2008

Davencourt at Pilgrims Landing Townhome Owners Association v. Davencourt At Pilgrims Landing, LeGrand Woolstenhulme, Michael D. Parry Construction Company, John Does, Townhome Owners Association : Amicus Brief

Utah Supreme Court

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IN THE UTAH SUPREME COURT

DAVENCOURT AT PILGRIMS LANDING TOWNHOME OWNERS ASSOCIATION, a Utah non-profit corporation, Plaintiffs, vs. DAVENCOURT AT PILGRIMS LANDING, LC, a Utah limited liability company, LeGRAND WOOLSTENHULME, an individual, MICHAEL D. PARRY CONSTRUCTION COMPANY, INC., a Utah corporation, and JOHN DOES 1-30 TOWNHOME OWNERS ASSOCIATION, a Utah non-profit corporation, Defendants.	Appeal No. 20070914

BRIEF OF AMICI CURIAE, AIA – Utah, ACEC, and AGC, IN SUPPORT OF DEFENDANTS/APPELLEES

On appeal from a Final Order of the Fourth Judicial District Court, Utah County, Provo Department, the Honorable Judge James R. Taylor

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INTEREST OF AMICI CURIAE

The Utah Society of the American Institute of Architects (AIA Utah), American Council of Engineering Companies (ACEC), and Associated General Contractors (AGC), submit this amicus brief regarding the application of the economic loss rule to defective design and construction claims. These amici parties are state or state chapters of national organizations involved in the design and construction industry in Utah. These amici parties are filing this brief in support of defendants/appellees and request this Court to keep the economic loss rule in its current form in order to preclude a non-intentional tort claim for defective design and construction.

STATEMENT OF JURISDICTION

This Court has jurisdiction over this appeal pursuant to Utah Code Ann. § 78A-3-102.

STATEMENT OF ISSUES ON APPEAL

Amici adopt the statement of issues and standards of review in defendants'/appellees' brief.

STATEMENT OF FACTS

Amici adopt the statement of facts in defendants'/appellees' brief.

STATEMENT OF THE CASE

Amici adopt the statement of the case in defendants'/appellees' brief.

STATUTE WHOSE INTERPRETATION IS DETERMINATIVE OF THE APPEAL

Utah Code Ann. § 78B-4-513 (Utah 2008)

1) Except as provided in Subsection (2), an action for defective design or construction is limited to breach of the contract, whether written or otherwise, including both express and implied warranties.
2) An action for defective design or construction may include damage to other property or physical personal injury if the damage or injury is caused by the defective design or construction.
3) For purpose of Subsection (2), property damage does not include:
   (a) the failure of construction to function as designed; or
   (b) diminution of the value of the constructed property because of the defective design or construction.
4) Except as provided in Subsection (2) and (6), an action for defective design or construction may be brought only by a person in privity of contract with the original contractor, architect, engineer, or the real estate developer.
5) If a person in privity of contract sues for defective design or construction under this section, nothing in this section precludes the person from bringing, in the same suit, another cause of action to which the person is entitled based on an intentional or willful breach of a duty existing in law.

6) Nothing in this section precludes a person from assigning a right under a contract to another person, including to a subsequent owner or a homeowners association.

SUMMARY OF ARGUMENTS

Under existing Utah law, a party may not assert a non-intentional tort claim to recover purely economic losses resulting from defective design or construction. An exception to this rule exists when a party can demonstrate an independent duty exists that arises separate from the design or construction entity's contractual obligations. An independent duty may exist where a direct relationship between parties requires one party possessing superior knowledge to disclose, when asked, any known and material defects. Utah law does not impose an independent duty to design or construct a defect free structure or residence. A claim for defective design and construction must be asserted through a breach of contract claim, as construction and real estate purchase contracts govern the parties' economic expectations and allocations of economic risk.

Although Utah law has created a workable standard that allows parties to freely negotiate and allocate economic risks and economic expectations, plaintiff and its supporting amicus request this Court to overturn a long line of cases establishing this rule. Under plaintiff's rule of law, design and construction entities cannot enter into a contract to define economic risks because such negotiated contractual provisions could be avoided through a non-intentional tort claim asserted by a party to the contract who found itself dissatisfied with the contract or by a third party whom the design and construction entity had never contemplated. Moreover, plaintiff requests this Court to adopt a rule that is

contrary to a statute governing defective design and construction claims that was enacted in 2008. This Court should affirm the trial court's rulings that correctly applied the economic loss rule to bar plaintiff's claims in this case.

ARGUMENT

I. Utah's economic loss rule is well defined and allows parties to enter into negotiated agreements to define each parties' economic risks and expectations.

This Court should not reverse *American Towers*, and it should reaffirm the application of the economic loss rule to preclude recovery of economic loss through a tort claim for negligent design and construction. Although plaintiff and its supporting amicus (collectively referred to as plaintiff) give short shrift to the Utah Legislature's new statute, Utah Code Ann. § 78B-4-513 effectively precludes the relief that plaintiff seeks – namely the ability to recover in tort for economic losses for defective design and construction. Rather than overturn a decade's worth of jurisprudence and enact a rule of law contrary to a newly enacted statute as plaintiff requests, this Court should keep a rule of law that allows parties to freely negotiate and allocate risks as the parties' circumstances require.

In its current state, Utah's economic loss rule bars a party from asserting a non-intentional tort claim for defective design and construction. Recent decisions have carved out exceptions to this rule when a party owes an independent duty of care; however, Utah's appellate courts have only imposed a duty when the parties' relationship requires one party to disclose known and material facts. In this case, as in most design and

construction defect cases, plaintiff has not alleged the builder or developer knew that defective design or construction caused the alleged water intrusion, nor has plaintiff alleged that defendants knew that defective soil conditions existed. The allegations are that defective design and construction caused water intrusion. In short, this case is nearly identical to *American Towers*. The same policy considerations that supported this Court's opinion in *American Towers* still apply, and as a consequence, this Court should affirm the trial court's rulings.

In order to fully understand why the economic loss rule applies to this case and how Utah Code Ann. § 78B-4-513 fits with this Court's opinions on the economic loss rule, a thorough understanding of the evolution of the economic loss rule in Utah is necessary:

a. Utah adopts the economic loss rule to preclude recovery of economic losses for negligent design and construction of homes.

In 1994, the Utah Court of Appeals adopted the economic loss rule to bar recovery of economic losses through a non-intentional tort claim, noting it was the "majority position." *See Maack v. Resource Design & Construction, Inc.,* 875 P.2d 570, 579-80 (Utah Ct. App. 1994) (*citing East River Steamship Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858, 866-75, 106 S. Ct. 2295 (1986)). In *Maack*, the Court of Appeals precluded a subsequent homeowner from asserting tort claims for negligent design and construction against the original homebuilder with whom the subsequent homeowner lacked contractual privity. *See id.* at 581. In reaching this decision, the Court of Appeals

stated that the economic loss rule was premised on the inherent differences between tort and contract law. The Court of Appeals stated: "Contract law protects expectancy interests created through agreement between the parties, while tort law protects individuals and their property from physical harm by imposing a duty to exercise reasonable care." *Id.* at 580.

A few months after *Maack*, the Court of Appeals reaffirmed Maack in *Schafir v. Harrigan*, 879 P.2d 1384, 1388 (Utah Ct. App. 1994). *Schafir*, like *Maack*, involved a subsequent homeowner's claims against the original builder for latent defects in the design and construction of a single family residence. *See id.* The plaintiff in *Schafir* cited to the Colorado opinion, *Cosmopolitan Homes, Inc. v. Weller*, 663 P.2d 1041, 1044 (Colo. 1983) to argue that economic losses are recoverable in negligent construction cases. *See id.* at 1388 and n.9. The Court of Appeals declined plaintiff's invitation to follow the Colorado rule in *Cosmopolitan Homes*, and instead, the Court of Appeals followed its prior opinion in *Maack*. *See id.* Accordingly, after *Maack* and *Schafir*, the economic loss rule precluded recovery in tort for defective design and construction of a single family home.

b. The Utah Supreme Court expands the economic loss rule to bar a condominium owners association's claims against design and construction entities.

In *American Towers*, the plaintiff, a condominium owners association like plaintiff in this case, asserted claims against the contractors for design and construction defects in the plumbing and mechanical systems in the condominium complex. *See American*

Towers Owners Association v. CCI Mechanical, Inc., 930 P.2d 1182, 1184 (Utah 1996). Like the plaintiff in this case, the American Towers owners association lacked privity of contract with the contractors. The damages sought in *American Towers* included the cost of repairing the alleged defects and the diminution in value of the condominiums due to the alleged defects. *See id.* Much like the claims in the present case, the plaintiff in *American Towers* asserted claims premised on theories of intended third-party beneficiary, negligence, and breach of warranty. *See id.*

Applying the economic loss rule to the claims, this Court rejected the American Towers owner association's claims. *See id.* First, this Court rejected any notion that the actual owers of the condominium units or the condominium owners association were intended third party beneficiaries to the design and construction contracts. *See id.* at 1188. Absent an express provision in the design and construction contracts evidencing an intent to make a third party an intended beneficiary of the contract, the subsequent owners and the association, even though known to exist, were not third party beneficiaries and had no contractual or warranty claims. *See id.*

This Court then turned to the application of the economic loss rule to negligent design and construction claims in the context of a large condominium complex. *See id.* at 1189-90. First, this Court rejected arguments that the association's claims for negligent design and construction of the plumbing and mechanical systems constituted negligent design of a product rather than the negligent design and construction of improvements to real property. *See id.* This Court expressly held that the association's negligent design

and construction of the plumbing and mechanical systems was not a negligent manufacture of a product. *See id.* at 1190. Moreover, this Court went on to clarify that damage to walls and personal property as a result of the defective plumbing does not constitute damage to "other property." *See id.* at 1191. This Court stated: "the 'property' was the entire complex itself that was constructed as an integrated unit under one general contract." *Id.*

Like the plaintiff in this case, the American Towers owners association argued that the economic loss rule unfairly allowed the builders of defective housing to avoid liability for negligent design and construction. *See id.* at 1190. This Court disagreed, stating: "Builders who construct low quality housing that does not cause injury to persons or property may still be held liable for damages, but that liability should be defined by the contract between the parties." *Id.* This Court went on to state: "The law of torts imposes no standards on the parties' performance of the contract; the only standards are those agreed upon by the parties. Tort law is concerned only with the safety of a product or an action." *Id.* This Court emphasized the important policy justification for the economic loss rule: "Otherwise, the extension of tort law would result in 'liability in an indeterminate amount for an indeterminate time to an indeterminate class.'" *Id.*

Instead, this Court determined that the economic loss rule was particularly well suited to claims of negligent construction. *See id.* "Construction projects are characterized by detailed and comprehensive contracts that form the foundation of the industry's operations. Contracting parties are free to adjust their respective obligations to

satisfy their mutual expectations." *Id.* In short, this Court reaffirmed the principle that the parties are free to negotiate their own contracts, and contracts set the parties' economic expectations and exposures. *See id.*

In the case of a party who purchases a single family residence, a unit in a condominium, or a residence in a planned unit development, the remedy is the same. The buyer enters into a contract to purchase the residence from a prior owner, a builder, or a developer. "A buyer can avoid economic loss resulting from defective construction by obtaining a thorough inspection of the property prior to purchase and then by either obtaining insurance or by negotiating a warranty or reduction in price to reflect the risk of any hidden defects." *Id.* In summary, this Court rejected the owners association's claims, stating: "To allow the claim would be to impose the [homeowners'] economic expectations upon parties whom the [homeowners] did not know and with whom they did not deal and upon contracts to which they were not a party." *Id.* at 1192. In short, this Court addressed and rejected each argument that plaintiff asserted to the trial court and now on appeal. Plaintiff has offered no factual, legal, or policy reason to justify a different outcome than this Court's previous decision in *American Towers*.

c. This Court reaffirms that the economic loss rule precludes a negligent design and construction claims that seek to recover purely economic losses.

In *SME Industries, Inc. v. Thompson, Ventulett, Stainback and Associates, Inc.*, this Court applied the economic loss rule to preclude a subcontractor's claims against design entities where the parties lacked privity of contract. *See id.*, 2001 UT 54, ¶¶31-45,

28 P.3d 669. Affirming its reasoning in *American Towers*, this Court noted that "all parties to a construction project, not just the buyers and developers at issue in *American Towers*, resort to contracts and contract law to protect their economic expectations." *Id.* at ¶36. In summary, this Court held: "to maintain the fundamental boundary between tort and contract law, we hold that when parties have contracted, as in the construction industry, to protect against economic liability, contract principles override the tort principles enunciated in section 552 of the Restate (Second) of Torts and, thus, economic losses are not recoverable." *Id.* at ¶44. Thus, this Court affirmed that the economic loss rule was particularly well-suited to defective design and construction claims and barred plaintiff's tort claims.

d. This Court adopts the independent duty exception to the economic loss rule.

Shortly after *SME*, this Court carved out an exception to the economic loss rule that allows recovery for unintentional torts when an independent duty exists between the parties. *See Hermansen v. Tasulis*, 2002 UT 52, ¶17, 48 P.3d 235. In *Hermansen*, the buyers of a newly constructed home asserted negligence claims against a real estate broker and his agent for failing to disclose a known and material fact that the soil composition was not suitable for residential construction. *See id.* In *Hermansen*, this Court noted that plaintiffs' claims were not premised on any contract or third party beneficiary theory. *See id.* at 14. Therefore, this Court distinguished both *American Towers* and *SME*. *See id.* This Court stated that *Hermansen* was not a case where "all

respective rights of the parties are negotiated and risk appropriately designated in a written instrument." *Id.* Rather, "[t]he relationship at issue is a direct relationship between buyers, a real estate broker, and his agent who allegedly failed to properly discharge their professional duties." *Id.* In short, this Court expressly noted that the claim was not for faulty construction of a new residence as in *American Towers*, *Schafir*, and *Maack*. *Id.* at ¶15.

Relying on two recent Colorado cases that adopted the economic loss rule, this Court adopted an interpretation of the economic loss rule that focuses on the source of the duty that was allegedly breached. *See id.* at ¶16 (*citing Grynberg v. Agric. Tech., Inc.*, 10 P.3d 1267 (Colo. 2000); *Town of Alma v. Azco Constr., Inc.* 10 P.3d 1256 (Colo. 2000)). This Court adopted Colorado's approach with respect to the independent duty exception to the economic loss rule that provides: "'The proper focus in an analysis under the economic loss rule is on the source of the duties alleged to have been breached. Thus, our formulation of the economic loss rule is that a party suffering only economic loss from the breach of an express or implied contractual duty may not assert a tort claim for such a breach *absent an independent duty of care* under tort law.'" *Id.* (*quoting Grynberg*, 10 P.3d at 1269).

In *Hermansen*, this Court expressly recognized that no contract governed the parties' relationship. *See id.* at ¶14. Thus, the source of any alleged duty could not be contractually based. This Court then examined the common law duties that real estate professionals owe to the general public. *See id.* at ¶¶18-22. Relying on past opinions,

this Court reinforced that real estate professionals owe the public a duty to act honestly, ethically, and competently. *See id.* This Court concluded that the real estate agents in the case owed no duty to independently inspect each property they sold; however, they breached the duty to be honest and ethical when they failed to disclose a known and material defect regarding the soil conditions in the lot sold to plaintiff. *See id.* at ¶23. Nothing in *Hermansen* indicated an intent to allow a party to assert a defective design or construction claim through the independent duty exception. Rather, this Court specifically distinguished *Hermansen* from a case where a contract existed and defined the parties' relationship.

e. Utah Court of Appeals applies the independent duty exception.

After this Court adopted the independent duty exception to the economic loss rule, the Court of Appeals applied this exception to hold that: (1) homebuilder and developer did not owe the buyer an independent duty with respect to disclosing possibility of mudslide on property, *see Fennell v. Green*, 2003 UT App 291, ¶¶13-15, 77 P.3d 339; and (2) real estate appraiser owed buyer an independent duty of care with respect to preparation and accuracy of appraisal of property, *see West v. Inter-Financial, Inc.*, 2006 UT App 222, ¶¶19-28, 139 P.3d 1059. The Court of Appeals' opinions in *Fennell* and *West* set forth the factors used to determine when an independent duty may exist and the limitations on the duty.

In *West*, the Court of Appeals went to great lengths to demonstrate why the relationship between the builder, developer, and buyer in *Fennell* was more analogous to

the relationship in *American Towers*. *See id.* at ¶¶19-25. Accordingly, the Court of Appeals concluded the buyer in *Fennell* could have protected himself through contractual allocation of risks as in *American Towers*. *See Fennell*, 2003 UT App 291 at ¶15; *West*, 2006 UT App 222 at ¶22-25. Moreover, plaintiff's evidence did not indicate that the builder and developer knew of the potential for mudslide and failed to disclose it. *See Fennell*, 2003 UT 291 at ¶12. In *Fennell*, the parties' relationship was well suited to arms-length contracts, and the record did not indicate a failure to disclose any known and material defects.

In contrast, the Court of Appeals concluded the buyers in *West* could not have entered into a contract with the appraiser. *See West*, 2006 UT App 222 at ¶22 Because the seller's selected and contracted with the appraiser, the appraiser owed an independent duty to the buyer's that was analogous to the duty a real estate agent owed to the public in *Hermansen*. *See West*, 2006 UT App 222 at ¶25.

When determining whether the independent duty exception applies, the analysis turns on the source of the duties and whether the source is contractual or independent of contract. *See Hermansen*, 2002 UT 52 at ¶16. The analysis focuses on the parties' relationship (more specifically whether the parties could have entered into a contract to allocate risks) and whether or not one party failed to disclose a known fact. *Compare Fennell*, 2003 UT App 291 at ¶12 (no evidence existed that builder and developer knew that possibility of mudslide existed); *with Hermansen*, 2002 UT 52 at ¶23 (real estate professionals owed no duty to go out and discover facts, rather real estate professionals

owed a duty to disclose known and material facts). In *West*, the Court of Appeals' decision was based largely on the fact that the buyer's could not contract with the appraiser that the seller's selected and that the appraisal report misrepresented the actual square footage of the home, which was an easily discoverable fact in the exercise of an appraiser's duty of care. *See West*, 2006 UT App 222 at ¶25. In summary, the availability of a contract and disclosure of known facts determined whether an independent duty was owed.

f. This Court expands the independent duty exception to find that homebuilders and developers owe buyers of newly constructed homes a limited duty to disclose a known and material defect.

i. Smith v. Frandsen

In *Smith v. Frandsen*, this Court addressed whether a buyer could sue a remote developer for failing to disclose improper soil compaction at a residential home site. *See id.*, 2004 UT 55, ¶16, 94 P.3d 919. In *Smith*, this Court concluded the developer may have owed a duty to disclose the soil condition to a purchaser of the land; however, this Court concluded that where the purchaser was a builder, the duty to disclose to a subsequent purchaser ended with the builder. *See id.* at ¶¶18-24. In other words, because the developer's relationship was with the builder, who was also a sophisticated party, the developer's duty to disclose facts did not continue indefinitely to include the remote buyer. *See id.* Because the builder knew or should have known of the soil condition, the developer's duties ended with the builder. *See id.* In reaching this conclusion, this Court stated: "we believe our holding will encourage builders and contractors to exercise that

level of care consistent with the expertise legally imputed to them." *Id.* at ¶27. Importantly, this Court reinforced the importance of the parties' relationships with one another and the parties' ability to freely negotiate for allocation of risks, stating: "By requiring plaintiffs generally to sue up the chain of title, the allocation of risks and expectations embodied in land sale contracts will be preserved." *Id.* Accordingly, this Court reinforced the policy considerations expressed in *Maack*, *Schafir*, *American Towers*, and *SME* in the context of residential construction. The remote purchasers had an available remedy, and that remedy was against the builder with whom the remote purchaser was in privity of contract.

ii. Yazd v. Woodside Homes Corp.

Relying on *Smith*, this Court clarified the application of the independent duty exception to require a homebuilder to disclose known facts to a buyer with whom the builder has a direct relationship. *See Yazd v. Woodside Homes Corp.*, 2006 UT 47, ¶24, 143 P.3d 283. In *Yazd*, this Court stated that the duty that builders owe to direct buyers as two parts: (1) "to insure that the subdivided lots are suitable for construction of some type of ordinary, average dwelling house;" and (2) to "disclose to his purchaser any condition which he knows or reasonably ought to know makes the subdivided lots unsuitable for such residential building." *See id.* at ¶24. Accordingly, *Yazd* does not impose an independent duty on design and construction entities to build a defect free home. *See id.* Rather, the parties' construction or real estate purchase contract governs any design or construction defects. *Yazd* requires a homebuilder to disclose known and

material facts to a purchaser with whom the builder has a direct relationship in certain instances.

iii. Moore v. Smith

In *Moore v. Smith*, the Court of Appeals applied *Yazd* to the claims of a buyer against a homebuilder. *See id.*, 2007 UT App 101, ¶¶32-36, 158 P.3d 562. In *Moore*, plaintiffs argued that the homebuilder failed to disclose a known defect with respect to the home's footings and foundation. Addressing plaintiffs' fraudulent nondisclosure claim for the home's footings and foundations, the Court of Appeals relied on *Yazd* to state the duty owed and requirements for recovering on a fraudulent nondisclosure claim: (1) a legal duty to communicate, (2) undisclosed material information, and (3) a showing that the information was known to the party who failed to disclose. *See id.* at ¶33. In *Moore*, the Court of Appeals reaffirmed that a builder owes a legal duty to communicate material information that is known to the builder to a party with whom the builder has a direct relationship. *See id.* at ¶35.

In addition to the fraudulent nondisclosure claim, the homeowners also asserted a breach of contract claim. The breach of contract claim was based on several building code violations that the buyer discovered after moving into the home. The buyer's breach of contract claim was based on two premises: (1) the seller's contractual disclosures failed to identify the building code violations in the home, and (2) because the seller was also the builder, the law imputed knowledge of the building code requirements to the seller. *See id.* at ¶¶37-38. The Court of Appeals agreed that homebuilders are imputed

knowledge of the building codes. *See id.* at ¶38. Thus, the Court of Appeals allowed the claims for defective design and construction as breach of contract claims, not tort claims. *See id.* Accordingly, the Court of Appeals did not expand the independent duty exception to impose a duty to design and construct a defect free home.

g. In the 2008 legislative session, the Utah Legislature enacts a statute limiting claims for defective design and construction to claim for breach of contract.

Consistent with this Court's past rulings, the Utah Legislature passed Senate bill 220 which precludes a party from asserting a tort claim for defective design and construction. Specifically, Utah Code Ann. § 78B-4-513 provides: "Except as provided in Subsection (2), an action for defective design or construction is limited to breach of the contract, whether written or otherwise, including both express and implied warranties." Utah Code Ann. § 78B-4-513(1). Consistent with general tort law, subsection (2) excepts claims for personal injury or damage to "other property." *See id.* at -513(2). Subsection (3) then clarifies subsection (2) by providing: "property damage does not include: (a) the failure of construction to function as designed; or (b) diminution of the value of the constructed property because of the defective design or construction." *See id.* at -513(3); *see also American Towers*, 930 P.2d at 1184, 1190 (defining property damage requirement for a tort claim). Subsection (4) further requires a person asserting a defective design or construction claim to be in privity of contract with the design and construction party. *See id.* at -513(4); *see also Smith*, 2004 UT 55 at ¶27 (requiring plaintiff to sue up the chain of title). Subsection (5) removes intentional tort claims from

the statute's provisions. *See id.* at -513(5). Finally, subsection (6) allows a party in privity of contract to assign its claims to another entity, including a homeowners association. *See id.* at -513(6).

To the extent plaintiff and its amicus seek to overturn *American Towers* and have this Court conclude that the economic loss rule does not preclude a non-intentional tort claim for defective design and construction, Utah Code Ann. § 78B-4-513 precludes the requested relief in this case. Like this Court's statement in *Smith v. Frandsen*, requiring plaintiff's to sue up the chain of title, the Utah Legislature has expressed an unequivocal requirement that claims for defective design and construction are limited to breach of contract claims. *See Utah Code Ann. § 78B-4-513; Smith*, 2004 UT 55 at ¶27. As such, only those parties in privity of contract, either directly or through an assignment, may assert a claim. Accordingly, the Utah Legislature enacted a statutory rule consistent with this Court's analysis in *American Towers*, *SME*, *Yazd*, and *Smith*. This Court should not overturn *American Towers*, but rather should affirm the trial court's proper application of the economic loss rule to bar plaintiff's claims in this case.

II. Colorado's economic loss rule, like Utah's, requires a Court to first determine the source of the duty.

This Court should not follow the Colorado rule announced in *A.C. Excavating v. Yacht Club II Homeowner's Association, Inc.*, 114 P.3d 862 (Colo. 2005) because the Colorado rule conflicts with Utah's defective construction cause of action statute and creates an inconsistent rule depending on the circumstances of the case. This Court has

created a sound rule that allows parties to freely negotiate contracts for the construction and sale of real property. Moreover, this Court has carved out narrow exceptions that create well-defined and equitable independent duties of care between parties. Consistent with this Court's approach, the Utah Legislature passed a bill that clearly defines how a cause of action for defective design and construction may be asserted.

Under Utah's independent duty exception, the economic loss rule will not bar a claim for negligence that seeks to recover solely economic losses when a party owes an independent duty of care that arises separate from that parties' contractual duty of care. *See Hermansen v. Tasulis*, 2002 UT 52, ¶17, 48 P.3d 235. Plaintiff argues that the builder and developer owed it an independent duty to construct a structure free from defects and cites to *Yacht Club II* for support. While it is true that Utah recognizes a narrow exception to economic loss rule when a party owes an independent duty, the independent duty exception is not applicable in this case where the builder's and developer's duties arise solely from the construction contracts and any subsequent real estate purchase contracts. In short, plaintiff reads the "independent" requirement out of the independent duty exception and requests this Court to do the same.

In *Hermansen v. Tasulis*, this Court modified Utah's economic loss rule in order to create a narrow exception to the general bar on recovery of solely economic damages when a duty exists that is independent of and separate from the contractual duties. *See Hermansen*, 2002 UT 52, ¶17, 48 P.3d 235. In creating this exception, however, the Court did not abandon the original concept behind the economic loss rule, and stated:

"[t]he proper focus in an analysis under the economic loss rule is on the source of the duties alleged to have been breached." *Hermansen*, 2002 UT 52 at ¶¶15-16 (*quoting Grynberg v. Agric. Tech, Inc.*, 10 P.3d 1267, 1269 (Colo. 2000) (emphasis added)). The Utah Supreme Court has modeled Utah's economic loss rule on the Colorado rule. *See Hermansen v. Tasulis*, 2002 UT 52, ¶¶15-16 (*quoting Grynberg*, 10 P.3d at 1269). The Colorado Supreme Court explained the Colorado rule in a later case:

> Our economic loss rule requires the court to focus on the contractual relationship between the parties, rather than their professional status, in determining the existence of an independent duty of care. The interrelated contracts contained [defendant's] duty of care. [Plaintiff's] tort claims are based on duties that are imposed by contract and therefore, contract law provides the remedies.

BRW, Inc. v. Dufficy & Sons, Inc., 99 P.3d 66, 67-68 (Colo. 2004) (addressing multiple inter-related contracts between commercially sophisticated parties on a large construction project). In advocating for this Court to overturn *American Towers* and to follow the Colorado rule in *Yacht Club II*, plaintiff has failed to address the *BRW* opinion and its effect on Colorado's economic loss rule.

In order to determine if the independent duty exception applies, a two-step analysis is used: (1) are the losses purely economic, and (2) what is the source of the duty being imposed. *See Gulfstream Aerospace Services Corp. v. United States Aviation Underwriters, Inc.*, 635 S.E.2d 38, 44 (Ga. Ct. App. 2006) (applying Utah's economic loss rule and finding source of duty was contractual rather than independent). If the losses are purely economic and the source of the duty is contractual, "it is improper to further analyze the existence of an independent tort duty in determining whether an economic

loss may be recovered." *See id.* In short, after determining the losses are purely economic, the next step is to look at the contract to determine if it provides the source of the duties being alleged. If a contract is the source of the duties alleged, the court does not need to determine if a parallel or overlapping duty exists. *See id.*; *see also BRW*, 99 P.3d at 67-68.

Although *BRW* was not overruled in *Yacht Club II*, plaintiff only refers this Court to *Yacht Club II* as setting forth the economic loss rule in Colorado. BRW, however, is still good law in Colorado, and it is more consistent with Utah's approach to the economic loss rule. In contrast, *Yacht Club II* is based on case law previously rejected in Utah. In *Yacht Club II*, the Colorado Supreme Court relied on its prior precedent in *Cosmopolitan Homes* to find that homebuilders owe a duty of care to construct homes free from defects. *See Yacht Club II*, 114 P.3d at 867. Thus, under *Cosmopolitan Homes*, a homeowner may assert a tort claim for defective design and construction claim against a builder. *See id.* In *Schafir*, however, the Utah Court of Appeals rejected the Colorado rule set forth in *Cosmopolitan Homes*. *Schafir*, 879 P.2d at 1388 and n.9. Thereafter, Utah has not adopted any rule allowing a tort claim for defective design and construction. Furthermore, Utah Code Ann. § 78B-4-513 is contrary to the Colorado rule in *Yacht Club II* and *Cosmopolitan Homes*. Finally, in Colorado, the economic loss rule is becoming inconsistent and unclear depending on which case is used. *Compare BRW*, 99 P.3d at 67-68 (if contract is source of duty, then no independent duty to design and construct a defect free structure); *with Yacht Club II*, 114 P.3d at 867 (builders owe an independent duty to

construct a home free from defects, regardless of whether a contract exists). Because the Colorado rule in *Yacht Club II* conflicts with this Court's past opinions and with a recently enacted Utah statute, this Court should not follow the Colorado rule *Yacht Club II*. Further, even if the Colorado rule did not conflict with Utah's economic loss rule and construction defect statute, this Court should not adopt a rule that would create a confusing and unworkable economic loss rule in Utah.

III. Eliminating the economic loss rule in Utah will subject design and construction entities to liability for an indeterminate amount for an indeterminate time to an indeterminate class.

As set forth in the Summary of Argument, Utah has a clearly defined economic loss rule that has evolved and adapted over the last 14 years. In its current form, Utah's economic loss rule allows parties to freely negotiate economic risks and expectations through contract without fear that the contractual remedies will be side-stepped through a tort claim. Utah has kept clearly defined boundaries between tort and contract law in order to protect parties' expectancy interests. As in Utah, many jurisdictions have wrestled with the economic loss rule, and it has been adopted in several different forms. *See, e.g.*, *The Economic Loss Doctrine in Construction Cases: Are the Odds for Design Professionals Better in Vegas?*, Beth M. Andrus, James L. Gessford, and William R. Joyce, 2 No. 1 ACCLJ 2 (2008). Whereas some decisions bemoan the lack of consistency with which the rule is applied depending upon the state, Utah has consistently adhered to the economic loss rule with only minor modifications as deemed appropriate.

Now plaintiff requests this Court to overrule its *American Towers* decision and

effectively eliminate the economic loss rule as a defense. With the economic loss rule in place, design and construction entities understand that they are free to negotiate for certain economic expectations and risks. The construction industry is a contract based industry that relies on arms-length negotiations to define a parties' risks, duties, and obligations to one another. If the economic loss rule is eliminated, design and construction entities will face confusion and uncertainty as to economic risks and exposures on each project they pursue.

In a large construction project, the entities involved in the design and construction have varying roles with respect to their risks and the level of involvement. A building contractor may have a very large role in the case of the general contractor who oversees the entire project, or a very minor role in the case of a subcontractor who only provides task specific labor or materials for a discrete portion of the project. Similarly, an engineer may have a large role if retained to provide the structural design for the entire project, or a much smaller role if the engineer is only responsible for the civil design of common areas or the project's lighting design. Based on the risk assumed and the level of involvement, the parties will negotiate appropriate fees for services rendered and also appropriate protections for risks and exposures through required insurance coverage and limitation of liability clauses contained in the parties' negotiated contracts.

With the economic loss rule and its contractual protections, any of these entities may negotiate a contract to govern its economic expectations. In the case of an engineer who provides structural design for a large commercial building, the contract will

compensate the engineer appropriately for the large role the engineer has in the project and correspondingly will take into account the larger possible economic exposure for an error or omission in the structural design. In other words, the compensation is commensurate to the exposure on the project. Furthermore, the engineer may be contractually required to have a minimum amount of insurance coverage to cover an error or omission.

These contractual protections break down when the economic loss rule is removed and an entity may be sued in tort. Take for example a geotechnical engineer on a large project. The engineer may have the minor task of providing a soils report for the project. The owner of the project is free to negotiate the fee for this work. The owner for a myriad of reasons is free to negotiate down the engineer's fee for its services on the project. For a fee of $28,500, the owner and engineer may agree to have the geotechnical work performed. Because the fee is only $28,500 and was negotiated down from the engineer's customary fee, the owner and engineer may also agree on a contractual limitation of liability clause of $50,000. The owner and engineer have an arms-length bargain for the appropriate compensation based on engineer's contractual duties and potential exposure.

As it turns out, the engineers work is deficient. Earth movement beyond that predicted by the engineer's geotechnical report occurs and causes extensive damage to the structure and corresponding delays to construction. The engineer now faces a $60 million negligence claim on a contract that paid the engineer $28,500 and which contained a

limitation of liability clause of $50,000. The above scenario is a real case. *See, e.g., Terracon Consultants Western, Inc. v. Mandalay Resort Group*, No. 47844 (currently pending before the Nevada Supreme Court); *see also* Andrus, Gessford, and Joyce, 2 No. 1 ACCLJ 2 at 1. In that case, despite negotiating down the engineer's fee in exchange for a limitation of liability clause, the owner is seeking to avoid the contractual limitations on its claim by asserting a tort claim. The owner is arguing the economic loss rule should not bar its tort claim.

Rather than opening up design and construction entities to "liability in an indeterminate amount for an indeterminate time to an indeterminate class" as rejected in *American Towers*, this Court should keep the economic loss rule in its current state in place. The economic loss rule provides some level of certainty to those entities involved in the construction industry. Furthermore, it preserves the boundaries between tort law and contract. In short, the policy reasons that led this Court to adopt the economic loss rule are as strong now as they were in 1996. Plaintiff has articulated no policy reasons to justify a wholesale abrogation of the economic loss rule in Utah. Rather, plaintiff argues for abrogation of the rule for the limited purpose of its own needs in this particular case without any explanation of why the individual owners could not or did not protect their own interests through a negotiated contract. A remedy at law existed in this case. The individual owners had the ability to conduct due diligence and contract for the allocation of risks. If a breach occurred, the owners' remedy, as set forth in Utah Code Ann. § 78B-4-513, was a breach of contract claim.

IV. This Court should reject plaintiff's request for implied warranties.

The parties to construction contracts and real estate purchase contract can negotiate contractual provisions and express warranties to better address the parties' expectations and duties of care. Because defective design and construction claims must be contractual, *see* Utah Code Ann. § 78B-4-513, this Court does not need to create new extra-contractual implied warranties as plaintiff and its amicus request. As such, this Court should reject plaintiff's request for implied warranties, including a warranty of habitability.

By requesting this Court to adopt implied warranties, including a warranty of habitability, plaintiff is asking this Court to require design and construction entities to guarantee their work. In *SME*, this Court rejected plaintiff's argument, stating: "a solid majority of jurisdictions have refused to hold that architects and design professionals impliedly warrant perfect plans or satisfactory results, but rather, limit the liability of architects to those situations in which the professional is negligent in the provision of his or her services." *SME*, 2001 UT 54 at ¶25. Furthermore, this Court cited strong policy and practical considerations for refusing to require a professional to guarantee perfect results: "Because of the inescapable possibility of error which inheres in these services, the law has traditionally required, not perfect results, but rather the exercise of that skill and judgment which can be reasonably expected from similarly situated professionals." *Id.* at ¶27 (citation omitted). In summary, this Court stated: "we hold that architects and

design professionals do not impliedly warrant or guarantee a perfect plan or satisfactory result." *Id.* at ¶28. Accordingly, the Court found that any breach of a design professional's duty of care was based in the contract for professional services, and the duty was only owed to the person to whom the professional services were to be rendered. *Id.* at ¶30. This Court's holding is consistent with Utah Code Ann. § 78B-4-513, which requires a defective design or construction claim to be contractual and to be asserted by a person in privity of contract.

Plaintiff has not articulated why this Court's holding in *SME* does not also apply to builders. To the contrary, plaintiff's supporting amicus brief recognizes that Utah has refused to adopt an implied warranty of habitability despite repeated requests from dissatisfied homeowners. The *American Towers* opinion articulated the policy reasons for refusing to impose additional standards to the parties' relationship: "Builders who construct low quality housing that does not cause injury to persons or property may still be held liable for damages, but that liability should be defined by the contract between the parties." *American Towers*, 930 P.2d at 1190. "The law of torts imposes no standards on the parties' performance of the contract; the only standards are those agreed upon by the parties." *Id.* By requesting this Court to impose implied warranties of habitability, plaintiff is essentially requesting this Court to impose tort standards on the performance of construction contracts. This Court has rejected this argument, and plaintiff has offered no new policy considerations to justify a new rule. Furthermore, the Utah Legislature has recently enacted a statute reinforcing this Court's prior decisions that decline to impose

implied warranties to design and construction entities.

CONCLUSION

Based on the foregoing authority, amici in support of defendants requests this Court to keep the economic loss rule in its current form in place. If this Court were to adopt plaintiff's arguments to overrule *American Towers*, this Court would be adopting a rule inconsistent with the policy recently announced by the Utah Legislature. This Court has carefully created a well reasoned and predictable rule of law that allows design and construction entities to assess and contract for economic expectations and economic allocations of risk.

DATED this 15 day of August 2008.

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that two true and correct copies of the foregoing brief was mailed, first-class, postage prepaid, on this 15 day of August, 2008, to the following:

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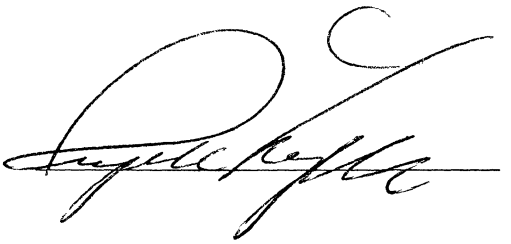

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