23 THE ECONOMIC LOSS RULE

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I. [§23.1] INTRODUCTION

The Economic Loss Rule (the "ELR" or the "Rule") has been called "one of the most confusing doctrines in tort law," R. Joseph Barton, *Drowning in a Sea of Contract: Application of the Economic Loss Rule to Fraud and Negligent Misrepresentation Claims*, 41 Wm. & Mary L. Rev. 1789, 1789 (2000); "obscure," John J. Laubmeier, *Demystifying Wisconsin's Economic Loss Doctrine*, 2005 Wis.L.Rev. 225, 225 (2005); and "a confusing morass," *Indemnity Insurance Co. of North America v. American Aviation, Inc.*, 891 So.2d 532, 544 (Fla. 2004) (Cantero, J., concurring).

Economic losses are sometimes referred to as commercial losses. See, *e.g.*, *Nobility Homes of Texas, Inc. v. Shivers*, 557 S.W.2d 77 (Tex. 1977); *Seely v. White Motor Co.*, 403 P.2d 145 (Cal. 1965) (using term "commercial losses" interchangeably with "economic losses"). It has been suggested that "commercial loss" is a more appropriate term. See *Miller v. U.S. Steel Corp.*, 902 F.2d 573, 574 (suggesting that "[i]t would be better to call it a 'commercial loss,' . . . because personal injuries and especially property losses are economic losses, too — they destroy values which can be and are monetized").

Professor Oscar S. Gray, a leading torts scholar, has expressed misgivings about attempts to formulate a unified economic loss rule. Professor Gray has observed:

I had not previously thought that there was any such thing as a single "economic loss rule." Instead, I had thought that there was a constellation of somewhat similar doctrines that tend to limit liability, in the case of purely economic loss, from what might have been expected under *Palsgraf* [*v. Long Island R.R.*, 162 N.E. 99 (N.Y. 1928)] in the case of physical loss. These doctrines seemed to work in somewhat different ways in different contexts, for similar but not necessarily identical reasons, with exceptions where the reasons for limiting liability were absent. Gray, *Some Thoughts on "The Economic Loss Rule" and Apportionment*, 48 Ariz.L.Rev. 897, 901–902 (Winter 2006).

Another scholar, Professor Ralph C. Anzivino, has similarly observed the difficulty encountered

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by the courts in applying such a rule uniformly to contracts executed under false colors of fraud:

Difficulties arise, however, when one is fraudulently induced to enter into a contract for a product, and only economic loss is incurred. There is no personal injury or damage. How does the fraud impact where the line is drawn under the economic loss doctrine? Is the public interest sufficiently involved to invoke tort law, or is this still a private matter between private contracting parties that invokes only contract law?

Anzivino, *The Fraud in the Inducement Exception to the Economic Loss Rule*, 90 Marquette Univ. Law Rev. 921, 922 (2007).

Many members of the Bar and our scholarly brethren have attempted to sort out, with varying degrees of success, the myriad of permutations on the ELR that courts have set forth in holdings, dicta, and publications. This chapter gathers much of that thought so that the practitioner may gain insight into both where we have been with the ELR and where we should go, particularly in a given case before a given bench. What the practitioner will find in this chapter, then, is a gathering of the thinking of those who have sought to address the ELR with some insight into how to apply those analyses in advocating for or defending the client.

As Professor Anzivino observes, whether to pursue damages that arise out of fraudulent inducement as a tort or contract action is a significant decision, driven by vagaries of contract and tort law. For example, privity is generally required in a contract action but not in tort; statutes of limitations differ between contract and tort; and pleading requirements and burdens of proof differ, from "preponderance of the evidence" in a contract case to "clear and convincing evidence" in a fraud case. Additionally, the type of damages recoverable differ, with damages available in tort intended to both (a) return the harmed party to the position that party was in before the wrongful actions of the defendant; and (b) deter others from such conduct; while contract damages aim to compensate the harmed party for the nonperformance of a contract. Mandatory claims and election of remedies may also apply. Therefore, whether to proceed in contract or tort is a critical strategic decision.

To make the appropriate decision thus requires that the practitioner discern between the three areas in which the Rule is invoked and applied:

- products liability cases, in which the issue is merely whether an allegedly defective product causes pure money damages to itself;

- contract cases, in which a tort claim for economic damages is presented when there is some other contract between the parties (*e.g.*, a service contract or a contract relating to non-defective goods or real estate) that allocates or could have allocated the risks of economic loss. As to these matters, there is a consensus that the breach of a purely contractual duty is not actionable as a tort if the only consequences are economic losses; and

- all other tort cases beyond defective product- or contract-related claims. In this vast territory, the operation of the economic loss rule is not well mapped, and whether there is a

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"rule" at all is a subject of contention.

See Johnson, *The Boundary-Line Function of the Economic Loss Rule*, 66 Wash. & Lee L. Rev. 523 (Spring 2009).

The disjointed evolution of the Rule has created some interesting and contrasting judicial conclusions in Florida. See *Indemnity Insurance Co. of North America*, 891 So.2d at 543 n.3 ("Intentional tort claims such as fraud, conversion, intentional interference, civil theft, abuse of process, and other torts requiring proof of intent generally remain viable either in the products liability context or if the parties are in privity of contract" because "a rule barring recovery for economic loss 'is not an escape hatch from intentional commercial torts'"); compare *Gulf Coast Produce, Inc. v. American Growers, Inc.*, 2008 WL 660100 (S.D. Fla. 2008) (economic loss rule is inapplicable to conversion claim). But see *Action Nissan, Inc. v. Hyundai Motor America*, 617 F.Supp.2d 1177, 1192–1193 (M.D. Fla. 2008) (stating that "[w]hile the economic loss rule does not automatically bar a breach of fiduciary duty claim, the rule does apply when the claim for breach of fiduciary duty is based upon and inextricably intertwined with the claim for breach of contract," and finding that plaintiff's claim was barred).

There are also distinctions to be drawn depending upon the nature of the underlying act. For example, fraud in the performance occurs "[w]hen the fraud relates to the performance of the contract, [in which case] the economic loss doctrine limits parties to contractual remedies," while fraud from "misrepresentations, statements, or omissions which cause the complaining party to enter into a transaction . . . is fraud in the inducement and survives as an independent tort." See *D & M Jupiter, Inc. v. Friedopfer*, 853 So.2d 485, 487–488 (Fla. 4th DCA 2003) (quoting *Allen v. Stephan Co.*, 784 So.2d 456, 457 (Fla. 4th DCA 2000)). See also *Shands Teaching Hospital & Clinics, Inc. v. Beech St. Corp.*, 899 So.2d 1222, 1228–29 (Fla. 1st DCA 2005) (holding that rule did not bar health care provider from suing administrator of state's group health insurance program for tortious interference with contract). Compare *PNC Bank, N.A. v. Colonial Bank, N.A.*, 2008 WL 2917639, at *3 (M.D. Fla. 2008) (finding that conversion claim was barred by economic loss rule when it related "directly to the performance of the Agreement and is therefore 'exactly coextensive'with . . . [the plaintiff's] breach of contract claim" (quoting *Future Tech International, Inc. v. Tae Il Media, Ltd.*, 944 F.Supp. 1538, 1569 (S.D. Fla. 1996)).

A variety of reasons have been stated to justify the development of the Rule, such as that the Rule

- Prevents liability for negligence that causes only economic harm (money damages) and prevents defendants from being exposed to unlimited claims;
- Prevents speculative damages claims;
- Prevents disproportionate liability awards; and

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- Has a chilling effect on non-negligent conduct.

> "Courts [therefore] reason . . . that the economic loss rule applies where the parties could or should have allocated the risk of loss, or had the opportunity to do so." On the other hand, the economic loss rule ensures respect for decisions made by the parties with respect to loss allocation. "The prohibition against tort actions to recover solely economic damages for those in contractual privity is designed to prevent parties to a contract from circumventing the allocation of losses set forth in the contract by bringing an action for economic loss in tort."
>
> The boundary-line justification for the economic loss rule is plausible both in common sense terms and on closer analysis. [Internal citations omitted]

Johnson, *supra* at 548.

II. DEVELOPMENT OF THE ECONOMIC LOSS RULE

A. [§23.2] Origins
B. The "Other Property" Exception
C. [§23.5] Professional Services
D. Fraudulent Inducement
E. [§23.9] Motions To Dismiss
F. [§23.10] The Economic Loss Rule And Negligent Misrepresentation Claims
G. [§23.11] Further Exceptions

A. [§23.2] Origins

Because a tort claim and a contract claim can arise from the same conduct, plaintiffs may be able to articulate their contract claims as tort claims. A claim under tort law provides at least three advantages over a claim under contract law. First, contract law generally limits recovery to parties in privity of contract. On the other hand, tort law generally allows any injured party to recover. Second, a plaintiff may be able to bring a tort claim long after the statute of limitations has run on the analogous contract claim because, in tort law, the statute of limitations begins to run only after the plaintiff knew or should have known of the injury. Third, nearly every state allows punitive damages for fraud, while contract law limits remedies to the benefit of the bargain. Given all the benefits of tort law for plaintiffs, courts developed the economic loss rule to prevent plaintiffs from using tort law "to trump contract law and render the parties' bargains and the careful allocation of duties and risks in the UCC meaningless." Heaton, *Eastwood's Answer to Alejandro's Question: The Economic Loss Rule Should Not Bar Fraud Claims*, 331 Wash. L. Rev. 86 (2011).

The ELR originated in disputes over defective products between commercial parties in the UCC context. As originally formulated, the Rule was intended to be limited to products or goods that caused harm after being transacted between commercial parties. Next, the definition of products and goods was

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expanded to include real property and improvements thereon. Consumer transactions were then added to the mix and, consequently, the application of the Rule went beyond the UCC to any contract dispute, whether or not it involved a product or good.

Prior to the 1986 decision of the United States Supreme Court in *East River Steamship Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858, 106 S.Ct. 2295, 90 L.Ed.2d 865 (1986) (in which Chief Justice Rehnquist famously expressed his concern that the law of contract might "drown in a sea of torts"), and the decisions of the Florida Supreme Court in *AFM Corp. v. Southern Bell Telephone & Telegraph Co.*, 515 So.2d 180 (Fla. 1987), and *Florida Power & Light Co. v. Westinghouse Electric Corp.*, 510 So.2d 899 (Fla. 1987), few lawyers and even fewer courts had ever heard of the economic loss rule. In less than 15 years, this judicially created rule became so prominent in Florida that one intermediate appellate court actually gave it the power to deny claimants recovery under statutorily created remedies. The Florida Supreme Court, adopting the dissent of Judge Gerald Cope of the District Court of Appeal, Third District, reined in the economic loss rule in *Comptech International, Inc. v. Milam Commerce Park, Ltd.*, 753 So.2d 1219 (Fla. 1999), and subsequent decisions.

Justice Harry Blackmun's opinion in *East River*, which held that "whether stated in negligence or strict liability, no products liability claim lies in admiralty when the only injury claimed is economic loss." *Id.* at 476 U.S. 876. That decision, along with the previously established rule that negligent interference with contract or prospective advantage is not actionable, catalyzed efforts by various courts to formulate an economic loss rule that applied beyond the fields of products liability or tortious interference. See *Giles v. General Motors Acceptance Corp.*, 494 F.3d 865, 873 (9th Cir. 2007) ("The 'economic loss doctrine' as a separately named and articulated doctrine dates only from the last half century").

The economic loss rule does not owe its origins to Florida jurisprudence. Rather, and much like many of the forward-thinking legal doctrines that later found resonance in Florida law (*i.e.*, the legal claim of breach of the covenant of good faith and fair dealing, prominently developed by the New Jersey Supreme Court in *Sons of Thunder, Inc. v. Borden, Inc.*, 690 A.2d 575 (1997)), the ELR has its origins in California, where it emerged from the strict liability cases as a defense to tort liability when parties had allocated risk through contract with specific warranty provisions covering potential product defects. The doctrine developed in 1965 when the Supreme Court of California ruled in *Seely v. White Motor Co.*, 403 P.2d 145 (Cal. 1965), that tort liability was not appropriate under a strict liability theory for the losses maintained when a truck overturned without injuring anyone. The court reasoned that the buyer of the truck suffered losses only because the truck failed to perform up to expectations; thus, tort damages were not appropriate. Because the losses were economic in nature, Justice Roger Traynor explained that the claim was grounded in contract and that consumers can "be fairly charged with the risk that the product will not match . . . [their] economic expectations unless the manufacturer agrees that it will." *Seely* at 150.

However, the reasoning employed in the *Seely* opinion directly contradicted an opinion on the same topic handed down in the same year by the New Jersey Supreme Court. The New Jersey case, *Santor v. A & M Karagheusian, Inc.*, 207 A.2d 305 (N.J. 1965), 16 A.L.R.3d 670, *abrogated* 695 A.2d

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