderson v. Chrysler Corp.*, 403 S.E.2d 189, 192-93 (W. Va. 1991).

**WISCONSIN: Majority Rule.** A commercial or consumer purchaser of a product may not sue the manufacturer in strict liability or tort for failure of the product unless the failure injures somebody or causes damage to other property. *Sunnyslope Grading, Inc. v. Miller, Bradford & Risberg, Inc.*, 437 N.W.2d 213 (Wis. 1989). The ELD also precludes tort recovery when the defective product causes damage to a system in which the product had been integrated as a component part. *Midwhey Powder Co. v. Clayton Industries, Inc.*, 460 N.W.2d 426 (Wis. App. 1990).

**WYOMING: Majority Rule.** Recovery under tort law is not allowed where the claim is solely for economic damages unaccompanied by personal injuries or damage to other property. Only theories allowed are breach of warranty or breach of contract. *Continental Ins. Co. v. Page Engineering, Co.*, 783 P.2d 641 (Wyo. 1983).